**PROSPECTUS** **CONFIDENTIAL**

# $2,000,000,000

# Tesco plc

**$850,000,000 5.50% Senior Notes due 2017**
**$1,150,000,000 6.15% Senior Notes due 2037**

The senior notes due 2017 (the "2017 notes") will bear interest at a rate of 5.50% per year and the senior notes due 2037 (the "2037 notes", and together with the 2017 notes, the "notes") will bear interest at a rate of 6.15% per year. Interest on the notes is payable on May 15 and November 15 of each year, beginning on May 15, 2008. The 2017 notes and the 2037 notes will mature on November 15, 2017 and November 15, 2037, respectively. The issuer may redeem the notes in whole or in part at any time at the redemption prices specified herein. See "Description of Notes — Redemption".

The notes will be our senior unsecured obligations and will rank equally with all of our other unsecured senior indebtedness.

Application has been made for the admission of the notes to listing on the Official List of the U.K. Listing Authority and to trading on the Professional Securities Market of the London Stock Exchange plc (the "London Stock Exchange"), an exchange-regulated market.

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**Investing in the notes involves risks. See "Risk Factors" beginning on page 8.**

**This document is an advertisement and not a prospectus for purposes of applicable measures implementing EC Directive 2003/71 (the "Prospectus Directive"). Investors should not subscribe for any transferable securities referred to herein except on the basis of information contained in the prospectus prepared pursuant to the Prospectus Directive which, if published, can be obtained at Tesco's registered office and otherwise as required by the Prospectus Directive.**

The notes have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws. Accordingly, the notes are being offered and sold only to qualified institutional buyers in accordance with Rule 144A under the Securities Act ("Rule 144A") and outside the United States in accordance with Regulation S under the Securities Act ("Regulation S"). Prospective purchasers that are qualified institutional buyers are hereby notified that the seller of the notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of certain restrictions on transfers of the notes, see "Plan of Distribution" and "Notice to Investors".

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**Price of the 5.50% Senior Notes due 2017: 99.579% plus accrued interest, if any, from November 5, 2007**
**Price of the 6.15% Senior Notes due 2037: 99.455% plus accrued interest, if any, from November 5, 2007**

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The initial purchasers expect to deliver the notes to purchasers in book entry form through The Depository Trust Company ("DTC") and through the Euroclear System and Clearstream, Luxembourg (as participants in DTC) on or about November 5, 2007.

*Joint Book-Running Managers*

**Citi** **JPMorgan**

*Joint Lead Manager*

**BNP PARIBAS**

October 29, 2007

**You should rely only on the information contained in this prospectus. We have not, and the initial purchasers have not, authorized anyone to provide you with different information, and you should not rely on any such information. We are not, and the initial purchasers are not, making an offer of these securities in any jurisdiction where this offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.**

**This prospectus comprises listing particulars given in compliance with the listing rules made under Section 74 of the Financial Services and Markets Act 2000 (the "FSMA") by the U.K. Listing Authority for the purpose of giving information with regard to us and the notes in connection with the application for admission of the notes to the Official List and to trading on the London Stock Exchange Professional Securities Market. THIS PROSPECTUS IS NOT A PROSPECTUS FOR PURPOSES OF SECTION 12(A)(2) OR ANY OTHER PROVISION OF, OR RULE UNDER, THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT").**

**This prospectus has been prepared by us solely for use in connection with the proposed offering of the securities described in this prospectus. This prospectus is personal to each offeree and does not constitute an offer to any other person or to the public generally to subscribe for or otherwise acquire securities.**

**Distribution of this prospectus to any other person other than the prospective investor and any person retained to advise such prospective investor with respect to its purchase is unauthorized, and any disclosure or any of its contents, without our prior written consent, is prohibited. Each prospective investor, by accepting delivery of this prospectus, agrees to the foregoing and to make no photocopies of this prospectus or any documents referred to in this prospectus.**

**Notwithstanding anything in this prospectus to the contrary, each prospective investor (and each employee, representative or other agent of the prospective investor) may disclose to any and all persons, without limitation of any kind, the U.S. tax treatment and U.S. tax structure of any offering and all materials of any kind (including opinions or other tax analyses) that are provided to the prospective investor relating to such U.S. tax treatment and U.S. tax structure, other than any information for which nondisclosure is reasonably necessary in order to comply with applicable securities laws.**

**The initial purchasers make no representation or warranty, express or implied, as to the accuracy or completeness of the information contained in this prospectus. Nothing contained in this prospectus is, or shall be relied upon as, a promise or representation by the initial purchasers as to the past or future. We have furnished the information contained in this prospectus. The initial purchasers have not independently verified any of the information contained herein (financial, legal or otherwise) and assume no responsibility for the accuracy or completeness of any such information.**

**None of the Securities and Exchange Commission (the "SEC"), any state securities commission nor any other regulatory authority, have approved or disapproved the securities nor have any of the foregoing authorities passed upon or endorsed the merits of this offering or the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.**

**In connection with the issue of the notes, Citigroup Global Markets Inc. (the "stabilizing manager") (or persons acting on behalf of the stabilizing manager) may over-allot notes or effect transactions with a view to supporting the market price of the notes at a level higher than that which might otherwise prevail. However, there is no assurance that the stabilizing manager (or persons acting on behalf of the stabilizing manager) will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the terms of the offer of the notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the notes and 60 days after the date of the allotment of the notes. Any stabilization action or over-allotment must be conducted by the stabilizing manager (or person(s) acting on behalf of the stabilizing manager) in accordance with all applicable laws and rules.**

**The notes are subject to restrictions on transferability and resale and may not be transferred or resold except as permitted under the Securities Act and the applicable state securities laws pursuant to registration or exemption therefrom. As a prospective purchaser, you should be aware that you may be required to bear the financial risks of this investment for an indefinite period of time. Please refer to the sections in this prospectus entitled "Plan of Distribution" and "Notice to Investors". In making an investment decision, prospective investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved. Prospective investors should not construe anything in this prospectus as legal, business or tax advice. Each prospective investor should consult its own advisors as needed to make its investment decision and to determine whether it is legally permitted to purchase the securities under applicable legal investment or similar laws or regulations.**

**We accept responsibility for the information contained in this prospectus, having taken all reasonable care to ensure that such is the case, the information contained in the prospectus is in accordance with facts and contains no omission likely to affect its import. To the best of our knowledge and belief, the information contained in this prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.**

**In this prospectus, we rely on and refer to information and statistics regarding our industry. We obtained this market data from independent industry publications or other publicly available information. Although we believe that these sources are reliable, we have not independently verified and do not guarantee the accuracy and completeness of this information. Where information has been sourced from a third party, we confirm that this information has been accurately reproduced and that as far as we are aware and are able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. Where third party information has been included, its source has been stated.**

**This prospectus contains summaries believed to be accurate with respect to certain documents, but reference is made to the actual documents for complete information. Copies of certain documents referred to herein will be made available to prospective investors upon request to us or the initial purchasers**.

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## NOTICE TO NEW HAMPSHIRE RESIDENTS

**NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER RSA 421-B WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.**

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## CERTAIN REGULATORY ISSUES RELATED TO THE UNITED KINGDOM

This prospectus is only being distributed to and is only directed at (i) persons who are outside the United Kingdom or (ii) to investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “Order”) or (iii) high net worth entities falling within Article 49(2)(a) to (d) of the Order, and other persons to whom it may lawfully be communicated (all such persons together being referred to as “relevant persons”). The notes are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such notes will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this prospectus or any of its contents.

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## PRESENTATION OF FINANCIAL AND OTHER DATA

### Financial Data

Our audited consolidated financial statements as of and for the fiscal years ended February 24, 2007 and February 25, 2006, our unaudited consolidated financial statement as of and for the fiscal year ended February 26, 2005 and our unaudited interim financial statements as of and for the 26-week periods ended August 25, 2007 and August 26, 2006 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union (the "EU"). IFRS as adopted by the EU differs in certain respects from IFRS as published by the International Accounting Standards Board (the "IASB"). We do not believe that our historical financial statements for the periods presented would be materially different had they been prepared in accordance with IFRS as published by the IASB. IFRS differs in significant respects from generally accepted accounting principles in the United States of America ("U.S. GAAP").

Some financial information in this prospectus has been rounded, and as a result the numbers shown as totals may vary slightly from the exact arithmetical aggregation of the relevant figures. Our fiscal year ends on the last Saturday in February.

In this prospectus, we present certain financial measures, including underlying profit before tax, trading profit, revenues plus value added tax, or "VAT" (which we refer to as "sales") and net debt, which are not recognized by IFRS. These measures are presented because we believe that they and similar measures are widely used in our industry as a means of evaluating operating performance. These measures may not be comparable to similarly titled measures used by other companies and are not measurements under IFRS or any other body of generally accepted accounting principles, and thus should not be considered substitutes for the information contained in our audited financial statements.

See "Independent Auditors" for a description of the independent auditors' reports, including language limiting the auditors' scope of duty in relation to such reports and the consolidated financial statements to which they relate. In particular, the April 16, 2007 and April 24, 2006 reports of PricewaterhouseCoopers LLP, with respect to such audited consolidated financial statements, in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, provides: "This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing." The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). If a U.S. court (or any other court) were to give effect to the language quoted above, the recourse that investors in the notes may have against the independent auditors based on their reports or the consolidated financial statements to which they relate could be limited.

### Industry Data

We have obtained the market data and information related to markets, market size, market share, growth rates and other industry data pertaining to our business and markets used in this prospectus under the captions "Risk Factors," "Industry Overview," and "Business," from internal surveys, industry sources, estimates based on management's knowledge of our sales and markets and our own and third-party research. This research includes private and publicly available surveys or studies. Where information has been sourced from a third party, it has been accurately reproduced and so far as we are aware and are able to ascertain from information published by the third party, no facts have been omitted which would render the reproduced information inaccurate or misleading.

**Trademark**

The Tesco trademark appearing on the front cover of this prospectus and variations thereon are registered trademarks of Tesco and are registered with, or subject to pending trademark applications with, the relevant registries of the United Kingdom and various other countries.

The third-party studies and surveys from which information contained in this prospectus has been extracted, and our internal estimates rely on the application of various assumptions. While we believe that these assumptions are reasonable, we cannot assure you that these assumptions are true, nor can we guarantee that an independent party applying different assumptions or using different methods to assemble, analyze or compute market or other industry data would obtain or generate the same results. Where information has been sourced from a third party, we confirm that this information has been accurately reproduced and that as far as we are aware and are able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. Where third party information has been included, its source has been stated.

## INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

The following cautionary statements identify important factors that could cause our actual results to differ materially from those projected in the forward-looking statements made in this prospectus. Any statements about our expectations, beliefs, plans, strategies, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as "will likely result," "are expected to," "will continue," "believe," "anticipated," "estimated," "intends," "expects," "plans," "seek," "projection" and "outlook". These statements involve estimates, assumptions and uncertainties, which could cause actual results to differ materially from those expressed in them. Any forward-looking statements are qualified in their entirety by reference to the factors discussed throughout this prospectus. Among the key factors that have had and we expect to continue to have a direct bearing on our results of operations are:

- Our ability to successfully execute our business and financial strategies;
- Economic downturns affecting levels of consumer spending;
- Our ability to compete with our U.K. and international competitors, particularly on price, product range, quality and service;
- Our ability to attract, retain, develop and motivate qualified employees at all levels of our operations;
- Damage to our reputation from, among other things, product safety issues, environmental issues or ethical breaches by third parties we rely on such as suppliers and joint venture partners;
- Escalating energy costs or energy-related environmental issues;
- Fraud by our employees;
- A significant failure of our information technology processes, particularly those used in our retail operations;
- Regulatory changes or political instability in the countries in which we operate;
- Terrorist activity;
- Liabilities arising from our pension plan; and
- Our ability to work successfully with our joint venture partners.

These and other factors are discussed in "Risk Factors" beginning on page 8 of this prospectus.

Because the risk factors referred to in this prospectus could cause actual results or outcomes to differ materially from those expressed in any forward-looking statements made in this prospectus by us or on our behalf, you should not place undue reliance on any of these forward-looking statements.

Furthermore, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. New factors will emerge in the future, and it is not possible for us to predict such factors. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those described in any forward-looking statements.

## CURRENCY PRESENTATION

In this prospectus, references to "sterling", "pounds sterling", "pound", "£" "pence" and "p" are to the lawful currency of the United Kingdom. References to "€" or "euro" and "euro cents" are to the single currency of the participating member states ("Member States") in the Third Stage of European Economic and Monetary Union of the Treaty Establishing the European Community, as amended from time to time. References to "U.S. dollars," "U.S.$" and "$" are to the United States dollar and references to "cents" are to United States cents, each the lawful currency of the United States of America.

## EXCHANGE RATE VARIATION

The following chart indicates (i) for the period from February 26, 2005 through February 24, 2007, our fiscal year end, period average and high and low Noon Buying Rates in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York and (ii) for each calendar month period or portion thereof from February 25, 2007 to October 29, 2007, the monthly period end, period average and high and low Noon Buying Rates, in each case expressed in U.S. dollars per £1.00. The rates below may differ from the actual rates used in the preparation of the combined financial statements and other financial information that appear elsewhere in this document. Our inclusion of these exchange rates is for illustrative purposes only and does not mean that the sterling amounts actually represent such U.S. dollar amounts or that such sterling amounts could have been converted into U.S. dollars at any particular rate, if at all. The Noon Buying Rate of the pound on October 29, 2007 was U.S.$2.06 = £1.00.

| | U.S. dollars per £1.00 | | | |
|---|---|---|---|---|
| | **High** | **Low** | **Period Average(1)** | **Period End** |
| **Fiscal Year** | | | | |
| 2005/06 | 1.92 | 1.71 | 1.80 | 1.74 |
| 2006/07 | 1.98 | 1.72 | 1.87 | 1.96 |
| 2007/08 (through October 29, 2007) | 2.06 | 1.92 | 2.00 | 2.06 |
| **Month in 2007** | | | | |
| February 25, 2007 to February 28, 2007 | 1.96 | 1.96 | 1.96 | 1.96 |
| March | 1.96 | 1.92 | 1.94 | 1.99 |
| April | 2.00 | 1.96 | 1.98 | 2.00 |
| May | 1.99 | 1.96 | 1.98 | 1.97 |
| June | 2.00 | 1.96 | 1.98 | 2.00 |
| July | 2.06 | 2.01 | 2.03 | 2.03 |
| August | 2.04 | 1.98 | 2.01 | 2.01 |
| September | 2.03 | 1.99 | 2.01 | 2.03 |
| October (through October 29, 2007) | 2.06 | 2.02 | 2.04 | 2.06 |

(1) The average of the Noon Buying Rates on the last business day of each month during the relevant period for yearly averages; on each business day of the month (or portion thereof) for monthly averages.

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## SUMMARY

*In this prospectus, references to "Tesco", "we", "our", "ours" and "us" refer to Tesco plc, a public limited company incorporated under the laws of England and Wales, together with our consolidated subsidiaries, unless stated otherwise or the context otherwise requires. The following summary may not contain all the information that may be important to you. Before making an investment decision, you should read this entire prospectus, including the "Risk Factors" section and the financial statements, together with the related notes, included in this prospectus.*

*Following the implementation of the relevant provisions of the Prospectus Directive (Directive 2003/71/EC) in each member state of the European Economic Area, no civil liability will attach to those persons who are responsible for this summary in any such member state solely on the basis of this summary, unless it is misleading, inaccurate or inconsistent when read together with the other parts of this prospectus. Where a claim relating to the information contained in this prospectus is brought before a court in a member state of the European Economic Area, the claimant may, under the national legislation of that member state, be required to bear the costs of translating this prospectus before legal proceedings are initiated. Civil liability is attached to those persons responsible for this summary including any translation of the summary, but only if the summary is misleading, inaccurate or inconsistent when read together with other parts of the prospectus.*

*The following summary should be read as an introduction to the prospectus. Any decision to invest in the securities should be based on consideration of the prospectus as a whole by an investor.*

**Overview**

We are the United Kingdom's largest food retailer, with over 80 years of operating history in the United Kingdom's retail food industry. As of August 25, 2007, we owned and operated a total of 3,409 stores in 12 countries, of which 2,033, or approximately 60%, were in the United Kingdom and 1,376, or approximately 40%, were located in our other markets. In the fiscal year ended February 24, 2007, we had revenue of £42.6 billion, an 8% increase over the fiscal year ended February 25, 2006, and we had revenue of £22.6 billion in the 26 weeks ended August 25, 2007, a 9% increase over the 26 weeks ended August 26, 2006. In the last ten years, we have rapidly expanded our operations internationally into other European markets and Asia, and in fiscal 2007/08 plan to commence business operations in the western United States. We have also expanded our operations to include non-food retailing of a variety of goods. Since 1997, we have also offered a variety of personal finance services and since 2003 have offered a range of telecommunication services. We sell our goods and services through our stores, our website at www.tesco.com and our catalog.

We believe that our broad customer base, our "every little helps" brand philosophy and our customers' trust in the Tesco brand to provide simple, excellent service that represents good value for money, together set us apart from our competitors in the United Kingdom and abroad. We intend to use these strengths and the international experience we have gained in the last ten years to further the growth of our business in the United Kingdom and abroad.

**Our Strategy**

The five key elements of our strategy are as follows:

- ***Grow our core U.K. business.*** Our U.K. market is the core of our business, representing nearly 80% of our profits in fiscal 2006/07. We plan to further grow our U.K. business by continuing to use a multi-store format approach to provide local customers the type of shopping environment most convenient for them.
- ***Become a successful international retailer.*** We believe that significant opportunity for future sustained growth and improved long-term returns lies in international markets. We plan to continue our already-successful international expansion by further expanding our business in our existing markets outside the United Kingdom and by moving into new international markets.

- ***Be as strong in non-food as we are in food.*** We strive to build a range of products that will make our non-food business as successful as our food business. Non-food sales represented 25% of total sales (excluding gasoline) in fiscal 2006/07.
- ***Develop retailing services.*** We believe that we can successfully leverage our customers' loyalty to our brand and our joint venture partners' expertise and infrastructure in order to continue to build our telecommunications and personal financial services businesses.
- ***Put the community at the heart of what we do.*** We aim to be a good neighbor, to be responsible, fair and honest in our dealings and to give customers the information and products they need to make more environmentally-conscious choices.

**Our Key Strengths**

We believe our key strengths include our broad customer base, customer-focused culture, strong, experienced management team and supportive and respectful relationship with our staff.

## The Offering

*The summary below describes the principal terms of the notes. Certain of the terms and conditions described below are subject to important limitations and exceptions. The "Description of the Notes" section of this prospectus contains a more detailed description of the terms and conditions of the notes.*

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| **Issuer** | Tesco plc. |
| **Notes Offered** | $850 million aggregate principal amount of 5.50% Senior Notes due November 15, 2017 (the "2017 notes").<br>$1.15 billion aggregate principal amount of 6.15% Senior Notes due November 15, 2037 (the "2037 notes").<br>We refer to the 2017 notes and the 2037 notes in this prospectus collectively as the "notes".<br>The 2017 notes and the 2037 notes will, in each case, be issued under a fiscal and paying agency agreement expected to be dated as of November 5, 2007 (together, the "FPAA") between us and Citibank, N.A., London Branch, as fiscal agent, paying agent, transfer agent and registrar. The 2017 notes and the 2037 notes will each be treated as a separate series of notes and, as such, they will vote and act, and may be redeemed, separately. |
| **Issue Date** | November 5, 2007. |
| **Maturity Date** | November 15, 2017 for the 2017 Notes and November 15, 2037 for the 2037 Notes. |
| **Interest Rate** | The 2017 Notes and the 2037 Notes will bear interest from the issue date at the rate of 5.50% and 6.15%, respectively, per annum, payable semi-annually in arrears. |
| **Interest Payment Dates** | Interest on the notes will be paid semi-annually in arrears on May 15 and November 15 of each year, beginning on May 15, 2008 (each, an "interest payment date"). |
| **Interest Periods** | The first interest period for the notes will be the period from and including the issue date to but excluding the first interest payment date. Thereafter, the interest periods for the notes will be the periods from and including each interest payment date to but excluding the immediately succeeding interest payment date. The final interest period will be the period from and including the interest payment date immediately preceding the maturity date to the maturity date. |
| **Regular Record Dates for Interest** | The close of business on May 1 or November 1 (whether or not a business day) immediately preceding each interest payment date. |
| **Business Day** | Any day which is not, in London, England on New York City a Saturday, Sunday, legal holiday or a day on which banking institutions are authorized or obligated by law to close (a "business day"). |

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| **Business Day Convention** | Following. |
| **Day Count Fraction** | 30/360. |
| **Optional Redemption** | We may redeem either or both series of the notes, in whole or in part, at our option, at any time and from time, to time, at a redemption price equal to the greater of (i) 100% of the principal amount of the notes to be redeemed and (ii) as determined by an independent investment banker, the sum of the present values of the applicable remaining scheduled payments discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months or, in the case of an incomplete month, the number of days elapsed) at the treasury rate plus, in the case of the 2017 notes, 20 basis points, and, in the case of the 2037 notes, 25 basis points, together with, in each case, accrued and unpaid interest on the principal amount of the notes to be redeemed to the redemption date. |
| **Redemption for Tax Reasons** | In the event of certain tax law changes that would require us to pay additional amounts on one or both series of notes, we may, under certain conditions, redeem in whole, but not in part, the notes of the affected series prior to maturity at a redemption price equal to 100% of the principal amount of the notes plus accrued and unpaid interest to the date of redemption. |
| **Repurchase Upon a Change of Control Offer** | If a Change of Control Triggering Event occurs, unless we have redeemed the applicable notes in full, we will be required to make an offer (the "change of control offer") to each holder of the applicable notes to repurchase all or any part (equal to $100,000 or an integral multiple of $1,000 in excess thereof) of that holder's applicable notes on the terms set forth in the notes. In the change of control offer, we will be required to offer payment in cash equal to 101% of the aggregate principal amount of applicable notes repurchased, plus accrued and unpaid interest, if any, on the applicable notes repurchased, to the date of repurchase. |
| **Payment of Additional Amounts** | If we are required by a U.K. taxing jurisdiction to deduct or withhold taxes in respect of payment on the notes we will, subject to certain exceptions, pay additional amounts to noteholders, but may exercise our right to redeem the notes. |
| **Covenants of the Issuer** | The notes will not specifically prohibit the issuer from entering into a merger, consolidation or similar combination with or into another party, or transferring all or substantially all of its assets to another party, whether or not the other party becomes liable for the issuer's obligations under the notes. Such a transaction may, |

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| | however, constitute a change of control described above or, under certain circumstances, an event of default. |
| **Ranking of the Notes** | The notes will be our unsecured and unsubordinated obligations and will rank *pari passu* in right of payment among themselves and with our other unsecured and unsubordinated indebtedness (save for certain obligations required to be preferred by law). |
| **Denominations, Form and Registration of Notes** | The notes will be issued in fully registered form and only in denominations of $100,000 and integral multiples of $1,000 in excess thereof. The notes will be initially issued as global notes. DTC will act as depositary for the notes. Except as set forth herein, global notes will not be exchangeable for certificated notes. |
| **Governing Law** | The State of New York. |
| **Listing** | Prior to the issuance of the notes, we will use our best efforts to obtain the listing of the notes on the Official List of the U.K. Listing Authority and the admission of the notes to trading on the London Stock Exchange Professional Securities Market. |
| **Restrictive Covenants** | The FPAA contains covenants restricting our ability to pledge our assets, secure certain borrowings and create or incur liens on our property. The FPAA does not contain any restrictions on our ability or that of our subsidiaries to secure indebtedness other than certain obligations or to enter into sale and leaseback transactions. |
| **Defeasance** | The notes will be subject to defeasance and covenant defeasance provisions in the FPAA. |
| **Further Issuances** | We may, from time to time, without notice to or the consent of the holders of the notes, "reopen" each series of notes and create and issue additional notes having identical terms and conditions as the 2017 notes or the 2037 notes, as the case may be (or in all respects except for the issue date, issue price, payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes), so that the additional notes are consolidated and form a single series of notes with the 2017 notes or the 2037 notes, as the case may be. We will not issue any additional notes unless such additional notes have no more than a *de minimis* amount of original issue discount or such issuance would constitute a "qualified reopening" for U.S. federal income tax purposes. |
| **Use of Proceeds** | The net proceeds of the offering will be used to refinance certain short-term indebtedness of the issuer and for the issuer's general corporate purposes. |

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| **Fiscal Agent, Paying Agent, Transfer Agent and Registrar** | Citibank, N.A., London Branch. |
| **Transfer Restrictions** | The notes have not been and will not be registered under the Securities Act and are subject to certain restrictions on resale and transfer. |
| **Timing and Delivery** | We currently expect delivery of the notes to occur on November 5, 2007. |
| **Ratings** | It is expected that the notes will be rated A1 by Moody's Investors Service, Inc., A+ by Standard & Poor's, a division of the McGraw-Hill Companies, Inc. and A+ by Fitch Ratings Ltd., subject to confirmation at closing. A security rating is not a recommendation to buy, sell or hold the notes. There is no assurance that a rating will remain for any given period of time or that a rating will not be lowered or withdrawn by the relevant rating agency if, in its judgment, circumstances in the future so warrant. In the event that a rating initially assigned to the notes is subsequently lowered for any reason, no person or entity is obliged to provide any additional support or credit enhancement with respect to the notes and the market value of the notes is likely to be adversely affected. |
| **CUSIP** | |
| **2017 notes** | 144A: 881575AA2<br>Regulation S: G87621AK7 |
| **2037 notes** | 144A: 881575AC8<br>Regulation S: G87621AL5 |
| **ISIN** | |
| **2017 notes** | 144A: US881575AA22<br>Regulation S: USG87621AK79 |
| **2037 notes** | 144A: US881575AC87<br>Regulation S: USG87621AL52 |

**Risk Factors**

Investing in the notes involves substantial risks. Risks relating to our business include uncertainty as to:

- the success of our strategy;
- levels of consumer spending;
- our ability to compete on price, product range, quality and service;
- our ability to attract and retain qualified employees;
- damage to our reputation from product safety issues, environmental issues or ethical breaches; and
- escalating energy costs.

Risks relating to the notes include:

- we may incur substantially more debt;
- an active and liquid trading market for the notes may not develop; and
- the transfer of the notes may be subject to restrictions.

**The Issuer**

The issuer, Tesco plc, is a public limited company incorporated under the laws of England and Wales. Our registered address and the business address of each of our directors is Tesco House, Delamare Road, Cheshunt, Hertfordshire EN8 9SL, United Kingdom and our telephone number is +44 (0) 1992 632222. Our website, at www.tesco.com, provides additional information about us. Our website and the information contained on it or connected with it shall not be deemed to be incorporated into this prospectus.

The issuer had an issued share capital of £392,577,321 comprised of 7,851,546,419 ordinary shares with a par value of 5p per share as of October 9, 2007. All shares are fully paid.

The issuer's statutory annual financial statements are prepared on the basis of a financial year ending on the last Saturday in February.

## RISK FACTORS

*An investment in the notes entails risk. There are a number of factors, including those specified below, which may adversely affect our ability to make payments under the notes. You could therefore lose a substantial portion or all of your investment in the notes. Consequently, an investment in the notes should only be considered by persons who can assume such risk. You should note that the risks described below are not the only risks that we face. We have described all risks we consider to be material. However, there may be additional risks that we currently consider immaterial or of which we are currently unaware, and any of these risks could have the effects set forth above.*

### Risks Relating to Our Business

***If our strategy follows the wrong direction or is not efficiently communicated, then our business may suffer.***

We need to understand and properly manage strategic risk in order to deliver long-term growth for the benefit of all our stakeholders. Our operations are based on a five part strategy — to grow our core U.K. business, to be as strong in non-food as in food, to develop retailing services, to become a successful international retailer and to put the community at the heart of what we do. Pursuit of this strategy has allowed our business to diversify, and at a strategic level, diversification and pursuit of growth in emerging markets have the effect of reducing overall risk by avoiding reliance on a small number of business areas. However, by its very nature, diversification also introduces new risks to be managed in areas of the business that are less mature and fully understood.

To ensure we continue to pursue the right strategy, our board of directors discusses strategic issues at each board meeting, and dedicates two full days a year to reviewing our strategy. The Executive Committee of our board of directors also holds specific sessions to discuss strategic issues on a regular basis. We have structured programs for engaging with all of our stakeholders, including customers, employees, investors, suppliers, government, media and non-governmental organizations. We also invest significant resources in ensuring that our strategy is communicated well and understood by the parties who are key to delivering it. The business operates a "Steering Wheel" — a balanced scorecard process whereby we set goals for different areas of our business and assess our overall progress on a quarterly basis — in all countries and significant business units to help manage performance and deliver on our business strategy.

***Financial strategy and group treasury risk.***

Our main financial risks relate to the availability of funds to meet business needs, the risk of default by counter-parties to financial transactions (credit risk), and fluctuations in interest and foreign exchange rates.

Our treasury function is mandated by our board of directors to manage the financial risks that arise in relation to underlying business needs. The function has clear policies and operating parameters, and its activities are routinely reviewed and audited. The function does not operate as a profit center and the undertaking of speculative transactions is not permitted.

***Operational threats and performance risk in the business.***

There is a risk that our business may not deliver its stated strategy in full, particularly since, like all retailers, the business is susceptible to economic downturn that could affect consumer spending. The continuing acquisition and development of property sites also forms an intrinsic part of our strategy, and this carries inherent risks.

We try to deliver what customers want better than our competitors by understanding and responding to customer behavior. All of our business units have "stretching targets" (aspirational targets for certain key performance indicators) based on the Steering Wheel, and the performance of all business units is monitored continually and reported monthly to our board of directors. We manage the acquisition and development of our property assets carefully. We consider and assess in detail every site at each stage of acquisition and development and ensure that relevant action is taken to minimize any risks.

Our aim is to have broad appeal to all customers in our different markets, minimizing the impact of changes to the economic climate.

***Competition and consolidation.***

The retail industry is highly competitive. We compete with a wide variety of retailers of varying sizes and face increased competition from U.K. retailers as well as from international operators in the United Kingdom and overseas.

Failure to compete with competitors on areas including price, product range, quality and service could have an adverse effect on our financial results.

We aim to have a broad appeal in price, range and store format in a way that allows us to compete in different markets. We track performance against a range of measures that customers tell us are critical to their shopping trip experience and constantly monitor customer perceptions of ourselves and our competitors to ensure that we can respond quickly if we need to.

***People capabilities.***

Our greatest asset is our employees. It is critical to our success to attract, retain, develop and motivate the best people with the right capabilities at all levels of operations. We consider our people policies regularly and are committed to investing in training and development and incentives for our people. Our "Talent Planning" process helps individuals achieve their full potential. We also carry out succession planning to ensure that the needs of the business going forward are considered and provided for. There are clear processes for understanding and responding to employees' needs through our People Management Group, staff surveys, regular performance reviews, involvement of trade unions and regular communication of business developments.

***Reputational risk.***

As the largest retailer in the United Kingdom, expectations of us are high. Failure to protect our reputation and brand could lead to a loss of trust and confidence. This could result in a decline in the customer base and affect our ability to recruit and retain good people.

Like other companies, we must consider potential threats to our reputation and the consequences of reputational damage. Emotional loyalty to the Tesco brand has helped us diversify into new areas such as retail services and non-food and we recognize the commercial imperative to do the right thing for all our stakeholders and avoid the loss of such loyalty. The "Tesco Values" are embedded in the way we do business at every level and our Code of Ethics guides our behavior in our dealings with customers, employees and suppliers. We engage with stakeholders in every sphere to take into account their views and try to ensure our strategy reflects them. The launch of the Community Plan (our set of community outreach programs). has demonstrated our commitment to tackling a wide range of societal and environmental issues. We have high-level committees, including our Corporate Responsibility Committee and Compliance Committee, to help guide and monitor our policies.

***Environmental risks.***

Our key environmental risks are related to minimizing energy usage in stores and transportation, waste management and our ability to respond to consumer concerns in this area. We develop environmental policy through engaging with key stakeholders and experts in this field to achieve sustainable growth and minimize our environmental impacts. Our approach is brought together in a consistent manner by the Corporate Responsibility Committee. Policy is reviewed regularly by the Compliance Committee and Corporate Responsibility Committee. We recognize the opportunities for competitive advantage through energy efficiency and look for continuous improvement though innovations and better ways to help customers act responsibly towards the environment.

***Product safety.***

The safety and quality of our products is of paramount importance to us as well as being essential for maintaining customer trust and confidence. A breach in confidence could affect the size of our customer base and hence financial results.

We have detailed and established procedures for ensuring product integrity at all times, especially for our own label products. There are strict product safety processes and regular management reports. We work in partnership with suppliers to ensure mutual understanding of the standards required. The business also monitors developments in areas such as health, safety and nutrition in order to respond appropriately to changing customer trends and new legislation. We have clear processes for crisis management, pulling together expert teams should we need to respond quickly on issues.

***Ethical risks in the supply chain.***

We do business with a large number of own-brand suppliers in over 90 countries and the supply chain is made up of complex relationships — from individual farmers and growers through to processors, manufacturers and distributors. There is a risk that any part of the supply chain might not adhere to our high ethical standards.

To minimize this risk we have a partnership approach to working with suppliers providing a certain and growing market for their products, regular payments and payments on time, and a commitment to sharing our understanding of customers and changing consumer behavior. We also have a program of regular risk assessments and audits of suppliers on ethical issues to complement our compliance work on product safety, quality and capability.

***Fraud and compliance.***

As our business grows in size and geographical spread, the risk of occurrence of fraudulent behavior by our employees increases. While we believe that the vast majority of our staff is completely honest, there remains the potential for fraud and other dishonest activity at all levels of the business from shop floor to senior management. We take extensive steps to reduce this risk. Relevant accounting and other procedures and controls at all levels are clearly set out and are audited across the business to reduce the risk of fraud. We give clear guidance on behavior to employees through our Values and Code of Ethics. Our Audit department undertakes detailed investigations into all areas of the business and highlights its findings to the Audit Committee of our board of directors. The Compliance Committee formulates and monitors the implementation of, and compliance with, appropriate policies on key areas of ethical behavior, including fraud.

***Information Technology ("IT") systems and infrastructure.***

Our business is dependent on efficient IT systems. Any significant failure in the IT processes of our retail operations (for example barcode scanning or supply chain logistics) would impact our ability to trade. We recognize the essential role that IT plays across our operations in allowing us to trade efficiently and that we can also achieve commercial advantage through implementing IT innovations that improve the shopping trip for customers and make life easier for employees. We have controls in place to maintain the integrity and efficiency of our IT infrastructure and we share systems from across our international operations to ensure consistency of delivery.

***Regulatory and political environment.***

We are subject to a wide variety of regulations in the different countries in which we operate because of the diverse nature of our business. We may be impacted by regulatory changes in key areas such as planning laws, trading hours and tax rules, as well as by scrutiny by the competition authorities. We may also be impacted by political developments in the countries in which we operate. We consider these uncertainties in the external environment when developing strategy and reviewing performance. We remain vigilant to future changes in the United Kingdom and abroad. As part of our day-to-day operations we engage with governmental and non-governmental organizations to ensure the views of our customers and employees are represented and try to anticipate and contribute to important changes in public policy.

***Activism and terrorism.***

A major incident or terrorist event incapacitating management, systems or stores could impact on our ability to trade. In addition to contingency plans, we have security systems and processes that we believe reflect best practice.

***Pension risks.***

Our pension arrangements are an important part of our employees' overall benefits package especially in the United Kingdom. We see them as a strong contributor to our ability to attract and retain good people, our greatest asset.

Since the implementation of IAS 19 'Employee Benefits' there is a risk that the accounting valuation deficit (which is recorded as a liability of our balance sheet) could increase if returns on corporate bonds are higher than the investment return on the pensions scheme's assets. IAS 19 requires that defined benefit pension plan obligations be measured at discounted present value (using the projected unit credit method) while plan assets are recorded at fair value, with the net obligation then recorded as a liability on the balance sheet.

We have considered our pension risks and have taken action by increasing contributions and by reducing risk in our investment strategy.

***Joint venture governance and partnerships.***

As we continue to enter into new partnerships and joint ventures, as well as to develop existing arrangements, there remains an inherent risk in managing these partnerships and joint ventures. It is more difficult to guarantee the achievement of joint goals that affect our partners and we rely on our partners to help achieve such goals. We may also be impacted by reputational issues that affect our partners. We choose partners with good reputations and set out joint goals and clear contractual arrangements from the outset. We monitor performance and governance of our joint ventures and partnerships.

## Risks Related to the Notes

***We may be able to incur substantially more debt in the future.***

We may be able to incur substantial additional indebtedness in the future, including in connection with future acquisitions, some of which may be secured by some or all of our assets. The terms of the notes will not limit the amount of indebtedness we may incur. Any such incurrence of additional indebtedness could exacerbate the related risks that we now face.

***An active liquid trading market for the notes may not develop, and the transfer of the notes will be subject to restrictions.***

The notes are a new class of securities that have never been traded. We have applied for the listing of the notes on the London Stock Exchange Professional Securities Market. However, we cannot assure you that the notes will be listed on any exchange at the time the notes are delivered to the initial purchasers or at any other time. The initial purchasers have informed us that they intend to make a market in the notes. However, they are not obligated to do so, and may discontinue such market making at any time without notice. There can be no assurance that an active trading market for the notes will develop, or if one does develop, that it will be sustained.

We have not registered the notes under the U.S. Securities Act or any U.S. state securities laws, and we have not agreed to and do not intend to register the notes under the U.S. Securities Act or under any other country's securities laws. Therefore, you may not offer or sell the notes, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the U.S. Securities Act and applicable state securities laws. You should read the discussion under the heading "Notice to Investors" for further information about the transfer restrictions that apply to the notes. It is your obligation to ensure that your offers and sales of notes within the United States and other countries comply with all applicable securities laws.

***The notes will initially be held in book-entry form and therefore you must rely on the procedures of the relevant clearing systems to exercise any rights and remedies.***

Unless and until notes in definitive registered form, or definitive registered notes, are issued in exchange for book-entry interests, owners of book-entry interests will not be considered owners or holders of notes. DTC, or its nominee, will be the registered holder of the Rule 144A and Regulation S global notes for the benefit of its participants including Euroclear and Clearstream Luxembourg. After payment to the registered holder, we will have no responsibility or liability for the payment of interest, principal or other amounts to the owners of book-entry interests. Accordingly, if you own a book-entry interest, you must rely on the procedures of DTC, Euroclear and/or Clearstream Luxembourg, and if you are not a participant in DTC, Euroclear and/or Clearstream Luxembourg, on the procedures of the participant through which you own your interest, to exercise any rights and obligations of a holder under the indenture. See "Book-Entry; Delivery and Form".

Unlike the holders of the notes themselves, owners of book-entry interests will not have any direct rights to act upon our solicitations for consents, requests for waivers or other actions from holders of the notes. Instead, if you own a book-entry interest, you will be permitted to act only to the extent you have received appropriate proxies to do so from DTC, Euroclear and/or Clearstream Luxembourg or, if applicable, from a participant. There can be no assurance that procedures implemented for the granting of such proxies will be sufficient to enable you to vote on any matters on a timely basis.

Similarly, upon the occurrence of an event of default under the fiscal and paying agency agreement, unless and until definitive registered notes are issued in respect of all book-entry interests, if you own a book-entry interest, you will be restricted to acting through DTC, Euroclear and/or Clearstream Luxembourg. We cannot assure you that the procedures to be implemented through DTC, Euroclear and/or Clearstream Luxembourg will be adequate to ensure the timely exercise of rights under the notes. See "Book-Entry; Delivery and Form".

***Investors in the notes may have limited recourse against the independent auditors.***

See "Independent Auditors" for a description of the independent auditors' reports, including language limiting the auditors' scope of duty in relation to such reports and the consolidated financial statements to which they relate. In particular, the April 16, 2007 and April 24, 2006 reports of PricewaterhouseCoopers LLP. with respect to such audited consolidated financial statements, in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, provide: "This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing." The SEC would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act or in a report filed under the Exchange Act. If a U.S. court (or any other court) were to give effect to the language quoted above, the recourse that investors in the notes may have against the independent auditors based on their reports or the consolidated financial statements to which they relate could be limited.

## USE OF PROCEEDS

We expect the net proceeds from the offering to be $1.96 billion (£953 million, translated at the October 29, 2007 exchange rate of $2.06 = £1.00), after deducting certain expenses and issue discounts relating to the offering. We intend to use the net proceeds from the offering to refinance certain short-term indebtedness and for general corporate purposes. For more information, see "Capitalization".

## CAPITALIZATION

The table below presents our consolidated cash and cash equivalents and capitalization as of August 25, 2007 on an actual basis and as adjusted to reflect the application of the net proceeds of this offering as discussed under "Use of Proceeds", as if the offering had been completed as of August 25, 2007. You should read this table together with "Use of Proceeds," "Operating and Financial Review — Liquidity and Capital Resources," "Description of the Notes," "Description of Certain Other Indebtedness" and our financial statements and the notes to those financial statements, which are included elsewhere in this prospectus.

Other than as reflected below, there have been no material changes to our capitalization since August 25, 2007.

| | As of August 25, 2007 | |
|---|---|---|
| | **Actual** | **Pro forma** |
| | (in millions of £) (unaudited) | |
| Cash and receivables: | | |
| Cash and cash equivalents[1] | 1,389 | 1,744 |
| Finance lease receivables | 8 | 8 |
| Joint venture loan receivables | 190 | 190 |
| Derivative financial instruments | 98 | 98 |
| Total cash and receivables | 1,685 | 2,040 |
| Current borrowings: | | |
| Bank loans and other borrowings | (1,884) | (1,286) |
| Finance lease payables | (53) | (53) |
| Derivative financial instruments and other liabilities | (96) | (96) |
| Total current borrowings | (2,033) | (1,435) |
| Non-current borrowings: | | |
| Bank and other borrowings | (4,355) | (4,355) |
| Finance lease payables | (233) | (233) |
| Derivative financial instruments and other liabilities | (390) | (390) |
| Notes offered hereby[2] | — | (953) |
| Total non-current borrowings | (4,978) | (5,931) |
| Net debt[3] | (5,326) | (5,326) |
| Total shareholders' equity | (10,695) | (10,695) |
| Minority interests | (59) | (59) |
| Total equity | (10,754) | (10,754) |
| Total borrowings | (7,011) | (7,366) |
| Total capitalization | (17,765) | (18,120) |

(1) Actual cash and cash equivalents includes cash at banks and in hand and short-term deposits. Pro forma cash and cash equivalents is calculated by adding the proceeds of the notes offered hereby of £960 million, less amounts used to retire debt outstanding of £598 million and amounts used to meet fee and expense obligations in respect of this offering of £7 million.

(2) Reflects the gross proceeds of the notes, translated into pounds sterling at the October 29, 2007 exchange rate of $2.06 = £1.00, net of debt issuance costs and issue discounts.

(3) Comprised of cash and cash equivalents, finance lease receivables, joint venture loan receivables, derivative financial instrument assets, current bank and other borrowings, current finance lease payables, current derivative financial instruments and other liabilities, non-current bank and other borrowings, non-current finance lease payables, and non-current derivative financial instruments and other liabilities.

## SELECTED FINANCIAL INFORMATION

The selected consolidated financial information as of and for the fiscal years ended February 24, 2007, February 25, 2006 and February 26, 2005 has been derived from our audited consolidated financial statements included elsewhere in this prospectus. The consolidated financial statements as of and for the fiscal years ended February 24, 2007 and February 25, 2006 have been prepared in accordance with IFRS as adopted by the EU, and have been audited by PricewaterhouseCoopers LLP. IFRS differs in significant respects from U.S. GAAP. The selected historical financial information as of August 25, 2007 and for the 26-week periods ended August 25, 2007 and August 26, 2006 has been derived from our unaudited condensed consolidated financial statements included elsewhere in this prospectus. The unaudited condensed consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and, in the opinion of our management, reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of this information. The results for any interim period are not necessarily indicative of the results that may be expected for a full year.

The selected financial and operating information set forth below should be read in conjunction with “Operating and Financial Review,” our financial statements and the notes to those financial statements included elsewhere in this prospectus.

## Selected Consolidated Financial and Operating Data

### Selected Group Income Statement Data

| | Fiscal Year Ended | | | 26 Weeks Ended | |
|---|---|---|---|---|---|
| | February 24, 2007 | February 25, 2006* | February 26, 2005 | August 25, 2007 | August 26, 2006 |
| | | | (unaudited) | (unaudited) | |
| | (in millions of pounds, except per share information) | | | | |
| **Continuing operations** | | | | | |
| **Revenue (sales excluding VAT)** | 42,641 | 39,454 | 33,866 | 22,631 | 20,735 |
| Cost of sales | (39,401) | (36,426) | (31,231) | (21,017) | (19,296) |
| Pensions adjustment – Finance Act 2006 | 258 | — | — | — | — |
| Impairment of the Gerrards Cross site(1) | (35) | — | — | — | — |
| **Gross profit** | 3,463 | 3,028 | 2,635 | 1,614 | 1,439 |
| Administrative expenses | (907) | (825) | (732) | (424) | (376) |
| Profit arising on property-related items | 92 | 77 | 49 | 119 | 38 |
| **Operating profit** | 2,648 | 2,280 | 1,952 | 1,309 | 1,101 |
| Share of post-tax profits of joint ventures and associates(2) | 106 | 82 | 74 | 32 | 60 |
| Profit on sale of investments in associates | 25 | — | — | — | — |
| Finance income | 90 | 114 | 103 | 52 | 54 |
| Finance costs | (216) | (241) | (235) | (104) | (123) |
| **Profit before tax** | 2,653 | 2,235 | 1,894 | 1,289 | 1,092 |
| Taxation | (772) | (649) | (541) | (351) | (317) |
| **Profit for the period from continuing operations** | 1,881 | 1,586 | 1,353 | 938 | 775 |
| **Discontinued operation** | | | | | |
| Profit/(loss) for the period from discontinued operation | 18 | (10) | (6) | — | 16 |
| **Profit for the period** | 1,899 | 1,576 | 1,347 | 938 | 791 |
| **Attributable to:** | | | | | |
| Equity holders of the parent | 1,892 | 1,570 | 1,344 | 936 | 788 |
| Minority interests | 7 | 6 | 3 | 2 | 3 |
| | 1,899 | 1,576 | 1,347 | 938 | 791 |
| **Earnings per share from continuing and discontinued operations** | | | | | |
| Basic | 23.84p | 20.07p | 17.44p | 11.83p | 9.95p |
| Diluted | 23.54p | 19.79p | 17.22p | 11.65p | 9.81p |
| **Earnings per share from continuing operations** | | | | | |
| Basic | 23.61p | 20.20p | 17.52p | 11.83p | 9.75p |
| Diluted | 23.31p | 19.92p | 17.30p | 11.65p | 9.61p |

* Results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and Republic of Ireland and 14 months for the majority of the remaining international businesses.

(1) The construction site of a new store being built on top of a tunnel, which collapsed. See ''Operating and Financial Review — Factors Affecting Our Operating Results''.

(2) Includes £47 million of property related items (2005/06 and 2004/05: £0); for the 26 weeks ended August 25, 2007 (2006: £36 million).

**Reconciliation of Profit Before Tax to Underlying Profit Before Tax**

| | Fiscal Year Ended | | | 26 Weeks Ended | |
|---|---|---|---|---|---|
| | February 24, 2007 | February 25, 2006* | February 26, 2005 | August 25, 2007 | August 26, 2006 |
| | | | (unaudited) | (unaudited) | |
| | (in millions of pounds, except per share information) | | | | |
| **Non-GAAP measure: underlying profit before tax(3)** | | | | | |
| Profit before tax (excluding discontinued operations) | 2,653 | 2,235 | 1,894 | 1,289 | 1,092 |
| **Adjustments for:** | | | | | |
| IAS 32 and IAS 39 'Financial instruments' – Fair value remeasurements | 4 | 9 | — | (7) | 5 |
| Total IAS 19 Income Statement charge for pensions | 432 | 303 | 268 | 190 | 210 |
| 'Normal' cash contributions for pensions | (321) | (270) | (237) | (155) | (155) |
| **Exceptional items:** | | | | | |
| Pensions adjustment – Finance Act 2006 | (258) | — | — | — | — |
| Impairment of the Gerrards Cross site | 35 | — | — | — | — |
| **Underlying profit before tax** | 2,545 | 2,277 | 1,925 | 1,317 | 1,152 |
| **Underlying diluted earnings per share from continuing operations** | 22.36p | 20.30p | 17.58p | 11.90p | 10.15p |

* Results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and Republic of Ireland and 14 months for the majority of the remaining international businesses.

(3) Underlying profit before tax is not defined by IFRS and is used by management to internally measure and analyze performance. It is defined as profit before taxation for the period from continuing operations, excluding exceptional items and certain re-measurement items, financial instruments, pension charges after including ''normal'' cash contributions as a charge. Underlying profit before taxation is not a presentation made in accordance with IFRS, is not a measure of financial condition, liquidity or profitability and should not be considered as an alternative to net income determined in accordance with IFRS or operating cash flows determined in accordance with IFRS. We believe that inclusion of underlying profit before taxation in this prospectus is appropriate to provide additional information to investors about our operating performance and to provide a measure of operating results unaffected by volatility of accounting for pensions, financial instruments and other significant and exceptional items. Because not all companies calculate or present underlying profit before taxation identically, this presentation of underlying profit before taxation may not be comparable to other similarly titled measures of other companies. This table reconciles our profit before taxation from continuing operations presented above to our underlying profit before taxation for the periods presented.

**Selected Group Balance Sheet Data**

| | As Of | | |
|---|---|---|---|
| | August 25, 2007 (unaudited) | February 24, 2007 | February 25, 2006 |
| | (in millions of pounds) | | |
| Property, plant and equipment | 18,161 | 16,976 | 15,882 |
| Other non-current assets | 3,462 | 3,255 | 2,762 |
| **Non-current assets** | 21,623 | 20,231 | 18,644 |
| Cash and cash equivalents | 1,389 | 1,042 | 1,325 |
| Other current assets | 3,408 | 3,126 | 2,426 |
| **Current assets** | 4,797 | 4,168 | 3,751 |
| Non-current assets held for sale(4) | 13 | 408 | 168 |
| Current borrowings | (1,937) | (1,554) | (1,646) |
| Other current liabilities | (7,321) | (6,598) | (5,786) |
| **Current liabilities** | (9,258) | (8,152) | (7,432) |
| **Net current liabilities** | (4,448) | (3,576) | (3,599) |
| Liabilities directly associated with the disposal group(5) | — | — | (86) |
| Non-current borrowings | (4,588) | (4,146) | (3,742) |
| Other non-current liabilities | (1,833) | (1,938) | (1,859) |
| **Non-current liabilities** | (6,421) | (6,084) | (5,601) |
| **Total liabilities** | (15,679) | (14,236) | (13,119) |
| **Net assets** | 10,754 | 10,571 | 9,444 |
| **Equity attributable to equity holders of the parent** | 10,695 | 10,506 | 9,380 |
| Minority interests | 59 | 65 | 64 |
| **Total equity** | 10,754 | 10,571 | 9,444 |

(4) Non-current assets held for sale are primarily in relation to properties held for sale, including the U.K. assets disposed of as part of a sale and leaseback transaction completed after the date of the balance sheet.

(5) Liabilities directly associated with the disposal group are in relation to the liabilities associated with the Group's business operations in Taiwan, which were sold to Carrefour on May 31, 2007 as part of a transaction to acquire Carrefour's Czech business.

## Selected Group Cash Flow Statement and Net Debt Data

| | Fiscal Year Ended | | | 26 Weeks Ended | |
|---|---|---|---|---|---|
| | February 24, 2007 | February 25, 2006* | February 26, 2005 | August 25, 2007 | August 26, 2006 |
| | | | (unaudited) | (unaudited) | |
| | | | (in millions of pounds) | | |
| **Cash flows from operating activities** | | | | | |
| Cash generated from operations | 3,532 | 3,412 | 3,009 | 1,916 | 1,787 |
| Interest paid | (376) | (364) | (350) | (155) | (168) |
| Corporation tax paid | (545) | (429) | (483) | (202) | (300) |
| **Net cash from operating activities** | 2,611 | 2,619 | 2,176 | 1,559 | 1,319 |
| **Net cash used in investing activities** | (2,343) | (1,962) | (1,501) | (1,002) | (1,109) |
| **Cash flows from financing activities** | | | | | |
| Dividends paid | (467) | (441) | (448) | (541) | (237) |
| Other net cash flows on financing activities | (66) | (51) | (203) | 329 | 113 |
| **Net cash used in financing activities** | (533) | (492) | (651) | (212) | (124) |
| **Net (decrease)/increase in cash and cash equivalents** | (265) | 165 | 24 | 345 | 86 |
| Net cash (inflow)/outflow from debt and lease financing | (268) | 115 | 206 | (813) | (195) |
| Loans and finance leases acquired with subsidiaries | — | — | (17) | — | — |
| Net debt included within disposal group | — | 55 | — | | |
| Other non-cash movements | 18 | (357) | 11 | 3 | 227 |
| (Increase)/decrease in net debt in the period | (515) | (22) | (224) | (465) | (18) |
| **Opening net debt at beginning of period** | (4,384) | (3,769) | (4,123) | (4,861) | (4,384) |
| **IAS 32 and 39 adjustments to net debt** | — | (588) | — | — | — |
| **Adjustment for joint venture loan receivables(6)** | 38 | (5) | 130 | — | — |
| **Opening net debt after IAS 32, 39 and joint venture loan receivables adjustments** | (4,346) | (4,362) | (3,993) | (4,861) | (4,384) |
| **Closing net debt at end of period** | (4,861) | (4,384) | (3,769) | (5,326) | (4,266) |

* Results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and Republic of Ireland and 14 months for the majority of the remaining international businesses.

(6) The measurement of net debt for all periods presented has been revised from net debt amounts reported previously to include loan receivables from joint ventures. Going forward from August 25, 2007, we will report net debt inclusive of the loan receivables from joint ventures.

## OPERATING AND FINANCIAL REVIEW

*This review of our financial condition and results of operations for the periods indicated below contains forward-looking statements that involve risks and uncertainties. The forward-looking statements are not historical facts, but rather are based on our current expectations, estimates, assumptions and projections about our industry, business and future financial results. Actual results could differ materially from the results contemplated by these forward-looking statements because of a number of factors, including those discussed in the sections of this prospectus entitled "Risk Factors," "Information Regarding Forward-Looking Statements" and other sections of this prospectus.*

*The unaudited interim financial statements for the periods indicated below include all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results for the unaudited interim period. The interim results are not necessarily indicative of the results that may be expected for a full year.*

### Overview

We are the United Kingdom's largest food retailer. As of August 25, 2007, we owned and operated a total of 3,409 stores in 12 countries, of which 2,033, or approximately 60% were in the United Kingdom and 1,376, or approximately 40% were located in our other markets. Our operations include:

- food retailing;
- non-food retailing of a variety of goods, including clothing, gasoline, consumer electronics, health and beauty, toys and sports, do-it-yourself, kitchenware and soft furnishings, seasonal goods such as barbeques and garden products, DVDs, stationery, news and magazines;
- personal financial services, including banking services, credit cards, insurance, mortgages and loans; and
- a range of telecommunication services, including mobile phone, internet, internet phone and home phone service.

We sell our goods and services through our stores, our website at www.tesco.com and our catalog.

We have a well-established and consistent strategy for growth, which has allowed us to strengthen our core U.K. business and drive expansion into new markets. Our four-part strategy to diversify the business was laid down in 1997 (and recently updated to add a fifth element) and we believe it has been the foundation of our success in recent years. The new businesses that have been created and developed over the last decade as part of this strategy now have scale (meaning they have the efficiencies that come with being more mature businesses) and are competitive and profitable. In 2006/07 they made more profit than all of our operations combined did in 1997. The objectives of the strategy, as discussed more fully in "Business" are:

- to grow the core U.K. business;
- to be as strong in non-food as in food;
- to become a successful international retailer;
- to develop retailing services (our personal finance and telecommunications services, tesco.com and Tesco Direct); and
- to put the community at the heart of what we do.

We divide our business into three geographical segments, based on our management and internal reporting structure: U.K. operations, operations in Europe excluding the United Kingdom (which we refer to simply as "Europe") and operations in Asia. Our U.K. segment includes all of our operations in the United Kingdom. Our Europe segment includes our operations in the Republic of Ireland, Poland, the Czech Republic, Slovakia, Hungary and Turkey. Our Asia segment includes our operations in Thailand, South Korea, Malaysia, China and Japan. When we refer to the results of the

"Group" or to "Group" operations, we refer to the combined results of our three geographical segments. When we refer to the results of "International", we refer to the combined results of our Europe and Asia geographical segments.

We have a 52-week fiscal year (or, in the case of every sixth year, 53 weeks), which ends on the last Saturday in February. The results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and the Republic of Ireland and 14 months for the majority of the remaining international businesses. This was due to the fact that in the year ended February 25, 2006, we aligned these businesses' period-ends from a calendar year-end to a February 28 year-end. The following discussion summarizes the significant factors and events affecting our results of operations and financial condition for each of the 26-week periods ending August 25, 2007 and August 26, 2006 and each of the years ending February 24, 2007 ("2006/07"), February 25, 2006 ("2005/06") and February 26, 2005 ("2004/05"), and should be read in conjunction with our financial statements and accompanying notes included elsewhere in this prospectus. We intend for this discussion to provide information that will assist in your understanding of our financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our financial statements. The discussion also provides information about the financial results of our three geographical segments, U.K. operations, our operations in Europe and our operations in Asia, and International as a whole, to provide a better understanding of how those segments and their results affect our financial condition and results of operations of the Group as a whole.

**Factors Affecting Our Operating Results**

Throughout this section, we refer to revenues, and also to "sales", by which we mean revenues plus value added tax, or "VAT", a tax levied on the sale of goods and services in several of our markets, including the United Kingdom, which we are required to collect from our customers when they make purchases from us. We believe the use of sales figures is helpful as it allows us to evaluate our financial data with reference to the prices actually paid by consumers. Our audited annual and unaudited interim financial statements provide information based on revenues.

The United Kingdom is the source of the majority of our revenues, representing 77% of our revenues in 2006/07 and 74% of our revenues in the 26 weeks ended August 25, 2007. In 2006/07 and the 26 weeks ended August 25, 2007 much of our revenue growth occurred in the United Kingdom, mainly due to increased sales volume and net new stores (meaning stores opened in the period less stores closed in the period). U.K. sales grew by 9.0% in 2006/07, with a 5.6% like-for-like sales increase, and U.K. sales grew 5.4% in the 26 weeks ended August 25, 2007, with a 2.7% like-for-like sales increase. Like-for-like sales represent a comparison of period-on-period sales of stores that were operating in both the current period and the comparable period the prior year. Both customer numbers and spend per visit increased in fiscal 2006/07 in the United Kingdom as a result of our investment in a number of improvements to our stores to improve the shopping experience for the customer.

We have continued to expand our international operations. Sales growth was strong in 2006/07 and in the 26 weeks ended August 25, 2007, largely due to our international store expansion. Margins in International continued to improve in 2006/07, despite absorbing significant integration costs from the in-market acquisitions we completed in the year in the Czech Republic, Poland and Malaysia. In the 26 weeks ended August 25, 2007, margins were stable.

We made several U.K. and international acquisitions during 2006/07 that, taken together, contributed £259 million to revenues (representing 0.6% of the 2006/07 revenues as a whole). In addition, on December 12, 2006, we increased our stake in Ting Cao (C.I.) Holding Corp., the holding company of a chain of retail stores in China doing business under the name Hymall ("Hymall"), giving us control of the company. As a result, we began fully consolidating Hymall's results from the beginning of the 26-week period ended August 25, 2007.

Our non-food sales have grown significantly faster than sales in our core operations and the proportion of our sales represented by non-food rose to 25% (excluding gasoline) in 2006/07. In the

26 weeks ended August 25, 2007, non-food sales grew 12% to £5.5 billion compared to the same period last year. We believe our non-food operations will continue to grow based on our relatively low market shares in many general merchandise categories, the growing popularity of our offer for customers and the scope to expand our stores or sell more though direct channels.

Our personal finance services operations saw profits decline in 2006/07 (from £139 million in 2005/06 to £130 million in 2006/07, of which our share under our joint venture arrangement with the Royal Bank of Scotland is 50%) due to difficult market conditions in two of its core markets, credit cards and motor insurance. However, personal finance services profits increased 6% over the comparable period to £53 million (of which our share is 50%) in the 26 weeks ended August 25, 2007, despite increased provisions for doubtful debts (although our performance in this area compared well with the financial services industry average). The increase in profit was also after absorbing greater than average home insurance claims due to mass flooding in England during the period, with approximately 40% of these claims charged in the first half of the year. Our retailing services business as a whole is continuing to grow based on the success of tesco.com and our telecommunications services operations. Tesco.com sales continued to grow by 29.2% in 2006/07 to £1,226 million, and by 35% in the 26 weeks ended August 25, 2007. Our telecommunications services began to be profitable in 2006/07 after we built up our customer base. We believe that this was due to a combination of attractive fee plans, customer service initiatives, and new product offerings.

Although much of our business is in the United Kingdom, our sales can be affected by exchange rate fluctuations. We therefore describe sales growth at actual and constant exchange rates to demonstrate the impact of exchange rates. Actual exchange rates describes exchange rates translated in accordance with note 1 to our financial statements. Constant exchange rates describes exchange rates translated at the rates applied to the prior period, without regard to any changes in actual exchange rates between the periods.

There are a number of contingent liabilities that arise in the normal course of our business which, if realized, are not expected to result in any material liability. We recognize provisions for liabilities when it is more likely than not that a settlement will be required and the value of such a payment can be reliably estimated.

On June 29, 2007, we reached a mutually agreeable settlement with Chiltern Railways in relation to a railway tunnel collapse that occurred on June 30, 2005 at our Gerrards Cross site while we were constructing a store over the tunnel. Chiltern Railways, a U.K. passenger railway company that used the railway line, commenced arbitration proceedings against us on July 3, 2006 seeking damages for lost revenues due to the collapse. The amount of the settlement is reflected in our results for the 26 weeks ended August 25, 2007, and is not significant in the context of our results. We do not expect any pending claims or counter claims with other parties in relation to the tunnel collapse to result in a material liability or gain. In our 2006/07 results, we also recognized an impairment charge on the cumulative capital expenditure incurred on the Gerrards Cross store development up until February 25, 2007 (£35 million) as part of our testing of individual stores for impairment, because indicators of impairment existed at the balance sheet date. We have recently confirmed that we intend to complete the construction of our store in Gerrards Cross, which will result in additional costs and capital expenditure being incurred.

## Results of Operations

### *26 weeks ended August 25, 2007 compared to 26 weeks ended August 26, 2006*

*Revenues*

Our revenues increased 9.1% in the 26 weeks ended August 25, 2007 to £22.6 billion from £20.7 billion in the 26 weeks ended August 26, 2006, and our sales increased 9.2% to £24.7 billion in the 26 weeks ended August 25, 2007 from £22.7 billion in the prior period. At constant exchange rates, sales increased by 9.5% in the 26 weeks ended August 25, 2007. Growth in the period was mainly due to the benefits of last year's acquisitions (including the first-time consolidation of Hymall), organic growth in selling space and by our investments to deliver an improved shopping trip for customers.

The following table breaks down our revenues by geographical region for the 26 weeks ended August 25, 2007 and August 26, 2006.

| | 26 Weeks Ended August 25, 2007 | Percent Increase | 26 Weeks Ended August 26, 2006 |
|---|---|---|---|
| | (in millions of pounds, except percentages) | | |
| United Kingdom | 16,854 | 5.6% | 15,967 |
| Europe | 3,121 | 18.3% | 2,638 |
| Asia | 2,656 | 24.7% | 2,130 |
| Total revenues | 22,631 | 9.1% | 20,735 |

*Profit*

Operating profit was up 18.9% in the 26 weeks ended August 25, 2007 to £1.3 billion from £1.1 billion in the prior period. The increase is due mainly to profits arising on property-related items, increased productivity and good expense control and improved market positions. The following table breaks down our operating profit by geographical region for the 26 weeks ended August 25, 2007 and August 26, 2006.

| | 26 Weeks Ended August 25, 2007 | Percent Increase | 26 Weeks Ended August 26, 2006 |
|---|---|---|---|
| | (in millions of pounds, except percentages) | | |
| United Kingdom | 1,041 | 19.4% | 872 |
| Europe | 147 | 18.5% | 124 |
| Asia | 121 | 15.2% | 105 |
| Total | 1,309 | 18.9% | 1,101 |

Our administrative expenses consist mainly of head-office employee-related costs such as wages, social security costs and retirement plan costs, and overheads such as rent, depreciation and utilities. As a percentage of revenues, administrative expenses have been relatively steady at 1.9% in the 26 weeks ended August 25, 2007 compared to 1.8% in the 26 weeks ended August 26, 2006.

We also track separately the amount of profit that arises from property-related items. In the 26 weeks ended August 25, 2007, profit from property-related items was up 61% to £119 million (net of losses) from £74 million in the 26 weeks ended August 26, 2006. The prior period includes £36 million of profit arising on property disposals by our joint ventures, recorded within share of post-tax profits of joint ventures and associates. This increase overall was due mainly to our plan of releasing cash from property through a sequence of sale-leaseback and other transactions, under which we divest property to joint ventures. See "— Off-balance sheet arrangements — Operating lease commitments".

Our total gross profit as a percentage of our revenues (our "gross margin") was 7.1% in the 26 weeks ended August 25, 2007, up from 6.9% in the 26 weeks ended August 26, 2006. Gross profit also rose 12.2% to £1.6 billion in the 26 weeks ended August 25, 2007 from £1.4 billion in the prior period. Margins were up in the 26 weeks ended August 25, 2007 mainly due to the relatively steady level of our cost of sales as compared to the increase in revenues.

In 2005/06, we began to use a non-GAAP measure, underlying profit before tax, to measure our performance internally. See "— Critical Accounting Policies" for an explanation of how we calculate underlying profit before tax. In the 26 weeks ended August 25, 2007, underlying profit before tax was up 14.3% to £1,317 million from £1,152 million in the 26 weeks ended August 26, 2006. This higher rate of increase than the increase in gross profit was due mainly to the relatively steady level of our expenses as compared to the increase in revenues and the increased profit on property-related items.

With our half-year interim results for 2006/07, we also began reporting Group and segmental trading profit, which we believe provides useful information on underlying trends and performance. Trading profit is an adjusted measure of operating profit that excludes property-related items and, as our underlying profit measure does, also excludes the non-cash element of the IAS 19 pension charge. Group trading profits were £1,249 million in the 26 weeks ended August 25, 2007, up 10.1% from

£1,134 million in the 26 weeks ended August 26, 2006. Below is a table showing the reconciliation of trading profit to operating profit for the periods indicated.

| | 26 Weeks Ended August 25, 2007 | | | | 26 Weeks Ended August 26, 2006 | | | |
|---|---|---|---|---|---|---|---|---|
| | U.K. | Asia | Europe | Group | U.K. | Asia | Europe | Group |
| | (in millions of pounds, except percentages) | | | | | | | |
| Revenues | 16,854 | 2,656 | 3,121 | 22,631 | 15,967 | 2,130 | 2,638 | 20,735 |
| **Trading profit** | **978** | **124** | **147** | **1,249** | **904** | **105** | **125** | **1,134** |
| Trading margin | 5.8% | 4.7% | 4.7% | 5.5% | 5.7% | 4.9% | 4.7% | 5.5% |
| Add/(deduct): Property profit/(loss) | 121 | (2) | — | 119 | 39 | — | (1) | 38 |
| Deduct: IAS 19 pensions charge | (207) | (5) | (2) | (214) | (223) | (2) | (1) | (226) |
| Add: Normal cash pension contributions | 149 | 4 | 2 | 155 | 152 | 2 | 1 | 155 |
| **Statutory operating profit** | **1,041** | **121** | **147** | **1,309** | **872** | **105** | **124** | **1,101** |

*United Kingdom*

U.K. revenues increased by 5.6% to £16.9 billion in the 26 weeks ended August 25, 2007 from £16.0 billion in the 26 weeks ended August 26, 2006. U.K. sales increased by 5.4% to £18.3 billion from £17.4 billion in the 26 weeks ended August 26, 2006, with like-for-like sales growing by 2.7% (3.5% excluding gasoline), and 2.7% from new stores. Like-for-like sales of 2.7% included volume of 2.1% (where "volume" refers to the portion of like-for-like growth related to the change in the number of items sold from a genuine increase or decrease in customer purchasing and a switch in customer purchasing to different brands/sizes). Like-for-like sales growth in the 26 weeks ended August 25, 2007 decreased from the 6.5% like-for-like sales growth recorded in the 26 weeks ended August 26, 2006. This was due to the effects on unseasonable weather in the 26 weeks ended August 25, 2007 compared to favorable weather in the prior period as discussed below. Operating profit rose by 19.4% to £1,041 million from £872 million in the 26 weeks ended August 25, 2007. In our stores, we saw modest price inflation of 0.9%, as our continued investment in lowering prices for customers was more than offset by the higher cost to us of some market commodities and seasonal fresh food supplies. Seasonal food prices were more volatile than normal during the 26 weeks ended August 25, 2007. U.K. trading profit rose by 8.2%, and trading margin rose to 5.8% in the 26 weeks ended August 25, 2007. These increases were due to increased productivity and good expense control, partially offset by £32 million in start-up costs expended for Tesco Direct and our U.S. expansion, and the effects of unseasonable weather discussed below.

The pattern of our operations during the 26 weeks ended August 25, 2007 was unusual. Although our performance in the first quarter was ahead of budget, sales subsequently slowed during June and July during a prolonged period of unseasonably cold, wet weather in the United Kingdom, compared with the particularly warm, early summer in the previous year. While in June and July of 2007 the weather in the United Kingdom was much cooler and wetter than it had been in June and July of 2006, August of 2007 had relatively similar weather to August of 2006, with both periods having seasonable weather. Primarily as a result of this, while like-for-like sales growth (excluding gasoline) in the second quarter of 2007 as a whole was 2.4% (including zero price inflation by us), like-for-like sales growth for August alone was higher, at approximately 5%. This higher figure was also attributable to our customers' positive response to our latest round of price cuts. The following table shows our U.K. sales, trading profit and trading margin.

| | 26 Weeks Ended August 25, 2007 | Growth |
|---|---|---|
| | (in millions of pounds, except percentages) | |
| U.K. sales | 18,329 | 5.4% |
| U.K. trading profit | 978 | 8.2% |
| Trading margin | 5.8% | — |

*International*

Revenues in International increased by 21.2% to £5.8 billion in the 26 weeks ended August 25, 2007 from £4.8 billion in the 26 weeks ended August 26, 2006. Total sales in these segments increased by 22.0% at actual exchange rates to £6.4 billion from £5.3 billion in the 26 weeks ended August 26, 2006 and by 23.1% at constant exchange rates. Our business in China, which was fully consolidated for the first time in the 26 weeks ended August 25, 2007, contributed £404 million to sales in the 26 weeks ended August 25, 2007. Excluding China, International sales grew by 14.3% at actual exchange rates and by 15.2% at constant exchange rates. Like-for-like sales in International grew by 1.2% in the first half, with net new store space contributing the remaining 21.9%.

International contributed £271 million to trading profit in the 26 weeks ended August 25, 2007, an increase of 17.8% over the £230 million in the 26 weeks ended August 26, 2006. Trading profit in the 26 weeks ended August 25, 2007 included £6 million of integration costs and initial operating losses (last year £5 million), principally on Leader Price stores acquired from Casino in Poland and Makro stores acquired in Malaysia. These acquisitions were completed in late 2006. Excluding the impact of consolidating the China business, margins in International rose by 13 basis points. At constant exchange rates, International trading profit grew by 19.3%. Before integration costs and initial operating losses, trading profit rose by 17.9% at actual exchange rates. The following table shows International sales, trading profit and trading margin at actual and constant exchange rates.

| | 26 Weeks Ended August 25, 2007 | | |
|---|---|---|---|
| | Actual rates | Growth at actual exchange rates | Growth at constant exchange rates |
| | (in millions of pounds, except percentages) | | |
| International sales | 6,420 | 22.0% | 23.1% |
| International trading profit | 271 | 17.8% | 19.3% |
| Trading margin | 4.7% | — | — |

*Europe*

In Europe, revenues rose by 18.3% to £3.1 billion in the 26 weeks ended August 25, 2007 from £2.6 billion in the 26 weeks ended August 26, 2006. Sales rose by 18.8% at actual exchange rates and 17.0% at constant exchange rates to £3.6 billion in the 26 weeks ended August 25, 2007 from £3.0 billion in the 26 weeks ended August 26, 2006. Operating profit rose by 18.5% to £147 million in the 26 weeks ended August 25, 2007 from £124 million in the 26 weeks ended August 26, 2006. Trading profit increased by 17.6% at actual rates to £147 million in the 26 weeks ended August 25, 2007 from £125 million in the 26 weeks ended August 26, 2006 and by 16.3% at constant rates. Trading margins were stable, after charging £3 million (prior period £5 million) of integration costs and initial operating losses principally on the Leader Price stores. These increases were due principally to strong growth in the Czech Republic and Slovakia, and strong performance in Turkey and Ireland. Performance in Turkey and Ireland was partially offset by expenses incurred in building a new distribution center in each of these countries, both of which opened during the 26 weeks ended August 25, 2007. The following table shows our Europe sales, trading profit and trading margin at actual and constant exchange rates.

| | 26 Weeks Ended August 25, 2007 | | |
|---|---|---|---|
| | Actual rates | Growth at actual exchange rates | Growth at constant exchange rates |
| | (in millions of pounds, except percentages) | | |
| Europe sales | 3,558 | 18.8% | 17.0% |
| Europe trading profit | 147 | 17.6% | 16.3% |
| Trading margin | 4.7% | — | — |

*Asia*

In Asia, revenues grew by 24.7% to £2.7 billion in the 26 weeks ended August 25, 2007 from £2.1 billion in the 26 weeks ended August 26, 2006. Sales in Asia rose by 26.1% at actual exchange rates to £2.9 billion in the 26 weeks ended August 25, 2007 from £2.3 billion in the 26 weeks ended August 26, 2006 and by 31.2% at constant exchange rates . Excluding China, sales grew by 8.3% and 12.9% at constant exchange rates. Operating profit grew by 15.2% to £121 million in the 26 weeks ended August 25, 2007 from £105 million in the 26 weeks ended August 26, 2006. After charging £3 million of integration costs and initial operating losses on the Makro stores, Asia trading profit increased by 18.1% to £124 million at actual rates (26 weeks ended August 26, 2006: £105 million) and by 22.8% at constant rates. Before integration costs and initial operating losses, trading profit increased by 21.0%. Excluding China, trading margins rose in Asia to 5.3% from 4.9% in the 26 weeks ended August 26, 2006, driven by strong performances in Korea, Thailand and Malaysia. The following table shows our Asia sales, trading profit and trading margin at actual and constant rates.

| | 26 Weeks Ended August 25, 2007 | | |
|---|---|---|---|
| | Actual rates | Growth at actual exchange rates | Growth at constant exchange rates |
| | (in millions of pounds, except percentages) | | |
| Asia sales | 2,862 | 26.1% | 31.2% |
| Asia trading profit | 124 | 18.1% | 22.8% |
| Trading Margin | 4.7% | — | — |

***Year ended February 24, 2007 compared to year ended February 25, 2006***

*Revenues*

Our revenues increased 8.1% in 2006/07 to £42.6 billion from £39.5 billion in 2005/06, and our sales increased 8.1% from £43.1 billion in 2005/06 to £46.6 billion in 2006/07. On a comparable 52-week basis, sales growth was 10.9% in 2006/07. At constant exchange rates, sales increased by 7.9% in 2006/07, with the comparable 52-week figure at 10.8%. Growth for the 2006/07 year was mainly due to our investing to improve the shopping experience for customers in our businesses around the world, increasing product ranges and the number of outlets.

The following table breaks down our revenues by geographical region for 2006/07 and 2005/06:

| | Year ended February 24, 2007 | Percent Increase | Year Ended February 25, 2006(1) |
|---|---|---|---|
| | (in millions of pounds, except percentages) | | |
| United Kingdom | 32,665 | 8.9% | 29,990 |
| Europe | 5,559 | 9.1% | 5,095 |
| Asia | 4,417 | 1.1% | 4,369 |
| Total revenues | 42,641 | 8.1% | 39,454 |

(1) Results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and the Republic of Ireland and 14 months for the majority of the remaining international businesses.

*Profit*

Operating profit was up 16.1% in 2006/07 to £2.6 billion from £2.3 billion in 2005/06. This higher rate of increase than increase in revenues is due mainly to the positive impact of the pension adjustment (referred to as “A-day”) in 2006/07. The following table breaks down our operating profit by geographical region in 2006/07 and 2005/06.

| | Year Ended February 24, 2007 | Percent Increase | Year Ended February 25, 2006(1) |
|---|---|---|---|
| | (in millions of pounds, except percentages) | | |
| United Kingdom | 2,083 | 16.5% | 1,788 |
| Europe | 324 | 23.2% | 263 |
| Asia | 241 | 5.2% | 229 |
| Total | 2,648 | 16.1% | 2,280 |

(1) Results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and the Republic of Ireland and 14 months for the majority of the remaining international businesses.

Our administrative expenses consist mainly of head-office employee-related costs such as wages, social security costs and retirement plan costs, and overheads such as rent, depreciation and utilities. As a percentage of revenues, administrative expenses have held relatively steady at 2.1% in both 2006/07 and in 2005/06.

In 2006/07, profit from property-related items was up 19.5% to £92 million (net of losses) from £77 million in 2005/06. This increase was due mainly to our plan of releasing cash from property through a sequence of sale-leaseback and other transactions, under which we divest property to joint ventures. See "— Off-balance sheet arrangements — Operating lease commitments".

Our gross margin was 8.1% in 2006/07, up from 7.7% in 2005/06. Margins were up in 2006/07 mainly due to the relatively steady level of our cost of sales as compared to the increase in revenues. Gross profit also rose 14.4% to £3,463 million in 2006/07 from £3,028 million in 2005/06. The increase was largely due to the positive impact of pension adjustment in 2006/07.

In 2006/07, underlying profit before tax was up 11.8% to £2,545 million from £2,277 million. This increase was due mainly to the relatively steady level of our cost of sales as compared to the increase in revenues and the increased profit on property-related items.

Group trading profits were £2,478 million in 2006/07, up 9.6% from 2005/06 and up 11.1% on a comparable 52-week basis. In 2006/07, trading profit also excluded the Pensions A-Day gain and the impairment charge on the Gerrards Cross store development site. Below is a table showing the reconciliation of trading profit to operating profit for the periods indicated.

| | Year Ended February 24, 2007 | | | | Year Ended February 25, 2006 | | | |
|---|---|---|---|---|---|---|---|---|
| | U.K. | Asia | Europe | Group | U.K. | Asia | Europe | Group |
| | (in millions of pounds, except percentages) | | | | | | | |
| Revenues | 32,665 | 4,417 | 5,559 | 42,641 | 29,990 | 4,369 | 5,095 | 39,454 |
| **Trading profit** | **1,914** | **246** | **318** | **2,478** | **1,752** | **238** | **271** | **2,261** |
| Trading profit margin | 5.9% | 5.6% | 5.7% | 5.8% | 5.8% | 5.4% | 5.3% | 5.7% |
| Add: Property profit/(loss) | 98 | (6) | — | 92 | 90 | (7) | (6) | 77 |
| Deduct: IAS 19 pensions charge | (452) | (9) | (5) | (466) | (318) | (5) | (5) | (328) |
| Add: Normal cash pension contributions | 308 | 10 | 3 | 321 | 264 | 3 | 3 | 270 |
| Add: Pensions adjustment-Finance Act 2006 | 250 | — | 8 | 258 | — | — | — | — |
| Deduct: Impairment of Gerrards Cross site | (35) | — | — | (35) | — | — | — | — |
| **Statutory operating profit** | **2,083** | **241** | **324** | **2,648** | **1,788** | **229** | **263** | **2,280** |

*United Kingdom*

U.K. revenues increased by 8.9% to £32.7 billion in 2006/07 from £30.0 billion in 2005/06. Operating profit rose by 16.5% to £2,083 million from £1,788 million in 2005/06. U.K. sales increased by 9.0% to £35.6 billion from £32.7 billion in 2005/06, with like-for-like growth (excluding gasoline) of 5.6% (including volume of 5.0%) and 3.4% growth from net new stores. In our stores, we saw modest price inflation of 0.2%, as our continued investment in lowering prices for customers was more than offset by the higher cost to us of seasonal fresh food supplies.

Increased productivity and good expense control have enabled us to absorb significant external cost increases in the year, arising mainly from higher oil-related costs and increases in local business taxes. Start-up costs totaling £42 million for Tesco Direct and establishing our operations in the United States were recorded in the U.K. segment. Although the combined start-up losses were a little below our estimate of £50 million, we expect these losses to increase during 2007/08, particularly in the U.S., as we recruit store and distribution center staff ahead of our planned launch later this year. See "Business — Expansion into United States". Despite absorbing these additional costs, U.K. trading profit rose 9.2%, with trading margins at 5.9%, similar to 2005/06. The following table shows our U.K. sales, trading profit and trading margin.

| | Year Ended February 24, 2007 | Growth |
|---|---|---|
| | (in millions of pounds, except percentages) | |
| U.K. sales | 35,580 | 9.0% |
| U.K. trading profit | 1,914 | 9.2% |
| Trading margin | 5.9% | — |

*International*

Revenues in International increased by 5.4% to £10.0 billion in 2006/07 from £9.5 billion in 2005/06, while sales increased by 5.3% to £11.0 billion in 2006/07. On a comparable 52-week basis, International sales grew by 17.9% at actual exchange rates to £11.0 billion and by 17.4% at constant exchange rates. The difference in the percent increase between sales on a statutory basis and sales on a comparable 52-week basis is due to the fact that actual 2005/06 sales included 60-weeks of sales for most countries in Europe and Asia, while sales in 2006/07 included 52 weeks of sales. Like-for-like sales in International grew by 2.0% in 2006/07, with net new space contributing the remaining 15.4%. Operating profit increased by 14.8% to £565 million in 2006/07 from £492 million in 2005/06. International contributed £564 million to trading profit, up 18.0% on last year on a comparable basis, with stable trading margins at 5.7%. At constant exchange rates, International trading profit grew by 16.5%. Before integration costs and initial operating losses, trading profit rose by 20.9% and margins increased slightly.

International growth was due to like-for-like growth in all markets except Hungary as well as the expansion of our store networks in our existing markets. We added 484 stores internationally in 2006/07, more than four times the amount of new space opened in the United Kingdom, both through organic growth and through acquisitions. The following table shows International sales, trading profit and trading margin on an adjusted comparable basis at actual and constant exchange rates.

| | Year ended February 24, 2007 | | | |
|---|---|---|---|---|
| | Comparable Basis 52 weeks vs. 52 weeks | | | Statutory Basis 52 weeks vs. 60 weeks |
| | Actual rates | Growth at actual exchange rates | Growth at constant exchange rates | Growth at actual exchange rates |
| | (in millions of pounds, except percentages) | | | |
| International sales | 11,031 | 17.9% | 17.4% | 5.3% |
| International trading profit | 564 | 18.0% | 16.5% | 10.8% |
| International trading margin | 5.7% | — | — | — |

*Europe*

In Europe, revenues rose by 9.1% to £5.6 billion in 2006/07 from £5.1 billion in 2005/06. Operating profit rose by 23.2% to £324 million from £263 million in 2005/06. Europe sales rose by 18.7% to £6.3 billion from £5.3 billion in 2005/06 on a comparable 52-week basis and by 8.7% on a statutory basis. At constant exchange rates on a comparable basis, sales grew by 20.3% in 2006/07. Trading profit increased by 17.3% at actual exchange rates to £318 million from £271 million in

2005/06 and by 18.0% at constant exchange rates. Trading margins declined slightly, after charging £14.0 million of integration costs and initial operating losses on stores acquired from Carrefour and Edeka in the Czech Republic and Casino in Poland in 2006/07. Improvements in our business in most of Central Europe, Ireland and Turkey were offset by the continuing effects of a weak economy in Hungary in 2006/07. Before charging integration costs, trading profit grew by 22.5% and margins rose. The following table shows our Europe sales, trading profit and trading margin on an adjusted comparable basis at actual and constant exchange rates.

| | Year Ended February 24, 2007 | | | |
|---|---|---|---|---|
| | Comparable Basis 52 weeks vs. 52 weeks | | | Statutory Basis 52 weeks vs. 60 weeks |
| | Actual rates | Growth at actual exchange rates | Growth at constant exchange rates | Growth at actual exchange rates |
| | (in millions of pounds, except percentages) | | | |
| Europe sales | 6,324 | 18.7% | 20.3% | 8.7% |
| Europe trading profit | 318 | 17.3% | 18.0% | 17.3% |
| Trading margin | 5.7% | — | — | — |

*Asia*

In Asia, revenues grew by 1.1% to £4.42 billion in 2006/07 from £4.37 billion in 2005/06. Operating profit grew by 5.2% to £241 million from £229 million in 2005/06. Asia sales grew by 16.8% at actual exchange rates on a comparable 52-week basis to £4.7 billion from £4.0 billion in 2005/06. At constant exchange rates, sales grew by 13.5% in 2006/07. After charging £0.3 million of integration costs and initial operating losses on the Makro stores acquired in Malaysia, Asia trading profit increased by 18.8% to £246 million at actual rates (2005/06: £207 million) on a comparable basis and by 14.5% at constant rates. Before integration costs and initial operating losses, trading profit increased by 14.7%. Trading margins rose in Asia to 5.6% from 5.4% in the prior 52-week period, driven by strong performances in Korea, Thailand and Malaysia. The following table shows our Asia sales, trading profit and trading margin, on an adjusted comparable basis at actual and constant exchange rates.

| | Year Ended February 24, 2007 | | | |
|---|---|---|---|---|
| | Comparable Basis 52 weeks vs. 52 weeks | | | Statutory Basis 52 weeks vs. 60 weeks |
| | Actual rates | Growth at actual exchange rates | Growth at constant exchange rates | Growth at actual exchange rates |
| | (in millions of pounds, except percentages) | | | |
| Asia sales | 4,707 | 16.8% | 13.5% | 1.0% |
| Asia trading profit | 246 | 18.8% | 14.5% | 3.4% |
| Trading margin | 5.6% | — | — | — |

***Year ended February 25, 2006 compared to year ended February 26, 2005***

*Revenues*

Our revenues increased 16.5% in 2005/06 to £39.5 billion from £33.9 billion in 2004/05. Our sales increased 16.7% from £37.0 billion in 2004/05 to £43.1 billion in 2005/06. On a comparable 52-week basis, sales growth was 13.2% in 2005/06. At constant exchange rates, sales increased by 15.0% in 2005/06, with the comparable 52-week figure at 11.6%. Growth for 2005/06 was mainly due to steady growth in the United Kingdom, with significant growth in Europe and Asia due to rising customer numbers, growing local scale, increasing store maturity and the benefits of central distribution. The following table breaks down our revenues by geographical region in 2005/06 and 2004/05.

| | Year Ended February 25, 2006[(1)] | Percent Increase | Year Ended February 26, 2005 |
|---|---|---|---|
| | (in millions of pounds, except percentages) | | |
| United Kingdom | 29,990 | 10.5% | 27,146 |
| Europe | 5,095 | 33.4% | 3,818 |
| Asia | 4,369 | 50.6% | 2,902 |
| Total | 39,454 | 16.5% | 33,866 |

(1) Results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and the Republic of Ireland and 14 months for the majority of the remaining International Businesses.

*Profit*

Operating profit was up 16.8% in 2005/06 to £2.3 billion from £2.0 billion in 2004/05. The increase is due mainly to good cost control and productivity. The following table breaks down our operating profit by geographical region for 2005/06 and 2004/05.

| | Year Ended February 25, 2006[(1)] | Percent Increase | Year Ended February 26, 2005 |
|---|---|---|---|
| | (in millions of pounds, except percentages) | | |
| United Kingdom | 1,788 | 14.9% | 1,556 |
| Europe | 263 | 8.2% | 243 |
| Asia | 229 | 49.7% | 153 |
| Total | 2,280 | 16.8% | 1,952 |

(1) Results for the year ended February 25, 2006 include 52 weeks for the United Kingdom and the Republic of Ireland and 14 months for the majority of the remaining International Businesses.

Our administrative expenses consist mainly of head-office employee-related costs such as wages, social security costs and retirement plan costs, and overheads such as rent, depreciation and utilities. As a percentage of revenues, administrative expenses have held relatively steady, with 2.1% in 2005/06 and 2.2% in 2004/05.

In 2005/06, profit from property-related items was up 57.1% to £77 million (net of losses) from £49 million in 2004/05. This increase was due mainly to our plan of releasing cash from property through a sequence of sale-leaseback and other transactions, under which we divest property to joint ventures. See "— Off-balance sheet arrangements — Operating lease commitments".

Our gross margin was 7.7% in 2005/06, a slight decrease from 7.8% in 2004/05. Gross profit rose 14.9% to £3,028 million in 2005/06 from £2,635 million in 2004/05.

*United Kingdom*

U.K. revenues increased by 10.5% to £30.0 billion in 2005/06 from £27.1 billion in 2004/05. Operating profit rose by 14.9% to £1,788 million from £1,556 million in 2004/05. U.K. pre-property operating profit rose 10.6% to £1,698 million, leaving the operating margin unchanged at 5.7%. U.K. sales increased by 10.7% to £32.7 billion from £29.5 billion in 2004/05, with like-for-like growth of 7.5% (including volume of 7.6%) and 3.2% growth from net new stores. In 2005/06, we saw deflation of 1.8% in our stores, due to our lowering prices for customers. Gasoline had an impact on sales growth in 2005/06. We absorbed significant external cost increases in 2005/06, arising mainly from higher oil-related costs and increase in local business taxes, by increasing productivity and controlling expenses.

*International*

Revenues from International increased by 40.8% to £9.5 billion in 2005/06 from £6.7 billion in 2004/05. Total sales in International grew by 40.7% to £10.5 billion in 2005/06 from £7.4 billion in 2004/05 and by 31.8% at constant exchange rates. On a 52-week basis, sales in International increased by 23% to £9.2 billion and at constant exchange rates, sales grew by 15.5%. International contributed £492 million to operating profit, up 24.2% from £396 million in 2004/05. Pre-property operating profit in International increased 28.8% on a 52-week basis. At constant exchange rates, pre-property operating profit in International grew by 21.6%. On a 52-week basis, International operating profit increased by 17.4% to £465 million. At constant exchange rates profit grew by 10.8%.

*Europe*

In Europe, revenues rose by 33.4% to £5.1 billion in 2005/06 from £3.8 billion in 2004/05. Europe sales rose by 33.8% to £5.8 billion in 2005/06 from £4.3 billion in 2004/05. At constant exchange rates, sales grew by 26.7%. In 2005/06, growth in Europe resulted from our strategic investment in lower prices, higher product quality and faster development of new space. Our programs of joint purchasing of own-brand products and the introduction of the Cherokee clothing range also strengthened our business. We had market share gains due to a rise in customer numbers.

Operating profit increased by 8.2% to £263 million in 2005/06 (2004/05: £243 million) and by 3.9% at constant exchange rates. On a 52-week basis, Europe operating profit increased by 9.1% to £265 million. At constant exchange rates, profit grew by 4.7%. Operating profit growth was impacted by the existence of a one-off £31 million property profit in the prior year. Europe pre-property operating profit rose 22.7% to £271 million on a 52-week basis.

*Asia*

In Asia, revenues grew by 50.6% to £4.4 billion in 2005/06 from £2.9 billion in 2004/05. Asia sales grew by 50.5% to £4.7 billion (2004/05: £3.1 billion). At constant exchange rates, sales grew by 39.0%. Operating profit increased by 49.7% to £229 million (2004/05: £153 million) and by 38.2% at constant rates. On a 52-week basis, Asia operating profit increased by 30.7% to £200 million. At constant exchange rates, profit grew by 20.6%. Asia pre-property operating profit rose 30.1% to £203 million on a 52-week basis. Our growth in 2005/06 was primarily due to the addition of store space and new stores, and the development of new store formats.

## Liquidity and Capital Resources

### *Funding and liquidity*

The Group finances its operations by a combination of retained profits, long and medium-term debt, capital market issues, commercial paper, bank borrowings and sale and leaseback transactions. Our objective is to ensure continuity of funding. Our policy is to smooth the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn committed bank facilities, and a strong credit rating so that maturing debt may be refinanced as it falls due. We currently have available undrawn committed bank facilities of £1,600 million that expire in July 2014.

Our long-term credit rating remained stable during the year. As of October 12, 2007, our credit rating was A1 from Moody's Investors Service, Inc. and A+ from Standard & Poor's, a division of the McGraw-Hill Companies, Inc and A+ from Fitch Ratings Ltd. New funding of £1.8 billion was arranged during 2006/07, including a net £0.5 billion from property joint ventures and £1.2 billion from medium-term notes ("MTNs"). At February 24, 2007, net debt was £4.9 billion (compared to £4.4 billion at February 25, 2006) and the average debt maturity was nine years (compared to six years at year end 2005/06). At August 25, 2007, net debt was £5.3 billion (compared to £4.3 billion on August 26, 2006) and the average debt maturity was 17 years (compared to seven years at August 26, 2006).

### *Cash flow and balance sheet*

Group capital expenditure (excluding acquisitions) rose to £1.6 billion in the 26 weeks ended August 25, 2007 (26 weeks ended August 26, 2006: £1.3 billion), and rose as planned to £3.0 billion in 2006/07 (2005/06: £2.8 billion). U.K. capital expenditure was £1.0 billion in the 26 weeks ended

August 25, 2007 (26 weeks ended August 26, 2006: £0.8 billion), including £443 million on new stores and £209 million on extensions and renovations to existing stores. U.K. capital expenditure in the 26 weeks ended August 25, 2007 also included £90 million invested in establishing our U.S. operations. We expect capital investment in the U.S. operations to be approximately £250 million total for 2007/08, in line with the guidance we issued when we announced our entry to the U.S. market in February 2006. U.K. capital expenditure was £1.9 billion during 2006/07 (2005/06: £1.8 billion), including £687 million on new stores and £295 million on extensions and renovations to existing stores, and including £89 million of capital invested in establishing our operations in the United States. International capital expenditure rose slightly to £0.6 billion in the 26 weeks ended August 25, 2007 (26 weeks ended August 26, 2006: £0.5 billion), which was composed of £0.3 billion in Asia and £0.3 billion in Europe, and rose slightly in 2006/07 to £1.1 billion (2005/06: £1.0 billion), which was composed on £0.4 billion in Asia and £0.7 billion in Europe. We expect total Group capital expenditure to be around £3.5 billion for 2007/08.

Cash flow from operating activities, including improvements of £89 million within working capital, totalled £1.9 billion in the 26 weeks ended August 25, 2007. Overall, we had a net cash inflow of £345 million to cash and cash equivalents during the 26 weeks ended August 25, 2007. Net borrowings at August 25, 2007 were £5.3 billion, compared to £4.3 billion on August 26, 2006. Gearing (net debt over total equity) was 50% at August 25, 2007, compared to 43% on August 26, 2006. Cash flow from operating activities, including an improvement of £11 million within working capital, totalled £3.5 billion in 2006/07. Overall, we had a net cash outflow of £265 million during 2006/07, leaving net borrowings of £4.9 billion at the year-end, £0.5 billion higher than 2005/06. Gearing was 46% in 2005/06 and 2006/07.

***Return on capital employed***

We are committed to increasing our post-tax return on capital employed (ROCE). We achieved slightly higher ROCE in 2006/07 — at 12.6% (prior year 12.7% and 2004/05 11.8%). Including the one-off benefit from Pensions A-Day, ROCE was 13.6% in 2006/07. This was achieved despite carrying the extra start-up costs and investment in the United States and Tesco Direct as well as the integration costs and capital employed in our international acquisitions and increased stake in Hymall. We purchased a further 40% share of Hymall on December 12, 2006, giving us control of the company.

***Finance costs and tax***

Net finance costs were £52 million in the 26 weeks ended August 25, 2007 (26 weeks ended August 26, 2006: £69 million), giving interest cover (based on EBIT) of 25.8 times (26 weeks ended August 26, 2006: 16.8 times). In the 26 weeks ended August 25, 2007, total Group tax was charged at an effective rate of 27.2% (26 weeks ended August 26, 2006: 29.0%). This reduction in the tax rate is primarily due to the adjustment of deferred tax balances as a result of the lowering of the rate of U.K. corporate tax from 30% to 28%, effective on April 1, 2008. Net finance costs were £126 million in 2006/07 (2005/06: £127 million, 2004/05: £132 million), giving interest cover of 22.1 times (2005/06: 18.6 times, 2004/05 15.3 times). In 2006/07, total Group tax was charged at an effective rate of 29.1% (2005/06: 29.0%, 2004/05: 28.6%).

***Certain contractual obligations***

The tables below show, prior to the issuance of the notes offered hereby and the application of the proceeds thereof as described in "Use of Proceeds", as of February 24, 2007 and August 25, 2007, our contractual obligations, excluding purchase commitments in the ordinary course of business, employment agreements, interest on debt obligations, operating lease commitments (in the case of August 25, 2007) and capital commitments. For details of capital commitments, please refer to "— Commitments and Contingencies — Capital Commitments".

The table as of February 24, 2007 is based on our audited consolidated financial statements as of February 24, 2007. The table as of August 25, 2007 is based on our unaudited condensed consolidated financial statements as of August 25, 2007.

**As of February 24, 2007**

| | Payment Due by Period | | |
|---|---|---|---|
| | Total | Less than 1 year | More than 1 year |
| | (in millions of pounds) | | |
| Trade and other payables | 6,075 | 6,046 | 29 |
| Borrowings[1] (including finance leases) | 5,700 | 1,554 | 4,146 |
| Contractual obligations recorded as liabilities as of February 24, 2007 | 11,775 | 7,600 | 4,175 |
| Future minimum lease payments under non-cancelable operating leases | 6,661 | 379 | 6,282 |

(1) For borrowings, please refer to our financial statements as of February 24, 2007 for further details of maturity dates.

**As of August 25, 2007**

| | Payment Due by Period | | |
|---|---|---|---|
| | Total | Less than 1 year | More than 1 year |
| | (in millions of pounds) | | |
| Trade and other payables | 6,677 | 6,647 | 30 |
| Borrowings (including finance leases) | 6,525 | 1,937 | 4,588 |
| Contractual obligations recorded as liabilities as of August 25, 2007 | 13,202 | 8,584 | 4,618 |

***Off-balance sheet arrangements***

*Commitments and Contingencies*

Capital commitments

On August 25, 2007, there were commitments for capital expenditure contracted for, but not provided, of £1,801 million, principally relating to the store development program. On February 24, 2007, there were commitments for capital expenditure contracted for, but not provided, of £2,003 million (compared to £1,578 million at February 25, 2006), principally relating to the store development program.

Contingent liabilities

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.

Tesco Personal Finance, the joint venture through which we provide our personal finance services and in which the Group owns a 50% share, had commitments, as described in its own financial statements as at December 31, 2006, of formal standby facilities, credit lines and other commitments to lend, totaling £5.5 billion (£6.0 billion in 2005/06). The amount is intended to provide an indication of the volume of business transacted and not of the underlying credit or other risks.

For details of assets held under finance leases, which are pledged as security for the finance lease liabilities, see note 11 to our financial statements.

There are a number of contingent liabilities that arise in the normal course of business which, if realized, are not expected to result in a material liability to the Group.

*Leasing Commitments*

Finance lease commitments

As a lessee, the Group has finance leases for various items of plant, equipment, fixtures and fittings. There are also a small number of buildings that are held under finance leases. The fair value of the Group's lease obligations approximate to their carrying value.

Operating lease commitments

As a lessee, the Group has operating lease obligations representing rentals payable by the Group for certain of its retail, distribution and office properties and other assets such as motor vehicles. The leases have varying terms, purchase options, escalation clauses and renewal rights. Since 1988, the Group has entered into several joint ventures and sold and leased back properties to and from these joint ventures. The terms of these sale and leasebacks vary; however, common factors include: the sale of the properties to the joint venture at market value, options at the end of the lease for the Group to repurchase the properties at market value, market rent reviews and 20-25 year lease terms. The Group reviews the substance as well as the form of the arrangements when making the judgment as to whether these leases are operating or finance leases; the majority of the leases under these arrangements are operating leases. As a lessor, the Group both rents out its investment properties and also sublets various leased buildings under operating leases.

See Note 31 to our financial statements for details of the payments payable or receivable under these operating leases.

As part of our plan to release cash from our property through a sequence of sale-leaseback and other transactions, under which we divest property to joint ventures, on December 20, 2006 we formed a property joint venture with British Airways Pension Fund, by way of a limited partnership. The limited partnership owns 16 of our superstores that we have sold to the partnership and then leased back from it. We sold assets with a net book value of £233 million for net proceeds of £510 million (approximately market value) to the limited partnership. 50% of the resulting profit has been recognized within profit arising on property-related items with the remaining percentage deferred on the balance sheet in accordance with IAS 31, "Interests in Joint Ventures". In another transaction completed during 2006/07, we sold three stores with a book value of £32 million, to a limited partnership we formed with Morley Fund Management Limited (a subsidiary of Aviva plc) for £73 million. On March 19, 2007 we announced the formation of another property joint venture with British Land Company plc. In this transaction, we sold 21 stores with a net book value of £350 million to the partnership for net proceeds of £652 million.

We currently plan to enter into approximately eight such joint ventures by February 2012, and to transfer approximately 10% of our U.K. property assets to such joint ventures in that time period, with a view towards releasing more than £5 billion from our properties by 2012. We plan to use the proceeds from these transactions to fund future growth and for share buy-backs. Our property joint ventures generally have a term of 20 years, with an early termination option in ten years. The rents we pay to the partnerships increase annually at a rate between zero and 3.5%, to be determined by reference to a limited prices index calculated by reference to the U.K. retail price index, a widely used general purpose domestic measure of inflation in the United Kingdom (the "Retail Price Index").

## Quantitative and Qualitative Disclosure about Credit and Market Risks

In the normal course of business, we are exposed to credit risk and market risk from fluctuations in interest rates and exchange rates. We address this risk through our hedging policies and procedures, which are implemented by our management and directors. We do not enter into any derivative transactions for speculative purposes.

### *Interest rate risk*

The objective is to limit our exposure to increases in interest rates while retaining the opportunity to benefit from interest rate reductions. Forward rate agreements, interest rate swaps, caps and collars are used to achieve the desired mix of fixed and floating rate debt. Our policy is to fix or cap a minimum of 40% of actual and projected debt interest costs. At February 24, 2007, £2.3 billion of debt was in fixed rate form (prior year £1.5 billion) with a further £1.0 billion of debt capped or collared, therefore 67% (prior year 55%) of net debt is fixed, capped or collared. Fixed rate debt includes £693 million of funding linked to the Retail Price Index (prior year £472 million).

This debt reduces interest risk by diversifying our funding portfolio. The remaining balance of our debt is in floating rate form.

The average rate of interest paid on a historic cost basis, excluding joint ventures and associates in 2006/07, was 4.8% (prior year 5.2%).

***Currency risk***

Our principal objective is to reduce the effect of exchange rate volatility on short-term profits. Transactional currency exposures that could significantly impact the income statement are hedged, typically using forward purchases or sales of foreign currencies and currency options. At the year-end 2006/07, forward foreign currency transactions, designated as cash flow hedges, equivalent to £764 million were outstanding (2005/06 — £548 million) as detailed in note 20 to the financial statements attached hereto.

We hedge the majority of our investments in our international subsidiaries via foreign exchange transactions in matching currencies. Our objective is to maintain a low cost of borrowing and hedge against material movements in our balance sheet value. During the year 2006/07, currency movements decreased the net value of the Group's overseas assets by £77 million (prior year increase of £27 million). We translate overseas profits at average exchange rates that we do not currently seek to hedge.

***Credit risk***

The objective is to reduce the risk of loss arising from default by parties to financial transactions across an approved list of counterparties of high credit quality. The Group's positions with these counterparties and their credit ratings are routinely monitored.

## Critical Accounting Policies

***Critical accounting policies and use of estimates***

*Use of assumptions and estimates*

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical estimates and assumptions are made in particular with regard to establishing uniform depreciation and amortization periods for the Group, impairment testing, assumptions for measuring pension provisions, determination of the fair value of obligations to purchase minority interests, classification of leases as operating leases versus finance leases (including on sale and leasebacks), the likelihood that tax assets can be realized and the classification of certain operations as held for sale.

These policies are described in greater detail below. Other accounting policies are disclosed in our financial statements included in this prospectus.

*Property, plant and equipment*

Property, plant and equipment assets are carried at cost less accumulated depreciation and any recognized impairment in value. Property, plant and equipment assets are depreciated on a straight-line basis to their residual value over their anticipated useful economic lives.

The following depreciation rates are applied for the Group:

- freehold and leasehold buildings with greater than 40 years unexpired — at 2.5% of cost;
- leasehold properties with less than 40 years unexpired are depreciated by equal annual installments over the unexpired period of the lease; and
- plant, equipment, fixtures and fittings and motor vehicles — at rates varying from 9% to 33%.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, when shorter, over the term of the relevant lease.

All tangible fixed assets are reviewed for impairment in accordance with IAS 36 'Impairment of Assets' when there are indications that the carrying value may not be recoverable.

*Intangible assets*

Acquired intangible assets

Acquired intangible assets, such as software or pharmacy licenses, are measured initially at cost and are amortized on a straight-line basis over their estimated useful lives.

Internally-generated intangible assets — Research and development expenditure

Research costs are expensed as incurred. Development expenditure incurred on an individual project is carried forward only if all the criteria set out in IAS 38 'Intangible Assets' are met, namely:

- an asset is created that can be identified (such as software or new processes);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortized over the project's estimated useful life, usually at 14%-25% of cost per annum.

*Impairment of tangible and intangible assets excluding goodwill*

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of the recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized as income immediately.

*Business combinations and goodwill*

All business combinations are accounted for by applying the purchase method.

On acquisition, the assets and liabilities and contingent liabilities of an acquired entity are measured at their fair value. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognized.

Goodwill arising on consolidation represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary, joint venture or associate at the date of acquisition. If the cost of acquisition is less than the fair value of the Group's share of the net assets of the acquired entity (*i.e.* a discount on acquisition) then the difference is credited to the income statement in the period of acquisition.

At the acquisition date of a subsidiary, goodwill acquired is recognized as an asset and is allocated to each of the cash-generating units expected to benefit from the business combination's synergies and to the lowest level at which management monitors the goodwill. Goodwill arising on the acquisition of joint ventures and associates is included within the carrying value of the investment.

Goodwill is reviewed for impairment at least annually by assessing the recoverable amount of each cash-generating unit to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized.

Any impairment is recognized immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, joint venture or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before February 29, 2004 (the date of transition to IFRS) was retained at the previous generally accepted accounting principles in the United Kingdom ("U.K. GAAP") amounts subject to being tested for impairment at that date. Goodwill written off to reserves under U.K. GAAP prior to 1998 has not been restated and will not be included in determining any subsequent profit or loss on disposal.

*Pensions and similar obligations*

The Group accounts for pensions and other post-employment benefits (principally private healthcare) under IAS 19 'Employee Benefits'.

In respect of defined benefit plans, obligations are measured at discounted present value (using the projected unit credit method) while plan assets are recorded at fair value. The operating and financing costs of such plans are recognized separately in the income statement; service costs are spread systematically over the expected service lives of employees and financing costs are recognized in the periods in which they arise. Actuarial gains and losses are recognized immediately in the statement of recognized income and expense.

Payments to defined contribution schemes are recognized as an expense as they fall due.

*Financial instruments*

Financial assets and financial liabilities are recognized on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

<u>Trade receivables</u>

Trade receivables are non interest-bearing and are recognized initially at fair value, and subsequently at amortized cost using the effective interest rate method, reduced by appropriate allowances for estimated irrecoverable amounts.

Investments

Investments are recognized at trade date. Investments are classified as either held for trading or available-for-sale, and are recognized at fair value.

For held for trading investments, gains and losses arising from changes in fair value are recognized in the income statement.

For available-for-sale investments, gains and losses arising from changes in fair value are recognized directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the net result for the period. Interest calculated using the effective interest rate method is recognized in the income statement. Dividends on an available-for-sale equity instrument are recognized in the income statement when the entity's right to receive payment is established.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that gives a residual interest in the assets of the Group after deducting all of its liabilities.

Interest-bearing borrowings

Interest-bearing bank loans and overdrafts are initially recorded at fair value, net of attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the income statement over the period of the borrowings on an effective interest basis.

Trade payables

Trade payables are non-interest bearing and are stated at amortized cost.

Equity instruments

Equity instruments issued by Tesco plc are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operating, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes, however if derivatives do not qualify for hedge accounting they are accounted for as such.

Derivative financial instruments are recognized and stated at fair value. The fair value of derivative financial instruments is determined by reference to market values for similar financial instruments, by discounted cash flows, or by the use of option valuation models. Where derivatives do not qualify for hedge accounting, any gains or losses on remeasurement are immediately recognized in the income statement. Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the hedge relationship and the item being hedged.

In order to qualify for hedge accounting, the Group is required to document from inception the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is performed at each period end to ensure that the hedge remains highly effective.

Financial instruments with maturity dates of more than one year from the balance sheet date are disclosed as non-current.

Fair value hedging

Derivative financial instruments are classified as fair value hedges when they hedge the Group's exposure to changes in the fair value of a recognized asset or liability. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged item that is attributable to the hedged risk.

Derivative financial instruments qualifying for fair value hedge accounting are principally interest rate swaps (including cross currency swaps).

Cash flow hedging

Derivative financial instruments are classified as cash flow hedges when they hedge the Group's exposure to variability in cash flows that are either attributable to a particular risk associated with a recognized asset or liability, or a highly probable forecasted transaction.

The effective element of any gain or loss from remeasuring the derivative instrument is recognized directly in equity.

The associated cumulative gain or loss is removed from equity and recognized in the income statement in the same period or periods during which the hedged transaction affects the income statement. The classification of the effective portion when recognized in the income statement is the same as the classification of the hedged transaction. Any element of the remeasurement of the derivative instrument which does not meet the criteria for an effective hedge is recognized immediately in the income statement within finance costs.

Derivative instruments qualifying for cash flow hedging are principally forward foreign exchange transactions and currency options.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognized in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognized in equity is transferred to the income statement.

Net investment hedging

Derivative financial instruments are classified as net investment hedges when they hedge the Group's net investment in an overseas operation. The effective element of any foreign exchange gain or loss from remeasuring the derivative is recognized directly in equity. Any ineffective element is recognized immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

Derivative instruments qualifying for net investment hedging are principally forward foreign exchange transactions and currency options.

Treatment of agreements to acquire minority interests

The Group has entered into a number of agreements to purchase the remaining shares of subsidiaries with minority shareholdings.

Under IAS 32 'Financial Instruments: Disclosures', the net present value of the expected future payments are shown as a financial liability. At the end of each period, the valuation of the liability is reassessed with any changes recognized in the income statement within finance costs for the year. Where the liability is in a currency other than pounds sterling, the liability has been designated as a net investment hedge. Any change in the value of the liability resulting from changes in exchange rates is recognized directly in equity.

*Leasing*

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as a lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment in the lease.

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease.

The Group as a lessee

Assets held under finance leases are recognized as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

Sale and leaseback

A sale and leaseback transaction is one where a vendor sells an asset and immediately reacquires the use of that asset by entering into a lease with the buyer. The accounting treatment of the sale and leaseback depends upon the substance of the transaction (by applying the lease classification principles described above) and whether or not the sale was made at the asset's fair value.

For sale and finance leasebacks, any apparent profit or loss from the sale is deferred and amortized over the lease term. For sale and operating leasebacks, generally the assets are sold at fair value, and accordingly the profit or loss from the sale is recognized immediately.

Following initial recognition, the lease treatment is consistent with those principles described above.

*Taxation*

The tax expense included in the income statement consists of current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted by the balance sheet date.

Tax is recognized in the income statement except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is calculated at the tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also recognized in equity.

Deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each Balance Sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset against each other when there is a legally enforceable right to set-off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

*Non-current assets held for sale*

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through sale rather than continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and it should be expected to be completed within one year from the date of classification.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

*Foreign currencies*

Transactions in foreign currencies are translated at the exchange rate on the date of the transaction. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. All differences are taken to the income statement for the period.

The financial statements of foreign subsidiaries are translated into pounds sterling according to the functional currency concept of IAS 21 'The Effects of Changes in Foreign Exchange Rates'. Since the majority of consolidated companies operate as independent entities within their local economic environment, their respective local currency is the functional currency. Therefore, assets and liabilities of overseas subsidiaries denominated in foreign currencies are translated at exchange rates prevailing at the date of the Group Balance Sheet; profits and losses are translated into pounds sterling at average exchange rates for the relevant accounting periods. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognized as income or expenses in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

*Revenue*

Revenue consists of sales through retail outlets. Revenue is recorded net of returns, relevant vouchers/offers and value-added taxes, when the significant risks and rewards of ownership have been transferred to the buyer. Relevant vouchers offers include: money-off coupons, conditional spend vouchers and offers such as buy one get one free and 3 for 2. Commission income is recorded based on the terms of the contracts.

*Inventories*

Inventories comprise goods held for resale and properties held for, or in the course of, development and are valued at the lower of cost and fair value less costs to sell using the weighted average cost basis.

*Use of non-GAAP profit measures — underlying profit before tax*

The Directors believe that underlying profit before tax and underlying diluted earnings per share measures provide additional useful information for shareholders on underlying trends and performance. These measures are used for internal performance analysis. Underlying profit is not defined by IFRS and therefore may not be directly comparable with other companies' adjusted profit measures. It is not intended to be a substitute for, or superior to IFRS measurements of profit. The adjustments made to reported profit before tax:

- IAS 32 and IAS 39 'Financial Instruments' — fair value remeasurements — under IAS 32 and IAS 39, the Group applies hedge accounting to its various hedge relationships when allowed under the rules of IAS 39 and when practical to do so. Sometimes the Group is unable to apply hedge accounting to the arrangements, but continues to enter into these arrangements as they provide certainty or active management of the exchange rates and interest rates applicable to the Group. The Group believes these arrangements remain effective and economically and commercially viable hedges despite the inability to apply hedge accounting.

  Where hedge accounting is not applied to certain hedging arrangements, the reported results reflect the movement in fair value of related derivatives due to changes in foreign exchange and interest rates. In addition, at each period end, any gain or loss accruing on open contracts is recognized in the income statement for the period, regardless of the expected outcome of the hedging contract on termination. This may mean that the income statement charge is highly volatile, while the resulting cash flows may not be as volatile. The underlying profit measure removes this volatility to help better identify underlying business performance.

- IAS 19 Income Statement charge for pensions — Under IAS 19 'Employee Benefits', the cost of providing pension benefits in the future is discounted to a present value at the corporate bond yield rates applicable on the last day of the previous financial year. Corporate bond yield rates vary over time, which in turn creates volatility in the income statement and balance sheet. IAS 19 also increases the charge for young pension schemes, such as Tesco's, by requiring the use of rates which do not take into account the future expected returns on the assets held in the pension scheme which will fund pension liabilities as they fall due. The sum of these two effects makes the IAS 19 charge disproportionately higher and more volatile than the cash contributions the Group is required to make in order to fund all future liabilities.

  Therefore, within underlying profit we have included the 'normal' cash contributions for pensions but excluded the volatile element of IAS 19 to represent what the Group believes to be a fairer measure of the cost of providing post-employment benefits.

- Exceptional items — due to their significance and special nature, certain other items which do not reflect the Group's underlying performance have been excluded from underlying profit. These gains or losses can have a significant impact on both absolute profit and profit trends, consequently, they are excluded from the underlying profit of the Group. In 2006/07, exceptional items are as follows:

  - Pensions adjustment relating to the Finance Act 2006 — Following changes introduced by the Finance Act with effect from April 2006 (Pensions A-Day), Tesco's U.K. approved pension schemes have implemented revised terms for members exchanging pension at retirement date, allowing them the option to commute (convert) a larger amount of their pension to a tax-free lump sum on retirement. Accordingly, the assumptions made in calculating the defined benefit pension liability have been revised, and a gain of £250 million has been recognized in the income statement during the year. Changes to scheme rules in the Republic of Ireland affecting early retirement have reduced pension liabilities by a further £8 million, which is also recognized in the income statement. Future revisions to the commutation assumption will be reflected within the Statement of Recognized Income and Expense.

  - Impairment of the Gerrards Cross site — The Group regards each individual store as a cash-generating unit, with each store tested for impairment if there are indications of impairment at the balance sheet date. In our 2006/07 results, we recognized an impairment charge on the cumulative capital expenditure incurred on the Gerrards Cross store development up until February 25, 2007 (£35 million) as part of our testing of individual stores for impairment, because indicators of impairment existed at the balance sheet date.

## BUSINESS

### Overview

We are the United Kingdom's largest food retailer, with over 80 years of operating history in the United Kingdom's retail food industry. As of August 25, 2007, we owned and operated a total of 3,409 stores in 12 countries, of which 2,033, or approximately 60%, were in the United Kingdom and 1,376, or approximately 40%, were located in our other markets. In the fiscal year ended February 24, 2007, we had revenue of £42.6 billion, an 8% increase over the fiscal year ended February 25, 2006, and we had revenue of £22.6 billion in the 26 weeks ended August 25, 2007, a 9% increase over the 26 weeks ended August 26, 2006. In the last ten years, we have rapidly expanded our operations internationally into other European markets and Asia, and in fiscal 2007/08 plan to commence business operations in the western United States. We have also expanded our operations to include non-food retailing of a variety of goods, including clothing, gasoline, consumer electronics, health and beauty, toys and sports, do-it-yourself, kitchenware and soft furnishings, seasonal goods such as barbeques and garden products, DVDs, stationery and news and magazines. Since 1997, we have also offered a variety of personal finance services, including banking services, credit cards, insurance, mortgages and loans, and since 2003 have offered a range of telecommunication services, which now includes mobile phone, internet and internet phone and home phone services. We sell our goods and services through our stores, our website at www.tesco.com and our catalog.

We believe that our broad customer base, our "every little helps" brand philosophy and our customers' trust in the Tesco brand to provide simple, excellent service that represents good value for money, together set us apart from our competitors in the United Kingdom and abroad. We intend to use these strengths and the international experience we have gained in the last ten years to further the growth of our business in the United Kingdom and abroad.

### Our Strategy

The five key elements of our strategy are as follows:

- ***Grow our core U.K. business.*** Our U.K. market is the core of our business, representing nearly 80% of our profits in fiscal 2006/07. We believe that this strong foundation can continue to provide support for our U.K. and worldwide growth. We plan to further grow our U.K. business by continuing to use a multi-store format approach to provide local customers the type of shopping environment most convenient for them and growing sales of non-food items. We use the information we collect on customers' shopping habits through our Tesco Clubcard program (our loyalty program whereby customers earn points every time they make a purchase from us) to serve our customers better, while at the same time rewarding their loyalty through discount vouchers.
- ***Become a successful international retailer.*** We have been expanding into markets outside the United Kingdom since the mid-1990s, and we believe that significant opportunity for future sustained growth and improved long-term returns lies in international markets. With that in mind, we plan to continue our already-successful international expansion by further expanding our business in our existing markets outside the United Kingdom and by moving into new international markets. We plan to add 105 new stores in our Europe segment and 193 new stores in our Asia segment in the remainder of 2007/08 and to focus on developing new store formats in these markets. In addition, we plan to expand our operations to include a limited number of stores in the western United States under the Fresh & Easy Neighborhood Market brand from November 2007. We believe that we are well positioned to succeed in our continued international expansion by using what we have learned in our ten years of international experience: to be flexible and adapt to local conditions and customer expectations in each market, to focus on building a leading brand in a few countries instead of taking a less-focused approach in more markets, to use multiple store formats to reach different customer needs, to build capabilities in these new markets by growing our personnel and business systems, and to build our brands to form a lasting relationship with customers.

We are carrying out our international expansion through a combination of organic growth and acquisitions. For example, in fiscal 2006/07 we acquired eight new stores in Malaysia through acquisitions, and we doubled our number of stores in the Czech Republic through an acquistion. As our international operations mature over time, we hope to see improving returns as a result of increasing efficiencies, such as established supply chains and developed relationships with suppliers, and increasing recognition of our brand and store locations.

- ***Be as strong in non-food as we are in food.*** Since the introduction of non-food items to our stores many years ago, we have strived to build a range of products that will make our non-food business as successful as our food business. We believe that we have made substantial progress towards this goal, with non-food sales representing 25% of total sales (excluding gasoline) in fiscal 2006/07. We plan to improve our selection of non-food items and our delivery service options in order to grow our share of the market for the items we sell, and to utilize and improve our global sourcing capabilities to save on our inventory purchases and pass these savings on to our customers. We believe that this strategy will increase profitability since margins on non-food items are generally higher than those on food items.

- ***Develop retailing services.*** We believe that we can successfully leverage our customers' loyalty to our brand and our joint venture partners' expertise and infrastructure assets in order to continue to build our telecommunications and personal financial services businesses with minimum capital investment costs to us. We believe that we can be successful in telecommunications and personal financial services by bringing simplicity and value to these sometimes confusing markets. We plan to extend our selection of services and introduce tailored products to better meet customer needs.

- ***Put the community at the heart of what we do.*** We aim to be a good neighbor in the communities in which our stores are located, to be responsible, fair and honest in our dealings and to give customers the information and products they need to make more environmentally-conscious choices. For example, we sponsor a variety of health-based programs, such as sporting events and other activities to encourage communities to be physically active. In order to encourage customers to re-use grocery bags, we award our customers "Green Clubcard Points", which can be redeemed for discount vouchers in our stores, every time they reuse a bag. In 2006 we launched our first annual Community Plan, a community outreach program currently covering eight countries which includes a range of community, environmental and health projects (such as sporting and cultural events and other classes and activities) all of which are tailored to the local community. We plan to eventually implement a Community Plan in all of our markets.

**Our Key Strengths**

We believe that we benefit from the following key strengths:

- ***Broad customer base.*** We are the United Kingdom's largest food retailer and have been operating our U.K. business for over 80 years. While we are proud of our successes, we believe that our company culture — summarized in our two key values "no one tries harder for customers" and "treat people as we like to be treated" — is to constantly look for little ways to improve our customers' experience. To that end, we use customer surveys, our loyalty card program, and other ways of engaging with our customers and the communities in which we operate in order to keep abreast of changing customer preferences and tastes.

- ***Customer-focused culture.*** Our focus is to make all facets of our customers' shopping experience better, a focus we express through our core mission to create value for customers and earn their lifetime loyalty, and our signature "every little helps" brand philosophy. "Every little helps" recognizes that small improvements, such as making our stores a bit easier to get around, having a little more choice, being a bit cheaper than our competitors, saving our customers a few minutes at the checkout and making sure our staff give the best possible service, ultimately improve our customers' experience in a significant way. We put the "every little helps" concept to work in many different ways. For example, in fiscal 2005/06 we conducted a survey of over 46,000 customers that asked questions aimed at determining how we can make their shopping experience better. Also in fiscal 2005/06, we invested in a system that measures the time customers have had to wait at our checkouts, and using the data collected we were able to shorten wait times through better staff scheduling. Through our Price-Check Survey system, we compare over 20,000 of our prices against those of our major competitors on a weekly basis. We also monitor rates of on-shelf availability of our products, and have improved on-shelf availability rates for five years running. Our staff regularly attends training programs that are aimed at reinforcing our commitment to customer service and the ways that we are seeking to improve customer service.

- ***Strong, experienced management team.*** Our management team includes five senior executives who have been with us for over 20 years, many of whom have held multiple roles with us during that time. This team has a proven track record of achieving growth and has led our successful international expansion and expansion into our non-food, personal financial services and telecommunications lines. We believe that the team's breadth and depth of experience has been and will continue to be instrumental to our growth and success.
- ***Supportive and respectful relationship with our staff.*** We believe that if we look after our people, they will look after our customers. To that end, we strive to listen to our employees' concerns and ideas, promote and recruit talented people and give employees the opportunity to participate in our success through share ownership and what we believe is a market-leading package of pay and other benefits. At any given time, approximately 10% of our staff is being trained to take on a more advanced job, and we believe we have created a work environment where anyone, regardless of his or her background, has an opportunity to advance his or her career. We also believe that the same things motivate many of our employees, namely: to be treated with respect, a manager who helps them, an interesting job and opportunities for job advancement. Through our Tesco Week in Store Together, 3,000 of our senior managers work alongside store employees for one week each year, and through our First Steps program, all employees are invited to submit their ideas about the business to us. We strive to recruit and promote talented people. Through our Talent Planning and International Development programs, we identify talent in every part of the world in which we operate and provide the support to enable the individuals identified to become future leaders within our business. We are continuing this program in the current year. In addition, through our Shares in Success and Save as You Earn plans, employees at all levels have access to share compensation and incentive plans.

### History

The first Tesco store was opened in 1929 in north London by Jack Cohen, who had begun selling groceries from a stall in London's East End ten years earlier. The business became a private limited company in 1932, and in 1947 the company's shares were listed on the London Stock Exchange. Our first self-service supermarket opened in a converted cinema in 1956, and by 1961, our Leicester store entered the Guinness book of world records as the largest store in Europe. By 1979, our annual sales had reached £1 billion. During the 1980s, our U.K. business expanded quickly, with annual sales reaching £2 billion by 1982, and 1987 seeing our announcement of a £500 million program to build another 29 stores in the United Kingdom. During the 1990s we began our international expansion, entering Hungary and several other European countries starting in 1994, and entering Asia starting in 1998. In 1995 we became the United Kingdom's largest food retailer. In 1999, we launched our online banking business, and in 2000 we launched our tesco.com online grocery shopping service. In 2006, we announced our plan to expand into the United States, our newest international market.

### Our Group

We are a publicly-held company, and except as indicated in "Shareholders", to our knowledge no shareholder beneficially owns more that 5% of our ordinary shares. We are a holding company, and are the ultimate parent company of our group. Our business is conducted by several wholly-owned operating subsidiaries, including Tesco Stores Limited, which holds our U.K. store, distribution and office assets. Our personal financial services are conducted by Tesco Personal Finance Group Limited, of which we own 50%, and our telecommunications services are conducted by Tesco Mobile Limited, of which we own 50%. Our operations outside the United Kingdom are generally conducted by entities incorporated in the relevant jurisdictions. We wholly-own some of these entities, and hold less than 100% of others.

**Our Business Segments**

We divide our business into three geographical segments, based on our management and internal reporting structure: U.K. operations, operations in Europe excluding the United Kingdom (we refer to this segment simply as "Europe"), and operations in Asia. Our U.K. segment includes all of our operations in the United Kingdom. Our Europe segment includes our operations in the Republic of Ireland, Poland, the Czech Republic, Slovakia, Hungary and Turkey. Our Asia segment includes our operations in Thailand, South Korea, Malaysia, China and Japan.

**U.K. Segment**

*Overview*

The U.K. market is our largest segment and represents the core of our business. Our U.K. segment accounted for £2.1 billion, or 79%, of our operating profits for fiscal 2006/07, and £1.8 billion, or 78%, of our operating profits for fiscal 2005/06.

In our U.K. segment, we divide our operations into our retail operations, which include our retailing of food, non-food products and gasoline at our store locations and a portion of the sale price from in-store sales of telecommunications services, and our retailing services, which include our retailing of personal finance services, telecommunications services and sales of food and non-food on tesco.com and Tesco Direct.

*Retail*

Our retail operations include our retailing of food, non-food products and gasoline at our store locations and a portion of the sale price from in-store sales of telecommunications services.

U.K. Stores

Our U.K. stores take one of four standard formats depending on what we determine is appropriate for a particular location: the Tesco Express store, the Tesco Metro store, the Tesco superstore and the Tesco Extra hypermarket. We also have recently developed the Homeplus non-food only store format.

- Tesco Express stores, which can be up to 3,000 square feet, are convenience-store style, and normally feature a range of product lines, including fresh produce, wines and spirits, bakery and certain non-food items such as news and magazines and health and beauty products. Tesco Express stores are designed to offer customers value, quality and fresh foods close to where they live and work, and tend to be located in urban sites, including those suited to gasoline retailing.
- Tesco Metro stores, which are generally between 7,000-15,000 square feet (but can be as small as 5,000 square feet or as large as 30,000 square feet), are designed to be a convenient grocery-shopping destination for people who live and work in town and city centers, and generally contain a tailored range of food items, including ready-made meals and sandwiches, as well as certain non-food items.
- Tesco superstores, between 20,000-60,000 square feet, are designed to contain everything a customer needs in his or her weekly grocery-shopping trip, and in recent years we have introduced a number of non-food ranges such as clothing, DVDs and books into superstores. Tesco superstores can be located in a variety of areas, including suburban areas, just outside suburban areas or town or city centers.

- Tesco Extra hypermarkets, which are 60,000 square feet and above, feature the widest range of food items, and also a comprehensive range of general merchandise, including clothing, electronics and telecoms. Tesco Extra hypermarkets tend can be located in a variety of areas, including suburban areas, just outside suburban areas or town or city centers.

- Homeplus stores, between 35,000 to 50,000 square feet, offer the widest range of our non-food items, and also feature Tesco Direct collection points where customers can collect items ordered via our catalog or website. Homeplus stores do not sell food.

Also, as of August 12, 2007, we had acquired 65.5% ownership of Dobbies Garden Centres PLC ("Dobbies"), which operates 21 stores in England and Scotland that sell plants, gardening equipment and food. We expect that the Dobbies stores will continue to operate under their current brand name, and will expand within England and Scotland. In addition to Dobbies' traditional products, through Dobbies we plan to offer our customers environmentally conscious products such as water recycling and alternative power source systems.

As of August 25, 2007, we operated 2,033 total stores (a total of 28.3 million square feet) in the United Kingdom, including 773 Tesco Express stores (a total of 1.7 million square feet), 163 Tesco Metro stores (a total of 1.9 million square feet), 433 Tesco superstores (a total of 13.2 million square feet), 153 Tesco Extra hypermarkets (a total of 10.7 million square feet) and seven Homeplus stores. We currently plan to increase our U.K. selling area by opening new stores and extending existing stores. We plan to devote a significant proportion of our expanded sales space to non-food products.

We intend to maintain the percentage of our store locations that we own at approximately 70%, and plan to lease the remaining locations. We view this mix as optimal because we believe our property assets give us both the ability to determine the form of our retailing space and also provide us with balance sheet strength for the long term of our business. In fiscal 2005/06, we announced our plan to enter into a sequence of sale-leaseback and other transactions, under which we divest property to joint ventures, with a view toward releasing more than £5 billion in cash from our property portfolio, and to use the proceeds to fund our expansion and share buyback plans. For more information on this, see "— Property Strategy". In all of our markets, we undertake an extensive consultation with local customers, communities and authorities to determine where and which type of store to open in their community.

Retail Products

*Food*

We sell a variety of groceries in our stores and on our website at tesco.com. Our food products include foods marketed under our private brands as well as other branded and non-branded products. In addition to groceries, our stores offer prepared food, such as our range of "Fresh in the Capital" sandwiches, a line of ready-made sandwiches available in many of our London stores.

In order to appeal to specific customer groups, we offer several product ranges, including our "Finest" range, a broad range of high-quality foods designed to appeal to customers looking for premium quality goods; our "Tesco Ingredients" range, which includes herbs and other seasonings designed to appeal to customers who prepare their own food; our "Free From" range, which features products designed to appeal to customers with food allergies by omitting certain common allergens from recipes, and clearly indicating this on the products' labeling; our "Wholefoods" range, which is designed to appeal to customers who seek out nutritious, minimally processed foods by offering such products as nuts and seeds, dried beans, and products containing whole grains; our "Organics Range", which includes foods grown, raised or manufactured without the use of certain pesticides or other chemicals; and our "Healthy Eating" range, which includes a variety of foods with lower fat, sodium and sugar and with clear labeling to facilitate customer awareness of their intake of these nutrients. Our "Tesco Kids" line includes products such as organic bananas and nutritionally balanced ready meals designed to appeal to nutrition-conscious parents and their children.

In order to appeal to customers' increasing interest in the nutritional contents of food, in fiscal 2006/07 we launched "front-of-pack" labeling. This labeling makes it easier for customers to determine their daily intake of certain nutrients by listing the amount of certain key nutrients clearly on the front of product labeling. We have found that this labeling has had the added benefit of driving sales of our more healthy products, and in response to this have worked with experts to reformulate the recipes of many of our own-brand products (such as prepared meals) in order to bring them more in line with developing customer desires and expectations.

In response to customer concern about climate change, we are currently conducting research to identify a measure that we can use to quantify the carbon footprint of each product on the product's label. This will allow our customers to compare the carbon footprint of our products in the same way they can now compare nutritional content.

*Non-Food*

We sell a variety of non-food items, including clothing, consumer electronics, health and beauty, toys and sports, do-it-yourself, kitchenware and soft furnishings, seasonal goods such as barbeques and garden products, DVDs, and stationery and news and magazines. Selected locations also have opticians and nearly 200 of our stores feature pharmacies. All of our store locations sell some non-food items, but our Extra and new Homeplus store formats offer the widest selection.

Our non-food offerings include own-brand items that we sell under the Value, Tesco and Finest brand names. We also offer clothing, including under the Florence and Fred and Cherokee brand names. Some other examples of items marketed under our own brand name are audio-visual accessories, toys and games and gardening tools. We also offer other leading brands as part of our non-food range. Through Dobbies, we will offer our customers Dobbies' traditional product offerings and also plan to offer a wider range of environmentally-conscious products such as water recycling and alternative power source systems. We plan to further increase our selection of non-food items as part of our strategy to be as strong in non-food as in food.

*Gasoline*

We operate gas stations located adjacent to certain of our stores throughout the United Kingdom and in certain of our other markets.

*Retailing Services*

Our retailing services, which include our sales of personal finance services, telecommunications services and our sales of food and non-food on tesco.com and our sale of non-food items through Tesco Direct.

Personal Finance

We offer our customers in the United Kingdom (as well as in our Europe segment in the Republic of Ireland, Hungary and Poland) a range of personal finance services, including banking, insurance, lending and savings and investments through a joint venture with the Royal Bank of Scotland plc. This joint venture is intended to be competitive by combining our knowledge of customers with RBS's expertise in financial services. Customers can purchase personal finance services in our stores and at tesco.com, and in fiscal 2006/07, over 50% of our personal finance sales (by number of transactions) were made online. In fiscal 2006/07, our personal finance service offered 22 products and services and had over five million customer accounts.

*Banking.* We offer savings accounts with low minimum deposit requirements that allow our customers to do their banking in many of our stores, by phone or over the internet.

*Insurance*. We offer a wide range of insurance products, including home insurance, pet insurance, travel insurance, life insurance, health insurance, dental insurance and car breakdown insurance.

*Lending*. We offer personal unsecured loans, credit cards and mortgage loans to our customers.

Tesco.com and Tesco Direct

Since 1995, our customers have been able to order grocery items for home delivery using our website at www.tesco.com. In 2006, we launched Tesco Direct to make our non-food offerings more accessible to customers through our catalog and website in addition to in our stores. Tesco Direct also sells a variety of our non-food items and a wider range of products, including larger, bulkier items such as home furnishings. We host a portion of our website at an in-house data facility, and a portion is hosted by a third party at its data center.

Our customers in the United Kingdom, the Republic of Ireland and South Korea are able to order groceries via tesco.com, producing total online grocery sales of £1 billion, with a base of one million active customers and over 250,000 orders completed each week in fiscal 2006. Tesco.com provides customers with the convenience of ordering groceries online, and of home delivery within a convenient two-hour delivery window.

Goods purchased on tesco.com are picked from the shelves of customers' local stores or, in certain areas, a single dedicated tesco.com store, and delivered to our customers in the United Kingdom using a fleet of vans that we lease, staffed by drivers who are our employees.

As well as having a wider selection of non-food items than is available in our stores, Tesco Direct (which includes our sales of non-food items via our website or catalog) offers customers the choice of ordering online, by phone, or in selected stores, with delivery options which we believe are market-leading, including two-hour home delivery windows and the option to pick up goods from certain stores. We plan for a Tesco Direct store pick-up option to be available at approximately 200 of our U.K. store locations by the end of fiscal 2007. We contract with several third party distribution suppliers for the delivery of Tesco Direct goods.

Regardless of whether our U.K. customers make purchases from us in a store or on our website, they are able to take advantage of the Tesco Clubcard program. In this loyalty program, customers can apply for a Clubcard account, and then earn points every time they make a purchase from us or from certain other vendors who are our partners in the program. We send customers discount vouchers tailored to their shopping habits that entitle them to discounts that are linked to the points they have accumulated. These vouchers can be redeemed online or at U.K. store locations. In addition to using the Clubcard program to encourage and reward customers' loyalty to us, we use the information we collect on customers' shopping habits to better serve them. Our Clubcard program currently has over 13 million active members.

Telecommunications

We offer our customers in the United Kingdom a range of telecommunications services, including pre-paid mobile phone, home phone, internet phone and home internet services through tesco.com and in certain of our store locations. At the end of fiscal 2006/07, the number of active customers using our telecommunications services was close to two million.

*Tesco Mobile.* Tesco Mobile, our mobile phone service, is offered to our customers on a pay-as-you-go basis through a joint venture with $O_2$ (UK) Limited, a leading provider of mobile services to consumers and businesses in the United Kingdom.

*Internet Service.* We offer customers broadband or dial-up internet service through a contractual arrangement with a third party.

*Home and Internet Phone Service.* We offer our customers a traditional fixed-line home phone service on a pay-as-you-go basis or on a monthly fee basis, with a choice of service/rate packages. We also offer customers an internet phone service which gives them the ability to make calls to other internet phone users or to conventional fixed-line and mobile numbers over the internet using voice over IP technology. Both services are provided through contractual arrangements with third parties.

*Seasonality*

Our U.K. segment's business is seasonal to a certain extent. Generally, its highest volume of sales occurs in the fourth fiscal quarter, which includes the holiday season, and the lowest volume occurs during the first fiscal quarter.

*Competition*

In our U.K. segment, we compete with a wide range of grocery retailers including the other major U.K. supermarket chains, convenience store chains and a large number of independent local retailers. We compete with a wide range of operators in our sales of non-food, including national and local retailers. For the telecommunications services we offer, we compete with other multinational and national telecommunications providers, and for the personal financial services we offer, we compete mainly with other retail banks.

*Supply and Distribution*

We work with many suppliers throughout the United Kingdom and internationally, with many of whom we have long-term relationships. Our supply chain consists of various different types of suppliers, which range from individual farmers and growers to processors, manufacturers and distributors, with whom we have a variety of business relationships. We are a signatory to the U.K. Supermarket's Code of Practice, a U.K. government code that governs signatory supermarkets' relations with their suppliers, and we train our buyers to promote understanding and compliance with the Code. We enter into a variety of buying arrangements with our suppliers, which include contracts of varying length and spot-market purchases. Our U.K. private label foods are supplied by a variety of suppliers, no single one of which supplies a material proportion of our private label products, under contracts of varying length. To ensure the quality and safety of the food and non-food we sell in our stores, all of our suppliers are required to adhere to the food safety standards of the British Retail Consortium, and are subject to compliance audits by third party audit companies. Our employees also conduct audits of certain of our suppliers' operations to ensure compliance with our standards. We believe that our relationship with our suppliers is good.

We employ buyers throughout the United Kingdom and in regional offices in our other markets. Our buyers function as our main contacts with our suppliers, and are responsible for selecting goods or services and entering into buying arrangements on our behalf. Particularly in sourcing our non-food items in the United Kingdom, we utilize our global network of buyers to save on our inventory purchases by sourcing purchases from the best-value markets. We plan to continue to develop our sourcing and supply chain for non-food items as part of our strategy to grow this portion of our business.

Regardless of the source of our goods, we require each of our suppliers worldwide to operate in a safe, ethical and legal manner. We are a member of the Ethical Trade Initiative (the "ETI"), a U.K.-based organization of commercial companies, labor unions and non-governmental organizations that brings these organizations together to collaborate on ethical standards in the good-sourcing context. We require each of our suppliers to adhere to the ETI Base Code, which prohibits our suppliers from employing certain abusive labor practices such as forced or prison labor or child labor and discrimination, and requires the payment of a living wage. We employ teams of trading standards experts who carry out ethical audits of our suppliers to determine compliance with these standards.

As of August 25, 2007, we operated 35 distribution centers in the United Kingdom. Generally, our fleet of trucks picks up stock from suppliers' locations or from ports or airports where stock has arrived from suppliers, and brings it to one of our distribution centers. In the distribution center, stock is sorted and repacked for delivery to the stores served by that distribution center. From there, our fleet of trucks transports stock to our stores. A small proportion of our goods are delivered directly to our stores by our suppliers.

## International Segments

Since 1994 Tesco has been investing in markets outside the United Kingdom, seeking new opportunities for growth and the generation of long-term returns. We believe that a long-term approach is required to succeed as an international retailer, and we have evolved our international strategy based on six elements:

- Be **flexible**. Each market is unique and requires a different approach.
- Act **local**. Local customers, local cultures, local supply chains and local regulations require a tailored offering delivered by local staff.
- Maintain **focus**. Being the leading local brand is a long-term effort.
- Use **multiple formats**. No single format can reach the whole market. A spectrum from convenience stores to hypermarkets must be considered and we need to take a discounter approach throughout.
- Develop **capability**. Skill, not scale, is most important so we strive for capability through people, processes and systems.
- Build **brands**. Brands enable the building of important lasting relationships with customers.

## Europe Segment

*Overview*

We opened our first international store in Hungary in 1994. Since then our Europe segment has grown significantly, and now includes operations in the Czech Republic, Hungary, Poland, the Republic of Ireland, Slovakia and Turkey. In fiscal 2006/07, we had a net addition of 275 stores covering 4.7 million square feet of store space in our Europe segment, representing a 30% increase in square footage in that period. Our Europe segment represented 13% of total revenues in fiscal 2006/07 and 11% in fiscal 2005/06.

*Products and Services*

Much like in our U.K. segment, in our Europe segment we sell a variety of groceries designed to appeal to local tastes and expectations in our stores and, in the Republic of Ireland, also on our website, also using our own brands and local brands that our customers know and trust.

We also sell a variety of non-food items in our Europe stores, especially in our hypermarkets. We recently introduced two of our clothing labels that have been successful in the United Kingdom to our stores in Hungary, Poland, the Czech Republic and Slovakia.

In the Republic of Ireland, Hungary and Poland we offer a more limited range of personal finance services similar to the personal finance services offered to our customers in the United Kingdom. We generally offer these services through joint venture arrangements with a local bank.

*Europe Stores*

The hypermarket format has been the focus of our Central European activities. At 50,000 square feet or more, hypermarkets have the space to offer extensive food and non-food ranges. We have also pursued the development of smaller stores. The chart below shows the distribution of our 671 stores by country and type of store in our Europe segment as of August 25, 2007:

| Country | Store Format | | | | | |
|---|---|---|---|---|---|---|
| | Hypermarkets | | Other | | Total | |
| | Stores | Sq. feet (millions) | Stores | Sq. feet (millions) | Stores | Sq. feet (millions) |
| Czech Republic | 47 | 3.4 | 38 | 0.8 | 85 | 4.4 |
| Hungary | 72 | 4.9 | 41 | 0.2 | 113 | 5.1 |
| Poland | 51 | 4.2 | 228 | 2.1 | 279 | 6.3 |
| Republic of Ireland | 5 | 0.3 | 90 | 2.0 | 95 | 2.3 |
| Slovakia | 37 | 2.1 | 16 | 0.5 | 53 | 2.6 |
| Turkey | 23 | 1.4 | 23 | >0.1 | 46 | 1.4 |
| Total | 235 | 16.7 | 436 | 5.6 | 671 | 22.3 |

During the remainder of 2007/08, we plan to add 105 additional stores in our Europe segment through a combination of new store openings and acquisitions. This is planned to include 14 stores in the Czech Republic, 12 stores in Hungary, 30 stores in Poland, 11 stores in the Republic of Ireland, seven stores in Slovakia and 31 stores in Turkey.

*Competition*

In our Europe segment, we compete with a wide range of multinational, national and local retailers.

*Supply and Distribution*

Our supply and distribution structure in our Europe segment is similar to that of our U.K. segment. Most of the goods in our Europe stores are locally sourced. See "— U.K. Segment — Supply and Distribution" for a discussion of the ethical standards and compliance assurance procedures that apply to our suppliers worldwide.

**Asia Segment**

*Overview*

We opened our first stores in Asia in 1998, and since then our Asia segment has grown significantly, and now includes operations in China, Japan, Malaysia, South Korea and Thailand. In fiscal 2006/07, we had a net addition of 192 stores covering 3.4 million square feet of store space in the Asia segment, representing a 22% increase in square footage in that period. The Asia segment represented 10% of revenues in fiscal 2006/07 and 11% in fiscal 2005/06.

*Products and Services*

Much like in our Europe segment, in Asia we sell a variety of groceries designed to appeal to local tastes and expectations in our stores and, in South Korea, also on our website. In Asia, we sell own-brand goods as well as local brands that we believe our customers know and trust. In Thailand, we offer a more limited range of personal finance services similar to the personal finance services we offer in the United Kingdom.

*Asia Stores*

Our Asia stores are in multiple formats, with a particular emphasis on hypermarkets and increasingly on smaller formats such as convenience stores. We have developed Tesco Express formats in several countries, with 266 stores in Thailand, 39 stores in South Korea and trial stores in Japan. Our growth in Thailand includes 17 "Value" stores, which are compact hypermarkets with lower construction costs that allow the introduction of hypermarkets in less populous areas. The chart below shows the distribution of our 704 stores by country and type of store in our Asia segment as of August 25, 2007:

| Country | Store Format | | | | | |
|---|---|---|---|---|---|---|
| | Tesco Express | | Other | | Total | |
| | Stores | Sq. feet (millions) | Stores | Sq. feet (millions) | Stores | Sq. feet (millions) |
| China[1] | 49 | 4.4 | — | — | 49 | 4.4 |
| Japan | — | — | 114 | 0.3 | 114 | 0.3 |
| Malaysia | 16 | 1.5 | — | — | 16 | 1.5 |
| South Korea[2] | 58 | 5.3 | 47 | 0.3 | 105 | 5.6 |
| Thailand | 81 | 7.0 | 339 | 1.0 | 420 | 8.0 |
| Total | 204 | 18.2 | 500 | 1.6 | 704 | 19.8 |

(1) Under the "Legou" brand name (meaning "happy shopper" in Chinese).

(2) Under the "Homeplus" brand name.

During the remainder of 2007/08, we plan to add 193 additional stores in our Asia segment through a combination of new store openings and acquisitions. This is planned to include five stores in China, 30 stores in Japan, six stores in Malaysia, 41 stores in South Korea and 111 stores in Thailand.

Our Asia stores offer products and a store layout that is designed to appeal to local tastes and expectations. For example, in China, it is customary to touch and feel products before purchasing them, and therefore our store design facilitates this. In Tokyo, customers tend to shop for small amounts of extremely fresh food every day, and therefore the "hypermarket" store format does not meet local needs. In response to this, we entered the Japanese market through the acquisition of an existing discount supermarket operator. Throughout Asia, we stock brands that customers in the relevant markets are familiar with. In China, we also sell food and non-food products under our Legou Tesco brand, which we launched in October 2005.

Customers in South Korea are able to order food and non-food items via our website in much the same way as our U.K. customers. See "— U.K. Segment — Retailing Services — Tesco.com and Tesco Direct".

*Competition*

In Asia, we compete with a wide range of multinational, national and local retailers.

*Supply and Distribution*

Our supply and distribution structure in our Asia segment is similar to that of our Europe segment. Most of the goods in our Asian stores are locally sourced. See "— U.K. Segment — Supply and Distribution" for a discussion of the ethical standards and compliance assurance procedures that apply to our suppliers worldwide.

**Expansion into the United States**

In November 2007, we plan to commence business operations in the United States with the opening of a limited number of Fresh & Easy Neighborhood Market stores in Phoenix, Arizona, Los Angeles, California, San Diego, California and Las Vegas, Nevada. Fresh & Easy Neighborhood

Market stores will be modeled on our Tesco Express stores, but will average approximately 10,000 square feet, and will sell mainly food items. Our U.S. headquarters has been established in El Segundo, California, and we are constructing our U.S. distribution center in Riverside, California.

In preparation for our expansion into the United States, we sent a team of our employees to live on the U.S. West Coast for approximately one year. This team collected valuable data about the shopping habits and desires of U.S. consumers by living in Americans' homes, accompanying them on shopping trips and making note of the products which they purchased and used. On the basis of this research, we believe that American consumers desire additional one-stop shopping options, fresher and more local produce and healthier prepared-food options. We have collected additional data on American customers by building a prototype store in California, and inviting customers to visit the store and give us feedback about their experience. We believe that, armed with this research and our experience gained over the last ten years in our international segments in tailoring our stores to meet the expectations of local customers, we are well positioned to succeed in the U.S. market.

**Employees and Labor Relations**

At the end of fiscal 2006, we employed approximately 450,000 individuals worldwide, including 267,000 employees in the United Kingdom, making us the largest private sector employee in our home market. Approximately half of our U.K. employees are represented by the Union of Shop, Distributive and Allied Workers (the "USDAW"). Our relations with the USDAW are governed by a master "partnership" agreement, which provides the framework of our relations with USDAW, including the number, location and role of union representatives, union access to employees and our responsibilities towards union representatives. We engage in collective bargaining regarding the other terms and conditions of employment with the USDAW on an annual basis. We have not experienced any recent disruptions as a result of these negotiations. In our international business segments, labor union representation varies country by country, with union representation in varying proportions. We have had no material labor-related work stoppages, and believe that our employee relations are good.

**Information Technology**

Since 2002, we have employed a standard suite of systems that we designed based on a survey of best practices across our operations that started in 2001. This suite of systems, which we refer to as the "Tesco Operating Model" allows direct communications between the information technology systems in our stores, distribution centers, head office and certain of our suppliers. The Tesco Operating Model is a suite of systems we have created by combining software licensed by various vendors, including Oracle, Oracle Retail Retalix and JDA. Our systems are supported by our service center in Bangalore, India with additional support from software vendors where necessary. Certain components of the Tesco Operating Model are currently in use in certain of our locations, including our head office and certain distribution centers, suppliers and stores. We currently use the Tesco Operating Model in our U.K. headquarters, and plan to expand its use to all of our markets over time. Many of our key IT processes, such as software we use in our purchasing, warehousing, merchandise management, general ledger, promotions and manufacturing and human resources activities are enabled globally by the Oracle eBusiness system, which we license from Oracle.

**Property Strategy**

We have sought in recent years to acquire most of our new selling space as freehold (owned, as opposed to leased) interests to avoid the difficulties in remodeling or expanding in leased developments. These appreciating freehold assets provide us with the platform to develop and expand our stores and enhance our balance sheet.

We are currently implementing a plan under which we intend to release more than £5 billion in cash over the next five years from our U.K. and international real estate portfolio. We are engaging in a sequence of sale-leaseback and other transactions, under which we are divesting certain of our U.K. real estate assets to joint ventures we are establishing with financial investor partners. We plan to use the proceeds from these transactions to fund our expansion and our share buyback program. We intend to maintain the percentage of our store locations that we own at approximately 70%, and plan to lease the remaining locations. See “Operating and Financial Review — Liquidity and Capital Resources and — Off-balance Sheet Arrangements”.

Our global headquarters, which we own, are located in Cheshunt, Hertfordshire, United Kingdom.

### Intellectual Property

We have trademark and service mark registrations and applications and domain name registrations necessary to operate our business around the world, including the Tesco trade- and service-mark. We regard our protected names as having significant value to our business and to the marketing of our brands. We are not aware of any circumstances that could be expected to have a material adverse affect on our intellectual property.

### Environmental Matters

We are subject to various environmental laws and regulations affecting the operation of our business, including regulations concerning waste-water disposal and licensing and consent requirements for gasoline retailing.

### Regulatory Overview

We are subject to various laws affecting the operation of our business. Each of our stores is subject to licensing and regulation by a number of governmental authorities, which include zoning, health, safety, sanitation, building and fire agencies, in the jurisdiction in which the store is located. Difficulties in obtaining, or the failure to obtain, required licenses or approvals can delay or prevent the opening of a new store in a particular area.

In the United Kingdom, we are subject to national and local laws and regulations concerning labor, health, sanitation and safety as well as planning permission requirements for store development and expansion. We are subject to U.K. and EC competition law, which, among other things, may result in inquiries into our plans to acquire new businesses or stores. We are subject to laws governing matters such as wages, working conditions, citizenship requirements and overtime. Our telecommunications operations are subject to regulation by the United Kingdom’s Office of Communications and our financial services operations are subject to regulation by the United Kingdom’s Financial Services Authority.

In Europe, Asia and the United States, our company and operations are subject to national and local laws and regulations, which are generally similar to those affecting our U.K. stores, including laws and regulations concerning labor, health, sanitation and safety. We are also subject to competition laws in these jurisdictions, which, among other things, may result in inquiries into our plans to enter or expand in these markets (including by acquiring shares in existing businesses), and may require us to obtain approval prior to doing so. Our operations in Europe and in Asia are also subject to tariffs and regulations on imported commodities and equipment and laws regulating foreign investment.

### Governmental, Legal and Arbitration Proceedings

We are subject to various legal proceedings and claims that arise in the ordinary course of our business. Although the outcome of these claims cannot be predicted with certainty, we do not believe that the ultimate resolution of these matters will have a significant effect on our financial position or profitability. Except as disclosed under the heading “Competition Commission Inquiry into the U.K. Grocery Industry”, in the past 12 months there have been no material governmental, legal or arbitration proceedings that may have, or have had in the recent past, a significant effect on our financial position or profitability, including any such proceedings which are pending or threatened of which we are aware.

*Competition Commission Inquiry into the U.K. Grocery Industry*

The U.K. Competition Commission (the "CC") is currently carrying out an inquiry into the United Kingdom's grocery industry. The investigation, which began in May 2006, is a general inquiry into the supply of groceries by retailers in the United Kingdom, and is not specific to any one retailer. The CC is investigating whether any features of the grocery industry prevent, restrict or distort competition and, if so, what action might be taken to remedy this. Particular attention is being paid to the structure of the grocery industry, the nature of retail competition, the behavior of the major grocery retailers towards their suppliers and retailers' acquisition, disposal, development and use of land. Should it make an adverse determination in this investigation, the CC would have the authority to take remedial action. The CC could impose any reasonable and practicable solution to remedy the adverse effect on competition identified and any detrimental effects on customers that result from the adverse effect on competition. The CC is required by applicable law to report the conclusions of this investigation by May 2008, and the current administrative timetable contemplates provisional findings being published by the end of October 2007. The parties can then make further submissions on these provisional findings, and on any possible remedies the CC is considering. We do not believe that our business has an adverse impact on competition in the grocery industry, and have made submissions to the inquiry in support of our position. As it is uncertain whether the CC will seek to impose a remedy in the present investigation, and as the power the CC has to impose remedies does not extend to the imposition of monetary damages, it is not possible to quantify the potential cost of such a remedy.

*Office of Fair Trading Statement of Objections*

On September 20, 2007 the U.K. Office of Fair Trading (the "OFT") issued a statement of objections to us, four of our competitors and five U.K. dairy processors alleging that we and these other parties conspired to fix prices for dairy products from 2002 to 2003 by sharing commercially sensitive information. We are currently preparing materials in our defense. The OFT is expected to render its final decision in 2008. If we are found to have committed the infringements alleged by the OFT, the OFT could impose a substantial penalty, however we do not believe the outcome of these proceedings would have a significant effect on our financial position or profitability.

## MANAGEMENT

We are governed by resolutions of our shareholders taken at general meetings of our shareholders, and by acts of our board of directors and committees of our board of directors.

### General Shareholders' Meeting

The highest level of management, and our ultimate decision-making body, is our shareholders acting at shareholders' general meetings. Our board of directors convenes a shareholders' general meeting at least once a year. Resolutions of our shareholders are generally passed by a simple majority, although in accordance with relevant statutory requirements some resolutions require the approval of 75% of shareholders.

Only the shareholders, acting at a shareholders' general meeting, can take action relating to:

- Alteration of our memorandum and articles of association;
- Our reorganization and liquidation, appointment of a liquidation committee and approval of interim and final liquidation balance sheets;
- Determination of the composition of our board of directors, election of its members and early termination of their powers;
- Determination of the amount, nominal value and type of authorized shares;
- Increases and reductions of our authorized capital;
- Appointment of our auditor;
- Approval of dividends;
- Approval of annual statutory accounting and reports; and
- Certain other matters provided for by law and our memorandum and articles of association.

### Board of Directors

Our board of directors is responsible for our general management, including the determination of our strategy and coordination and general supervision, with the exception of those matters that are designated by law or by our memorandum and articles of association as being the exclusive responsibility of our shareholders. Our board of directors normally meets eight times a year and makes its decisions by simple majority. Our board of directors is currently composed of seven executive directors, seven independent non-executive directors and Mr. D. E. Reid, non-executive chairman. Mr. R. F. Chase is our deputy chairman and the senior independent non-executive director of our board of directors. The chairman of our board of directors has primary responsibility for running the board of directors. Our chief executive, Sir Terry Leahy, has executive responsibilities for the operations, results and strategic development of the Group.

The following table sets forth the name, age and position of each member of our board of directors as of October 9, 2007. We consider only the members of our board of directors to be our key managers.

| Name | Age | Position |
|---|---|---|
| David Reid | 60 | Non-executive Chairman |
| Rodney Chase CBE | 64 | Deputy Chairman and Senior Non-executive Director |
| Sir Terry Leahy | 51 | Chief Executive |
| Richard Brasher | 46 | Commercial and U.K. Marketing Director |
| Philip Clarke | 47 | International and IT Director |
| Andrew Higginson | 50 | Finance and Strategy Director |
| Tim Mason | 50 | President and Chief Executive Officer, Fresh & Easy Neighborhood Market |
| Lucy Neville-Rolfe CMG | 54 | Corporate and Legal Affairs Director |
| David Potts | 50 | Retail and Logistics Director |
| Charles Allen CBE | 50 | Non-executive Director |
| Karen Cook | 54 | Non-executive Director |
| E. Mervyn Davies CBE | 54 | Non-executive Director |
| Dr. Harald Einsmann | 73 | Non-executive Director |
| Ken Hydon | 62 | Non-executive Director |
| Carolyn McCall | 46 | Non-executive Director |
| Jonathan Lloyd | 41 | Company Secretary |

The business address of the members of our board of directors is Tesco House, Delamare Road, Cheshunt, Hertfordshire, EN8 9SL.

**Board Practices**

Our board of directors governs through clearly identified board committees to which it delegates certain powers. Our board of directors itself is serviced by the company secretary, who reports to the chairman in respect of his core duties to our board of directors. Our board committees include the executive committee, the audit committee, the remuneration committee and the nominations committee. These committees are properly authorized under our memorandum and articles of association to make decisions and act on behalf of our board of directors within the parameters laid down by our board of directors. Our board of directors is kept fully informed of the work of these committees. Any issues requiring resolution will be referred to the full board of directors.

**Executive Committee**

Our board of directors delegates responsibility for formulating and implementing the strategic plan and for management of the Group to the executive committee. This committee meets formally every week and its decisions are communicated throughout the Group on a regular basis. The executive committee is composed of the seven executive directors and is chaired by the chief executive. A number of senior executives also attend executive committee meetings.

The executive committee has authority for decision-making in all areas, with certain exceptions. The executive committee is responsible for implementing Group strategy and policy, for monitoring the performance of the business and reporting on these matters in full to the board of directors.

**Nominations Committee**

The nominations committee leads the process for directors' appointments, re-election and succession of directors and the chairman, and meets as necessary. As of February 24, 2007, the nominations committee was chaired by Mr. Reid, and was composed of Mr. Allen, Mr. Chase, Mrs. Cook, Mr. Davies, Dr. Einsmann, Mr. Hydon, Ms. McCall and Sir Terry Leahy.

**Remuneration Committee**

The remuneration committee's role is to determine and recommend to the board of directors the remuneration of the executive directors. The remunerations committee is composed entirely of independent non-executive directors. As of February 24, 2007, the remuneration committee was chaired by Mr. Allen, and was composed of Mr. Chase, Mrs. Cook, Mr. Davies and Dr. Einsmann. The company secretary also attends in his capacity as secretary of the committee.

**Audit Committee**

The audit committee's primary responsibilities are to review the financial statements, to review the Group's internal control and risk management systems, to consider the appointment of the external auditors, their independence and reports to the audit committee, as well as to review the program of internal audit. The audit committee's annual schedule includes a review of the effectiveness of external and internal audit. Each year the audit committee conducts a review of its own effectiveness and its terms of reference (charter). As of February 24, 2007, the audit committee was chaired by Mr. Hydon, who has recent and relevant financial experience, and was composed of Mr. Chase, Mr. Davies and Ms. McCall. The company secretary also attends in his capacity as secretary of the audit committee.

*Biographical Information*

*David Reid*. Mr. Reid became Non-executive Chairman on April 2, 2004. Prior to his appointment he was Deputy Chairman of Tesco plc and has served on our board since 1985. Mr. Reid is a Non-executive Director of Reed Elsevier Group PLC and Chairman of Kwik-Fit Group.

*Rodney Chase CBE.* Mr. Chase was appointed a Non-executive Director on July 1, 2002. He is a Non-executive Chairman of Petrofac Limited and a Non-executive Director of Computer Sciences Corporation in Los Angeles, California, Nalco Company in Chicago, Illinois and Tesoro Corporation in San Antonio, Texas. He also serves as Senior Advisor to Lehman Brothers, both in the United States and Europe.

*Sir Terry Leahy.* Sir Terry became Chief Executive in 1997. Joining Tesco in 1979, he held a number of marketing and commercial positions prior to being appointed to the board of directors of Tesco plc on October 5, 1992.

*Richard Brasher.* Mr. Brasher was appointed to our board of directors on March 15, 2004. He joined Tesco in 1986. He has held a number of marketing, commercial and store operations positions, most recently U.K. marketing director.

*Philip Clarke.* Mr. Clarke was appointed to our board of directors on November 16, 1998. Prior to his appointment he held a number of roles in our store operations, commercial and marketing. He is a Non-executive Director of Whitbread PLC.

*Andrew Higginson.* Mr. Higginson was appointed to our board of directors on November 17, 1997. He is a member of the 100 Group of Finance Directors, Chairman of Tesco Personal Finance and a Non-executive Director of BSkyB PLC. He is also responsible for retailing services, including tesco.com, Tesco Telecoms and Tesco Direct.

*Tim Mason.* Mr. Mason was appointed to our board on February 16, 1995. He joined Tesco in 1982 and has been President of our U.S. operations since 2006.

*Lucy Neville-Rolfe CMG.* Ms. Neville-Rolfe was appointed to our board in December 2006. She joined Tesco in 1997 and was Company Secretary from 2004-2006. She is Deputy Chair of the British Retail Consortium and a member of the China Britain Business Council and of the Corporate Leaders Group on Climate Change.

*David Potts.* Mr. Potts was appointed to our board on November 16, 1998. He joined Tesco in 1973. From 1997 he directed the integration of our businesses in Northern Ireland and the Republic of Ireland before returning to the U.K. in 2000 as Director responsible for U.K. Retail Operations. From 2004, his responsibilities have included the U.K. supply chain.

*Charles Allen CBE.* Mr. Allen was appointed a Non-executive Director on February 19, 1999. He was Chief Executive of ITV PLC from 2004 to 2007. He is a Non-executive Director of the London Organizing Committee of the Olympics and Paralympics.

*Karen Cook.* Ms. Cook was appointed a Non-executive Director on October 1, 2004. She is a Managing Director of Goldman Sachs International and President of Goldman Sachs, Europe. She is also a member of the firm's European Management Committee and Partnership Committee.

*E. Mervyn Davies CBE.* Mr. Davies was appointed a Non-executive Director on July 7, 2003. He is Chairman of Standard Chartered PLC.

*Dr. Harald Einsmann.* Dr. Einsmann was appointed a Non-executive Director on April 1, 1999. He is on the board of Carlson Group of Companies and Checkpoint Systems Inc., as well as the board of Stora Enso Oy, part of the Wallenberg Group, and the board of Rezidor AB in Sweden.

*Ken Hydon.* Mr. Hydon was appointed a Non-executive Director on February 23, 2004. He is also a Non-executive Director of Reckitt Benckiser PLC, the Royal Berkshire NHS Foundation Trust and Pearson PLC.

*Carolyn McCall.* Ms. McCall was appointed a Non-executive Director on March 1, 2005. She is Chief Executive of the Guardian Media Group PLC. She chairs Opportunity Now, the United Kingdom's leading membership organization working towards gender equality and diversity in the workplace.

*Jonathan Lloyd.* Mr. Lloyd was appointed Company Secretary to our board of directors in December 2006. He joined Tesco as Deputy Company Secretary and Corporate Secretariat Director in April 2005 from Freshfields Bruckhaus Deringer.

**Compensation**

In the 2006/07 financial year, the aggregate remuneration in the form of salaries, bonuses and other amounts we paid to the members of our board of directors was £19.6 million.

**Interests of Directors**

As of October 29, 2007, there were no outstanding transactions other than in the ordinary course of business undertaken by us in which our directors were interested parties. Certain of our directors have direct or beneficial interests in our ordinary shares. See "Principal Shareholders".

**Conflicts of Interests**

None of the members of our management or board of directors have been subject to any bankruptcy, receivership or liquidation proceedings, nor have any of them been convicted of any fraudulent offense or been subject to any official public incrimination or sanctions by statutory or regulatory authorities (including designated professional bodies) in acting as founder, director or senior manager of any company for the last five years, nor has any of them been disqualified by a court from acting as a member of the management or supervisory bodies of an issuer or from acting in the management or conduct of the affairs of any issuer for the last five years.

There are currently no actual or potential conflicts of interest between the duties of the directors and managers set out above in this section owed to the entities whose directors or managers they are and their private interests.

## PRINCIPAL SHAREHOLDERS

### Share Capital

As of October 9, 2007, we had an authorized share capital of £542,900,000 comprised of 10,858,000,000 ordinary shares with a par value of 5p per share and an issued share capital of £392,577,321 comprised of 7,851,546,419 ordinary shares with a par value of 5p per share.

### Shareholders

The following table sets forth information regarding the beneficial ownership of our ordinary shares as of April 11, 2007 by our directors as a group and by stockholders known by us to beneficially own more than five percent of our outstanding ordinary shares.

| Name | Number of Shares Held | Percent Ownership |
|---|---|---|
| Fidelity International/FMR Corporation | 463,856,456 | 5.85% |
| Directors as a group[1] | 13,091,537 | 0.16% |
| Total | 476,947,993 | 6.01% |

(1) Directors' holdings include ordinary share holdings and ordinary shares and options held under company share plans at April 11, 2007 and which were available or exercisable at April 11, 2007 or became available or exercisable within 60 days of April 11, 2007. Shares and options held under company share plans which were not available or exercisable at April 11, 2007 or within 60 days of April 11, 2007 are not included. Any shares or options acquired or awarded and any share disposals after April 11, 2007 are not included.

## DESCRIPTION OF THE NOTES

*The following is a summary of the material provisions of the notes and the Fiscal and Paying Agency Agreements (as described below). Copies of the Fiscal and Paying Agency Agreements will be available for inspection during normal business hours at any time after the closing date of the offering of the notes at the offices of the Agent (as defined below) at the address below. Any capitalized term used herein but not defined shall have the meaning assigned to such term in the Fiscal and Paying Agency Agreements.*

### General

The $850,000,000 5.50% Senior Notes due 2017 (the "2017 notes") and the $1,150,000,000 6.15% Senior Notes due 2037 (the "2037 notes" and, together with the 2017 Notes, the "notes") will be issued in and treated as two separate series of debt securities under, in each case, a Fiscal and Paying Agency Agreement, each such agreement expected to be dated as of November 5, 2007 (together, such Fiscal and Paying Agency Agreements in respect of each of the 2017 notes and the 2037 notes, the "FPAA"), in each case between Tesco PLC (the "issuer") and Citibank N.A., London Branch, as fiscal agent, paying agent, transfer agent and registrar (in each and all such capacities, the "Agent"), Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB. The FPAA will not be qualified under the U.S. Trust Indenture Act of 1939, as amended. Consequently, the Holders of notes generally will not be entitled to the protections provided under such Act to holders of debt securities issued under a qualified indenture, including those requiring a trustee to resign in the event of certain conflicts of interest and to inform the Holders of notes of certain relationships between it and the issuer. In this "Description of the Notes", the terms "Holder", "Noteholder" and other similar terms refer to a "registered holder" of notes, and not to a beneficial owner of a book-entry interest in any notes, unless the context otherwise clearly requires.

The initial purchasers propose to resell the Rule 144A notes in registered form to certain institutions in the United States in reliance upon Rule 144A under the Securities Act. The Rule 144A notes may not be sold or otherwise transferred except, in the United States, pursuant to registration under the Securities Act or in accordance with Rule 144A or, outside the United States, pursuant to Rule 904 of Regulation S thereunder or, in either case, in a resale transaction that is otherwise exempt from such registration requirements, and each global note representing Rule 144A notes (a "Rule 144A global note") will bear a legend to this effect. In light of current U.S. securities laws, subject to certain exceptions, an exemption should be available for a sale or transfer of a Rule 144A note after its Specified Date. The "Specified Date" means, with respect to any Rule 144A note, the date which is two years (or such other period as shall constitute the required holding period pursuant to Rule 144(k) of the Securities Act) after the later of (a) the original issue date of such Rule 144A note and (b) the last date on which the issuer or an affiliate of the issuer was the beneficial owner of such Rule 144A note, in each case demonstrated to the reasonable satisfaction of the issuer (which may require delivery of legal opinions). Unless a Holder of a Rule 144A global note holds such Rule 144A note for a period of two years (or such other period as shall constitute the required holding period pursuant to Rule 144(k) of the Securities Act), such Holder may not be able to determine the Specified Date because such Holder may not be able to determine the last date on which the issuer or any affiliate of the issuer was the beneficial owner of such Holder's Rule 144A global note. The Agent will not be required to accept for registration or transfer any Rule 144A global notes, except upon presentation of satisfactory evidence (which may include legal opinions) that the restrictions on transfer have been complied with, all in accordance with such reasonable regulations as the issuer may from time to time agree with such Agent.

For so long as any notes remain outstanding and are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, the issuer will, during any period in which it is neither subject to Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act") nor exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, make available to any registered Holder of notes (or any Holder of a book-entry interest in such notes designated by the registered holder thereof) in connection with any sale thereof and to any prospective purchaser of notes or a book-entry interest in notes designated by such registered holder, in each case upon request of such registered holder, the information specified in, and meeting the requirements of, Rule 144A(d)(4) under the Securities Act. As of the date of this prospectus the issuer is exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act.

The Regulation S notes will be resold outside the United States in offshore transactions in reliance on Regulation S under the Securities Act.

It is expected that the notes will be rated A1 by Moody's Investors Service, Inc., A+ by Standard & Poor's, a division of the McGraw-Hill Companies, Inc. and A+ by Fitch Ratings Ltd., subject to confirmation at closing. A security rating is not a recommendation to buy, sell or hold the notes. There is no assurance that a rating will remain for any given period of time or that a rating will not be lowered or withdrawn by the relevant rating agency if, in its judgment, circumstances in the future so warrant. In the event that a rating initially assigned to the notes is subsequently lowered for any reason, no person or entity is obliged to provide any additional support or credit enhancement with respect to the notes and the market value of the notes is likely to be adversely affected.

**Principal, Maturity and Interest**

The notes will be unsecured and unsubordinated obligations of the issuer. The 2017 notes and the 2037 notes are initially issuable in aggregate principal amounts not to exceed $850 million and $1.15 billion, respectively, and will mature on November 15, 2017 and November 15, 2037, respectively. The 2017 notes and the 2037 notes will bear interest at 5.50% and 6.15%, respectively, per annum from the date of the initial issuance of such notes or from the most recent interest payment date to which interest has been paid or provided for, payable semi-annually in arrears on May 15 and November 15, commencing (each, an "interest payment date") to the person in whose name any such 2017 note or 2037 note, as applicable, is registered at the close of business on the May 1 or November 1 (whether or not a business day) immediately preceding such interest payment date (each, a "record date"), notwithstanding any transfer or exchange of such notes subsequent to the record date and prior to such interest payment date, except that, if and to the extent the issuer shall default in the payment of the interest due on such interest payment date and the applicable grace period shall have expired, such defaulted interest may at the option of the issuer be paid to the persons in whose names notes are registered at the close of business on a subsequent record date (which shall not be less than ten days prior to the date of payment of such defaulted interest) established by notice given by mail by or on behalf of the issuer to the Holders (which term means registered holders) of the 2017 notes or the 2037 notes, as applicable, not less than 15 days preceding such subsequent record date. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months and in the case of an incomplete month, the number of days elapsed. If the date on which any interest payment or principal payment is to be made is not a business day in New York City, London, England, and the place of payment of such interest or principal, such payment will be made on the next day which is a business day in New York City, London, England and the place of payment of such interest or principal without any further interest or other amounts being paid or payable in connection therewith.

**Form and Denomination**

The notes will be issued in fully registered form and only in denominations of $100,000 and integral multiples of $1,000 in excess thereof. The notes will be issued initially as global notes.

**Further Issues**

The issuer may, from time to time, without notice to or the consent of the Holders of the notes, "reopen" each series of notes and create and issue additional notes having identical terms and conditions as the 2017 notes or the 2037 notes, as the case may be (or in all respects except for the issue date, issue price, payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes) so that the additional notes are consolidated and form a single series of notes with the 2017 notes of the 2037 notes, as the case may be.

The issuer will not issue any additional notes unless such additional notes have no more than a *de minimis* amount of original issue discount or such issuance would constitute a "qualified reopening" for U.S. federal income tax purposes.

**Status of the Notes**

The notes will be unsecured and unsubordinated obligations of the issuer and will rank *pari passu* in right of payment among themselves and with all other unsecured and unsubordinated indebtedness of the issuer (save for certain obligations required to be preferred by law).

**Payment of Additional Amounts**

The issuer will make payments of, or in respect of, principal and interest on the notes without withholding or deduction for or on account of any present or future tax, levy, impost or other governmental charge whatsoever imposed, assessed, levied or collected ("Taxes") by or for the account of the United Kingdom or any political subdivision thereof or any authority thereof having the power to tax (a "U.K. Taxing Jurisdiction"), unless such withholding or deduction is required by law.

If the issuer is required by a U.K. Taxing Jurisdiction to deduct or withhold Taxes, the issuer will pay to a Holder of a note such additional amounts ("Additional Amounts") as may be necessary so that the net amount received by such Holder will not be less than the amount such Holder would have received if such Taxes had not been withheld or deducted; *provided, however*, that the issuer shall not be required to pay any Additional Amounts for or on account of:

(i) Any Taxes that would not have been so imposed, assessed, levied or collected but for the fact that the Holder or beneficial owner of the applicable note (or a fiduciary, settlor, beneficiary, member or shareholder of, or possessor of a power over, such Holder, if such Holder is an estate, trust, partnership or corporation) is or has been a domiciliary, national or resident of, or engaging or having been engaged in a trade or business or maintaining or having maintained a permanent establishment or being or having been physically present in, a U.K. Taxing Jurisdiction or otherwise having or having had some connection with a U.K. Taxing Jurisdiction other than the mere holding or ownership of, or the collection of principal of, and interest on, a note;

(ii) Any Taxes that would not have been so imposed, assessed, levied or collected but for the fact that, where presentation is required in order to receive payment, the applicable note was presented more than 30 days after the date on which such payment became due and payable or was provided for, whichever is later except to the extent that the Holder or beneficial owner thereof would have been entitled to Additional Amounts had the applicable note been presented for payment on any day during such 30 day period;

(iii) Any estate, inheritance, gift, sales, transfer, personal property or similar Taxes;

(iv) Any Taxes that are payable otherwise than by deduction or withholding from payments on or in respect of the applicable note;

(v) Any Taxes that would not have been so imposed, assessed, levied or collected but for the failure by the Holder or the beneficial owner of the applicable note to comply with a written request addressed to the Holders (A) to provide any certification, identification, information, documents or other evidence concerning the nationality, residence or identity of the Holder or the beneficial owner or its connection with the U.K. Taxing Jurisdiction or (B) to make any valid or timely declaration or claim or satisfy any other reporting, information or procedural requirements relating to such matters if, in either case, compliance is required by statute, treaty, regulation or administrative practice of the U.K. Taxing Jurisdiction as a condition to relief or exemption from such Taxes;

(vi) Any withholding or deduction imposed on a payment to or for the benefit of an individual that is required to be made pursuant to Council Directive 2003/48/EC or any other Directive on the taxation of savings implementing the conclusion of the ECOFIN council meeting of November 26-27, 2000, or any law implementing or complying with, or introduced in order to conform to, such Directive;

(vii) Any withholding or deduction that is imposed on the applicable note that is presented for payment, where presentation is required, by or on behalf of a Holder who would have been able to avoid such withholding or deduction by presenting such note to another paying agent in a member state of the EU; or

(viii) Any combination of the Taxes described in (i) through (vii) above.

In addition, Additional Amounts will not be paid in respect of any payment in respect of the applicable notes to any Holder of the applicable notes that is a fiduciary, a partnership, a limited liability company or any person other than the sole beneficial owner of such payment to the extent such payment would be required by the laws of a U.K. Taxing Jurisdiction to be included in the income for tax purposes of a beneficiary or settlor with respect to such fiduciary, a member of such partnership, an interestholder in such limited liability company or a beneficial owner that would not have been entitled to such amounts had such beneficiary, settlor, member, interestholder or beneficial owner been the Holder of such notes.

Unless otherwise stated, references in any context to the payment of principal of, and any premium or interest on, any Note, will be deemed to include payment of Additional Amounts to the extent that, in such context, Additional Amounts are, were or would be payable in respect thereof.

**Redemption**

***Optional Redemption***

The issuer may redeem the applicable notes in whole or in part, at the issuer's option, at any time and from time to time at a redemption price equal to the greater of (i) 100% of the principal amount of the notes to be redeemed and (ii) as determined by the Independent Investment Banker, the sum of the present values of the applicable Remaining Scheduled Payments discounted to the date of redemption (the "redemption date") on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months or, in the case of an incomplete month, the number of days elapsed) at the Treasury Rate plus, in the case of the 2017 notes, 20 basis points, and, in the case of the 2037 notes, 25 basis points, together with, in each case, accrued and unpaid interest on the principal amount of the notes to be redeemed to the redemption date. In connection with such optional redemption the following defined terms apply:

- "Treasury Rate" means, with respect to any redemption date, the rate per annum equal to the semi-annual equivalent yield to maturity (computed as of the third business day immediately preceding that redemption date) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for that redemption date.

- "Comparable Treasury Issue" means the United States Treasury security selected by the Independent Investment Banker that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the 2017 notes or the 2037 notes, as the case may be.

- "Comparable Treasury Price" means, with respect to any redemption date, (i) the average of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) on the third business day preceding that redemption date, as set forth in the daily statistical release designated H.15 (519) (or any successor release) published by the Federal Reserve Bank of New York and designated "Composite 3:30 p.m. Quotations for U.S. Government Notes" or (ii) if such release (or any successor release) is not published or does not contain such prices on such business day, (A) the average of the Reference Treasury Dealer Quotations for that redemption date, after excluding the highest and lowest of such Reference Treasury Dealer Quotations or (B) if the Independent Investment Banker for the notes obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such Quotations.

- "Independent Investment Banker" means one of the Reference Treasury Dealers appointed by the issuer to act as the "Independent Investment Banker".

- "Reference Treasury Dealer" means each of Citigroup Global Markets Inc. and J.P. Morgan Securities Inc., their respective successors and two other nationally recognized investment banking firms that are Primary Treasury Dealers specified from time to time by the issuer; *provided, however*, that if any of the foregoing shall cease to be a primary U.S. Government securities dealer in New York City (a "Primary Treasury Dealer"), the issuer shall substitute therefor another nationally recognized investment banking firm that is a Primary Treasury Dealer.

- "Reference Treasury Dealer Quotation" means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the Independent Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Independent Investment Banker by such Reference Treasury Dealer at 3:30 p.m., New York City time, on the third business day preceding that redemption date.

- "Remaining Scheduled Payments" means, with respect to each note to be redeemed, the remaining scheduled payments of the principal thereof and interest thereon that would be due after the related redemption date but for such redemption; *provided, however*, that if that redemption date is not an interest payment date with respect to such notes, the amount of the next succeeding scheduled interest payment thereon will be reduced by the amount of interest accrued thereon to that redemption date.

Notice of any optional redemption will be given in accordance with "Notice" below at least 30 days but not more than 60 days before the redemption date to each Holder of the notes to be redeemed.

***Repurchase Upon a Change of Control Offer***

If a Change of Control Triggering Event occurs, unless the issuer has exercised its option to redeem the applicable notes in full as described above or the notes have been redeemed in full for tax reasons as described below, the issuer will be required to make an offer (the "Change of Control Offer") to each Holder of the applicable notes to repurchase all or any part (equal to $100,000 or an integral multiple of $1,000 in excess thereof) of that Holder's applicable notes on the terms set forth in the notes. In the Change of Control Offer, the issuer will be required to offer payment in cash equal to 101% of the aggregate principal amount of applicable notes repurchased, plus accrued and unpaid interest, if any, on the applicable notes repurchased to the date of repurchase (the "Change of Control Payment"). Within 30 days following any Change of Control Payment Triggering Event or, at the issuer's option, prior to any Change of Control, but after public announcement of the transaction that constitutes or may constitute the Change of Control, a notice will be mailed to Holders of the notes describing the transaction that constitutes or may constitute the Change of Control Payment Triggering Event and offering to repurchase the applicable notes on the date specified in the notice, which date will be no earlier than 30 days and no later than 60 days from the date such notice is mailed (the "Change of Control Payment Date"). The notice will, if mailed prior to the date of consummation of the Change of Control, state that the offer to purchase is conditioned on the Change of Control Payment Triggering Event occurring on or prior to the Change of Control Payment Date.

On the Change of Control Payment Date, the issuer will, to the extent lawful:

- accept for payment all applicable notes or portions of applicable notes properly tendered pursuant to the Change of Control Offer;

- deposit with the paying agent an amount equal to the Change of Control Payment in respect of all applicable notes or portions of applicable notes properly tendered; and

- deliver or cause to be delivered to the Agent the applicable notes properly accepted together with an officers' certificate stating the aggregate principal amount of applicable notes or portions of applicable notes being repurchased.

The issuer will not be required to make a Change of Control Offer upon the occurrence of a Change of Control Payment Triggering Event if a third party makes such an offer in the manner, at the times and otherwise in compliance with the requirements for an offer made by the issuer and the third party repurchases all notes properly tendered and not withdrawn under its offer. In addition, the issuer will not repurchase any notes if there has occurred and is continuing on the Change of Control Payment Date an Event of Default under the applicable notes (as defined below under "Events of Default"), other than a default in the payment of the Change of Control Payment upon a Change of Control Payment Triggering Event.

The issuer will comply with the requirements of Rule 14e-1 under the Exchange Act, and any other securities laws and regulations thereunder to the extent those laws and regulations are applicable in connection with the repurchase of the applicable notes as a result of a Change of Control Payment Triggering Event. To the extent that the provisions of any such securities laws or regulations conflict with the Change of Control Offer provisions of the notes, the issuer will comply with those securities laws and regulations and will not be deemed to have breached the issuer's obligations under the Change of Control Offer provisions of the notes by virtue of any such conflict.

For purposes of the Change of Control Offer provisions of the notes, the following terms will be applicable:

- "Change of Control" means the occurrence of any of the following: (1) the consummation of any transaction (including, without limitation, any merger, consolidation, amalgamation or other combination) the result of which is that any "person" (as that term is used in Section 13(d)(3) of the Exchange Act) (other than the issuer or one of its Subsidiaries) becomes the beneficial owner (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, of more than 50% of the issuer's voting stock or other voting stock into which the issuer's voting stock is reclassified, consolidated, exchanged or changed, measured by voting power rather than number of shares; (2) the direct or indirect sale, transfer, conveyance or other disposition (other than by way of merger, consolidation, amalgamation or other combination), in one or more series of related transactions, of all or substantially all of the issuer's assets and the assets of the issuer's Subsidiaries, taken as a whole, to one or more "persons" (as that term is used in Section 13(d)(3) of the Exchange Act) (other than the issuer or one of its Subsidiaries); or (3) the first day on which a majority of the members of the issuer's board of directors are not continuing directors. Notwithstanding the foregoing, a transaction will not be deemed to involve a change of control if (1) the issuer becomes a direct or indirect wholly-owned subsidiary of a holding company and (2)(A) the direct or indirect holders of the voting stock of such holding company immediately following that transaction are substantially the same as the holders of the issuer's voting stock immediately prior to that transaction or (B) immediately following that transaction no person (other than a holding company satisfying the requirements of this sentence) is the beneficial owner, directly or indirectly, of more than 50% of the voting stock of such holding company. Although there is a limited body of case law interpreting the phrase "substantially all," there is no precise established definition of the phrase under applicable law. Accordingly, in certain circumstances there may be a degree of uncertainty as to whether a particular transaction would involve a disposition of "all or substantially all" of the issuer's assets. As a result, it may be unclear as to whether a Change of Control has occurred and whether a Holder of a note may require the issuer to make an offer to repurchase the notes as described above.
- "Change of Control Triggering Event" means the occurrence of both a Change of Control and a Rating Event in respect of that Change of Control.
- "Continuing directors" means, as of any date of determination, any member of the issuer's board of directors who (1) was a member of such board of directors on the date the notes were issued; or (2) was nominated for election, elected or appointed to such board of directors with the approval of a majority of the continuing directors who were members of such board of directors at the time of such nomination, election or appointment (either by a specific vote or by approval of the issuer's notice of annual general meeting in which such member was named as a nominee for election as a director, without objection to such nomination).
- "Fitch" means Fitch Ratings.

- “Investment grade rating” means a rating equal to or higher than BBB− (or the equivalent) by Fitch, Baa3 (or the equivalent) by Moody’s and BBB− (or the equivalent) by S&P, or the equivalent investment grade credit rating from any replacement rating agency or rating agencies selected by us.
- “Moody’s” means Moody’s Investors Service, Inc.
- “Rating agencies” means (1) each of Fitch, Moody’s and S&P; and (2) if any of Fitch, Moody’s or S&P ceases to rate the notes or fails to make a rating of the notes publicly available for reasons outside of the issuer’s control, a “nationally recognized statistical rating organization” within the meaning of Rule 15c3-1(c)(2)(vi)(F) under the Exchange Act selected by the issuer (as certified by a resolution of the issuer’s board of directors) as a replacement agency for Fitch, Moody’s or S&P, or all of them, as the case may be.
- “Rating Event” means the rating on the 2017 notes or the 2037 notes, as applicable, is lowered by each of the rating agencies, and the applicable notes are rated below an investment grade rating by each of the rating agencies, on any day within the 60-day period (which 60-day period will be extended so long as the rating of the applicable notes is under publicly announced consideration for a possible downgrade by any of the rating agencies) after the earlier of (1) the occurrence of a Change of Control; and (2) public notice of the occurrence of a Change of Control or the issuer’s intention to effect a Change of Control; *provided, however,* that a Rating Event otherwise arising by virtue of a particular reduction in rating will not be deemed to have occurred in respect of a particular Change of Control (and thus will not be deemed a Rating Event for purposes of the definition of Change of Control Payment Triggering Event) if the rating agencies making the reduction in rating to which this definition would otherwise apply do not announce or publicly confirm or inform the Agent in writing at the issuer’s or its request that the reduction was the result, in whole or in part, of any event or circumstance comprised of or arising as a result of, or in respect of, the applicable Change of Control (whether or not the applicable Change of Control has occurred at the time of the Rating Event).
- “S&P” means Standard & Poor’s Rating Services, a division of The McGraw-Hill Companies, Inc.
- “Voting stock” means, with respect to any specified “person” (as that term is used in Section 13(d)(3) of the Exchange Act) as of any date, the capital stock of such person that is at the time entitled to vote generally in the election of the board of directors of such person.

***Redemption for Tax Reasons***

Each series of notes is also redeemable by the issuer, in whole but not in part, at 100% of the principal amount of such notes plus accrued and unpaid interest to the applicable redemption date (including any Additional Amounts) at the issuer’s option at any time prior to their maturity if due to a Change in Tax Law (as defined below) (i) the issuer, in accordance with the terms of the applicable notes, has, or would, become obligated to pay any Additional Amounts to the Holders or beneficial owners of notes of that series; and (ii) such obligation cannot be avoided by the issuer taking reasonable measures available to it. In such case, the issuer may redeem the applicable notes as a whole, but not in part, upon not less than 30 nor more than 60 days’ notice as provided in “*Notice*” below, at 100% of the principal amount of the applicable notes plus accrued and unpaid interest to the redemption date (including any Additional Amounts); *provided* that, (a) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the issuer would be obligated to pay any such Additional Amounts were a payment in respect of the applicable notes then due and (b) at the time such notice is given, such obligation to pay such Additional Amounts remains in effect. The issuer’s right to redeem the applicable notes shall continue as long as the issuer is obligated to pay such Additional Amounts, notwithstanding that the issuer shall have made payments of Additional Amounts. Prior to the giving of any such notice of redemption, the issuer must deliver to the Agent (1) a certificate stating that the issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the issuer so to redeem have occurred and (2) an opinion of independent counsel of recognized standing selected by the issuer to the effect that the issuer has, or would, become obligated to pay such Additional Amounts as a result of such change or amendment.

For purposes hereof, "Change in Tax Law" shall mean (i) any changes in, or amendment to, any law of a U.K. Taxing Jurisdiction (including any regulations or rulings promulgated thereunder) or any amendment to or change in the application or official interpretation (including judicial or administrative interpretation) of such law, which change or amendment becomes effective on or after October 29, 2007 or (ii) if the issuer consolidates, merges, amalgamates or combines with, or transfers or leases its assets substantially as an entirety to, any person that is incorporated or tax resident under the laws of any jurisdiction other than a U.K. Taxing Jurisdiction and as a consequence thereof such person becomes the successor obligor to the issuer in respect of Additional Amounts that may become payable (in which case, for purposes of this redemption provision, all references to the issuer shall be deemed to be and include references to such person), any change in, or amendment to, any law of the jurisdiction of incorporation of such person or any successor entity, or any political subdivision or taxing authority thereof or thereon for purposes of taxation (including any regulations or rulings promulgated thereunder) or any amendment to or change in the application or official interpretation (including judicial or administrative interpretation) of such law, which change or amendment becomes effective on or after the date of such consolidation, merger, amalgamation, combination or other transaction.

***General***

Upon presentation of any note redeemed in part only, the issuer will execute and the Agent will authenticate and deliver to or on the order of the Holder thereof, at the expense of the issuer, a new note or notes, of authorized denominations, in principal amount equal to the unredeemed portion of the note so presented.

On or before any redemption date, the issuer shall deposit with the Agent money sufficient to pay the redemption price of and accrued interest on the notes to be redeemed on such date. If less than all the notes are to be redeemed, the notes to be redeemed shall be selected by the Agent by such method as the Agent shall deem fair and appropriate and is consistent with the rules of DTC. The redemption price shall be calculated by the Independent Investment Banker and the issuer, and the Agent shall be entitled to rely on such calculation.

On and after any redemption date, interest will cease to accrue on the notes or any portion thereof called for redemption.

***Final Redemption***

Unless previously purchased or redeemed by the issuer or any of its Subsidiaries, and cancelled, the principal amount of the 2017 notes and the 2037 notes will mature and become due and payable on November 15, 2017 and November 15, 2037, respectively, in an amount equal, in each case, to their principal amount, with accrued and unpaid interest to such date.

***Reacquisition***

There is no restriction on the ability of the issuer or any of its Subsidiaries to purchase or repurchase notes, provided that any notes so repurchased shall be cancelled and not reissued.

### Certain Definitions

Set forth below is a summary of certain of the defined terms used in the notes and the FPAA. You should refer to the FPAA for the full definition of all defined terms.

- "Material Subsidiary" means a Subsidiary of the issuer whose profits before tax and extraordinary items or whose net assets (in each case attributable to the issuer) calculated by reference to its latest audited accounts represent ten per cent or more of the consolidated profits before tax and extraordinary items or net assets (in each case attributable to the issuer), as the case may be, of the issuer and its Subsidiaries similarly calculated. A certificate of any two directors of the issuer that in their opinion a Subsidiary is or is not or was or was not at any particular time a Material Subsidiary shall, in the absence of manifest error, be conclusive and binding on all parties.

- "Obligation" means any present or future indebtedness evidenced by notes, bonds, debentures (as defined in Section 744 of the U.K. Companies Act 1985) or other securities which, except where it is the intention of the issuer or the relevant Subsidiary that such securities will not be so quoted or traded, are, at the request or with the concurrence of the issuer or such Subsidiary, quoted or traded for the time being on any stock exchange or other generally recognized market for securities, excluding any secured loan stock listed on the Official List denominated or payable in Sterling and initially distributed primarily to investors in the United Kingdom.

- "Sterling" and "£" means the currency of the United Kingdom.

- "Subsidiary" means a subsidiary within the meaning of Section 736 of the U.K. Companies Act of 1985.

### Covenants of the Issuer

So long as any of the notes remain outstanding neither the issuer nor any of its Subsidiaries will create any mortgage, charge, pledge, lien or other security interest on any of its present or future undertaking or assets or enter into any arrangement, the practical effect of which is to grant similar security, in either case in respect of (i) any Obligation of the issuer or any other person or (ii) any guarantee or indemnity in respect of any Obligation of the issuer or any other person, without at the same time securing the notes and all amounts payable under the applicable FPAA equally and ratably therewith to the satisfaction of the Agent or providing such other security therefor which the Agent in its absolute discretion shall deem not materially less beneficial to the Noteholders or as shall be approved by Holders of a majority of the principal amount of the relevant notes.

The FPAA and the notes do not contain any restrictions on the ability of the issuer or its Subsidiaries (i) to secure indebtedness other than Obligations or (ii) to enter into sale and leaseback transactions.

The notes will not specifically prohibit the issuer from entering into a merger, consolidation or similar combination with or into another party, or transferring all or substantially all of its assets to another party, whether or not the other party becomes liable for the issuer's obligations under the notes. Such a transaction may, however, constitute a Change of Control described under "—Repurchase Upon A Change of Control Offer" or an Event of Default under clause (vi) under "—Events of Default".

The notes will not contain covenants or other provisions to afford protection to the Holders in the event of a highly leveraged transaction or a change in control of the issuer except as provided above.

**Events of Default**

The following will be Events of Default (each an "Event of Default") with respect to the applicable notes:

(i) default in the payment of any installment of interest (excluding Additional Amounts) upon any applicable note as and when the same shall become due and payable, and continuance of such default for 30 days; or

(ii) default in the payment of the applicable Additional Amounts as and when the same shall become due and payable, and continuance of such default for a period of 30 business days; or

(iii) default in the payment of all or any part of the principal of any applicable note as and when the same shall become due and payable either at maturity, upon any redemption, by declaration or otherwise and continuance of such default for two business days; or

(iv) default in the performance or breach of any covenant or warranty of the issuer in respect of the applicable notes or applicable FPAA (other than those described in paragraphs (i), (ii) and (iii) above), and continuance of such default or breach for a period of 60 days after there has been given a written notice, by registered or certified mail, to the issuer by the Agent or to the issuer and the Agent by the Holders of at least 25% in principal amount of the outstanding notes affected thereby, specifying such default or breach and requiring it to be remedied and stating that such notice is a "Notice of Default" under the notes; or

(v) any indebtedness for borrowed money having an aggregate outstanding principal amount of at least £25,000,000 (or its equivalent in any other currency or currencies at the date declared due) of the issuer or any Material Subsidiary shall be or be declared due and payable prior to the date on which the same would otherwise become due and payable by reason of the occurrence of an event of default (howsoever described) in relation thereto or the issuer or any Material Subsidiary defaults in the repayment of any indebtedness for borrowed money having an aggregate outstanding principal amount of at least £25,000,000 (or its equivalent in any other currency or currencies at the date of maturity) at the maturity thereof or at the expiry of any applicable grace period or any guarantee of any such indebtedness given by the issuer or any Material Subsidiary shall not be paid when due and called upon save in any such case where there is a bona fide dispute as to whether payment or repayment is due; or

(vi) the issuer or any Material Subsidiary stops or threatens to stop payment generally or ceases or threatens to cease to carry on its business or a substantial part of its business (except, in the case of a Material Subsidiary, a cessation or threatened cessation for the purpose of a reconstruction or amalgamation the terms of which have previously been approved in writing by a majority of the Holders, or in connection with the transfer of all or the major part of the business, undertaking and assets of such Material Subsidiary to the issuer or a subsidiary of the issuer); or

(vii) an encumbrancer takes possession or an administrative or other receiver is appointed of the whole or any material part of the undertaking or assets of the issuer or any Material Subsidiary or a distress, execution or similar proceeding is levied or enforced upon or sued out against any of the chattels or property of the issuer or any Material Subsidiary and is not discharged within 21 days; or

(viii) the issuer or any Material Subsidiary is deemed unable to pay its debts within the meaning of Section 123(1)(b), (c) or (d) of the Insolvency Act 1986, or the issuer or any Material Subsidiary becomes unable to pay its debts as they fall due or the value of its assets falls to less than the amount of its liabilities (taking into account for both these purposes its contingent and prospective liabilities) or the issuer or any Material Subsidiary otherwise becomes insolvent, or the issuer or any Material Subsidiary suspends making payments (whether principal or interest) with respect to all or any class of its debts or announces an intention to do so or if an administration order in relation to the issuer or any Material Subsidiary is made; or

(ix) an order is made or an effective resolution passed for the winding up of the issuer or any kind of composition, scheme of arrangement, compromise or other similar arrangement involving the issuer or any Material Subsidiary and the creditors of them generally (or any class of such creditors) is entered into or made.

The notes will provide that if an Event of Default occurs and is continuing, then and in each and every such case, unless the principal of all the applicable notes shall have already become due and payable, the Holders of not less than 25% in aggregate principal amount of the applicable notes then outstanding, by notice in writing to the issuer and to the Agent, may declare the entire principal amount of all applicable notes issued pursuant to the applicable FPAA, and interest accrued and unpaid thereon, if any, to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, without any further declaration or other act on the part of any Holder. Under certain circumstances, the Holders of a majority in aggregate principal amount of the applicable notes then outstanding, by written notice to the issuer and the Agent, may waive defaults and rescind and annul declarations of acceleration and its consequences, but no such waiver or rescission and annulment shall extend to or shall affect any subsequent default or shall impart any right consequent thereon.

The Holders of a majority in aggregate principal amount of the applicable notes then outstanding will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Agent, or exercising any trust or power conferred on the Agent, subject to certain limitations to be specified in the FPAA.

An Event of Default with respect to the 2017 notes would not necessarily constitute an event of default with respect to the 2037 notes.

The FPAA will also provide that the issuer will furnish to the Agent on or before June 30 in each year (commencing on June 30, 2008), if any notes are then outstanding, a certificate from an officer as to his or her knowledge of the issuer's compliance with all conditions and covenants under the FPAA, which certificate may merely state that such officer has no knowledge of any default.

**Defeasance**

The notes will provide that the issuer will have the option either (a) to be deemed to have paid and discharged the entire indebtedness represented by, and obligations under, the applicable notes and to have satisfied all the obligations under the applicable notes relating to the applicable notes (except for certain obligations, including those relating to the defeasance trust and obligations to register the transfer or exchange of notes, to replace mutilated, destroyed, lost or stolen notes and to maintain paying agencies) on the 91st day after the applicable conditions described below have been satisfied or (b) to cease to be under any obligation to comply with the covenants described above under "Negative Pledge" under the applicable notes, and non-compliance with such covenants and the occurrence of certain events described above under "Events of Default" will not give rise to any Event of Default under the applicable notes, at any time after the applicable conditions described below have been satisfied.

In order to exercise either defeasance option, the issuer must deposit with the Agent, irrevocably in trust, money or U.S. Government Obligations (as defined in the notes) for the payment of principal of and interest on the outstanding applicable notes to and including the redemption date irrevocably designated by the issuer on or prior to the date of deposit of such money or U.S. Government Obligations, and must comply with certain other conditions, including delivering to the Agent an opinion of U.S. counsel to the effect that "U.S. holders" of the applicable notes (as defined below in "Tax Considerations — Certain United States Federal Income Tax Considerations") will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the exercise of such option and will be subject to U.S. federal income tax on the same amount and in the same manner and at the same time as would have been the case if such option had not been exercised, which opinion, in the case of (a) above, is based on either (i) a change in applicable U.S. federal income tax law since the date of this prospectus or (ii) a ruling received from or published by the United States Internal Revenue Service.

### Modification and Waiver

#### *Without Consent of Noteholders*

Each FPAA will contain provisions permitting the issuer, without the consent of the Holders of any of the applicable notes at any time outstanding, from time to time and at any time, to enter into a fiscal and paying agency agreement or fiscal and paying agency agreements supplemental thereto:

- to convey, transfer, assign, mortgage or pledge to the Agent as security for the applicable notes any property or assets;
- to evidence the succession of another person to the issuer, or successive successions, and the assumption by the successor person of the covenants, agreements and obligations of the issuer, pursuant to the FPAA;
- to evidence and provide for the acceptance of appointment of a successor or successors to the Agent in any of its capacities;
- to add to the covenants of the issuer, such further covenants, restrictions, conditions or provisions as the issuer shall consider to be for the protection of the Holders of the applicable notes, and to make the occurrence, or the occurrence and continuance, of a default in any such additional covenants, restrictions, conditions or provisions an Event of Default under the notes permitting the enforcement of all or any of the several remedies provided in the applicable FPAA; *provided* that, in respect of any such additional covenant, restriction, condition or provision, such supplemental FPAA may provide for a particular period of grace after default (which may be shorter or longer than that allowed in the case of other defaults) or may provide for an immediate enforcement upon such an Event of Default or may limit the right of Holders of a majority in aggregate principal amount of the applicable notes to waive such an Event of Default;
- to modify the restrictions on, and procedures for, resale and other transfers of the applicable notes pursuant to law, regulation or practice relating to the resale or transfer of restricted securities generally;
- to cure any ambiguity or to correct or supplement any provision contained in the FPAA which may be defective or inconsistent with any other provision contained therein or to make such other provision in regard to matters or questions arising under the applicable notes as the issuer may deem necessary or desirable and which will not adversely affect the interests of the Holders of the applicable notes in any material respect; and
- to "reopen" the applicable series of notes and create and issue additional notes having identical terms and conditions as the applicable notes (or in all respects except for the issue date, issue price, payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes) so that the additional notes are consolidated and form a single series with the outstanding applicable notes.

#### *With Consent of Noteholders*

The FPAA will contain provisions permitting the issuer and the Agent, with the consent of the Holders of not less than a majority in aggregate principal amount of the applicable notes at the time outstanding (including consents obtained in connection with a tender offer or exchange offer for the applicable notes), from time to time and at any time, to enter into a fiscal and paying agency agreement or fiscal and paying agency agreements supplemental hereto for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the applicable notes or of modifying in any manner the rights of the Holders of the applicable notes, *provided* that no such fiscal and paying agency agreement may, without the consent of the Holder of each of the notes so affected:

- change the stated maturity of the applicable note of, or the date for payment of any principal of, or installment of interest on, any note; or

- reduce the principal amount of or the rate or amount of interest on any note or Additional Amounts payable with respect thereto or reduce the amount payable thereon in the event of redemption or default; or
- change the currency of payment of principal of or interest on any applicable note or Additional Amounts payable with respect thereto; or
- change the obligation of the issuer to pay Additional Amounts (except as otherwise permitted by such applicable note); or
- impair the right to institute suit for the enforcement of any such payment on or with respect to any applicable note; or
- reduce the percentage of the aggregate principal amount of the applicable notes outstanding, the consent of whose Holders is required for any such supplemental fiscal and paying agency agreement;

provided that no consent of any Holder of any applicable note shall be necessary to permit the Agent and the issuer to execute supplemental fiscal and paying agency agreements as described under "Modification and Waiver — Without Consent of Holders" above.

Any modifications, amendments or waivers to the FPAA or to the conditions of the applicable notes will be conclusive and binding on all Holders of the applicable notes, whether or not they have consented to such action or were present at the meeting at which such action was taken, and on all future holders of the applicable notes, whether or not notation of such modifications, amendments or waivers is made upon such notes. Any instrument given by or on behalf of any Holder of such a note in connection with any consent to any such modification, amendment or waiver will be irrevocable once given and will be conclusive and binding on all subsequent registered holders of such note.

**Prescription**

Under New York's statute of limitations, any legal action upon the notes in respect of interest or principal must be commenced within six years after the payment thereof is due. Thereafter the notes will become generally unenforceable.

**Notice**

So long as the notes are listed on the Official List of the U.K. Listing Authority and admitted to trading on the London Stock Exchange Professional Securities Market, notices to Holders of notes will be given by publication in a leading newspaper having general circulation in London, England (which is expected initially to be the *Financial Times*). Notices to Holders of notes will also be given by first-class mail postage prepaid to the last addresses of such Holders as they appear in the notes register. Such notices will be deemed to have been given on the date of such publication or mailing.

**Listing**

Application has been made to list the notes on the Official List of the U.K. Listing Authority and for the admission of the notes to trading on the London Stock Exchange Professional Securities Market. The issuer has agreed to use its reasonable best efforts to maintain any such listing and admission to trading of the notes for so long as any of the notes remain outstanding.

**Consent to Service**

The issuer will initially designate Fresh & Easy Neighborhood Market Inc., 2120 Park Place, Suite 200, El Segundo, California 90245, Attention: General Counsel, as its authorized agent for service of process in any legal suit, action or proceeding arising out of or relating to the performance of its obligations under the FPAA and the notes brought in any state or federal court in the Borough of Manhattan, the City of New York, and will irrevocably submit (but for those purposes only) to the non-exclusive jurisdiction of any such court in any such suit, action or proceeding.

### Governing Law

The notes and the FPAA shall be governed by and construed in accordance with the laws of the State of New York, without regard to principles of conflicts of laws thereof.

### Regarding the Agent

In acting under the FPAA and in connection with the notes, the Agent is acting solely as agent of the issuer and does not assume any obligation towards or relationship of agency or trust for or with the owners or Holders of the notes, except that any funds held by the Agent for payment of principal of or interest on the notes or Additional Amounts with respect thereto shall be held in trust by it for such owners and such Holders and applied as set forth in the notes, but need not be segregated from other funds held by it except as required by law. For a description of the duties and immunities and rights of the Agent under the FPAA, reference is made to the FPAA, and the obligations of the Agent are subject to such immunities and rights.

## BOOK ENTRY; DELIVERY AND FORM

The notes that are initially offered and sold in the United States to QIBs (the "Rule 144A notes") will be represented by beneficial interests in two or more Rule 144A global notes in registered form without interest coupons, which will be deposited on or about the closing date of the offering of the notes with Citibank, N.A., London Branch, as custodian (the "Custodian") for DTC and registered in the name of Cede & Co. as nominee of DTC.

The notes that are offered and sold in reliance on Regulation S (the "Regulation S global notes") will be represented by beneficial interests in two or more Regulation S global notes in registered form without interest coupons, which will be deposited on or about the closing date of the offering of the notes with the Custodian, and registered in the name of Cede & Co., as nominee of DTC. Investors may hold their interests in the global notes directly through DTC if they are participants in, or indirectly through organizations that are participants in, such systems. Euroclear and Clearstream will hold interests in the Regulation S global notes on behalf of their participants through customers' securities accounts in their respective names on the books of their respective depositaries, which are participants in DTC.

So long as DTC or its nominee is the registered holder of a global note, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the applicable notes represented by the applicable global note for all purposes under the applicable FPAA and the applicable notes (except as the context otherwise requires in respect of Additional Amounts). The notes (including beneficial interests in the global notes) will be subject to certain restrictions on transfer set forth therein and in the FPAA and will bear a legend regarding such restrictions as set forth under "— Transfer Restrictions". Under certain circumstances, transfers may be made only upon receipt by the Agent, in its capacity as transfer agent, of a written certification (in the form set out in the applicable FPAA).

### Transfers within Global Notes

Subject to the procedures and limitations described herein, transfers of beneficial interests within a global note may be made without delivery to the issuer or the Agent of any written certifications or other documentation by the transferor or transferee.

### Transfers between Global Notes

A beneficial interest in a Rule 144A global note may be transferred to a person who wishes to take delivery of such beneficial interest through the applicable Regulation S global note only upon receipt by the Agent of a written certification (in the form set out in the FPAA) from the transferor to the effect that such transfer is being made in accordance with Rule 903 or 904 of Regulation S or, in the case of an exchange occurring following the Specified Date, Rule 144. Prior to the expiration of the distribution compliance period, a beneficial interest in a Regulation S global note may be transferred to a person who wishes to take delivery of such beneficial interest through the applicable Rule 144A global note only upon receipt by the Agent of a written certification (in the form set out in the FPAA) from the transferor to the effect that such transfer is being made to a person whom the transferor reasonably believes is a Qualified Institutional Buyer ("QIB") within the meaning of Rule 144A, in a transaction meeting the requirements of Rule 144A and in accordance with any applicable securities laws of any state of the United States and any other jurisdiction. After the expiration of the distribution compliance period, such certification requirements will no longer apply to such transfers, but such transfers will continue to be subject to applicable transfer restrictions under the Securities Act and the laws of any state of the United States and other jurisdictions. Any beneficial interest in a Rule 144A global note or a Regulation S global note that is transferred to a person who takes delivery in the form of a beneficial interest in the other global note will, upon transfer, cease to be a beneficial interest in such global note and become a beneficial interest in the other global note and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to a beneficial interest in such other global note for so long as such person retains such an interest.

**Transfers or Exchanges from Global Notes to Definitive Notes**

No global note may be exchanged in whole or in part for notes in definitive registered form ("definitive notes") unless:

- DTC notifies the issuer that it is unwilling or unable to hold the applicable global note or DTC ceases to be a clearing agency registered under the Exchange Act, and in each case the issuer does not appoint a successor depositary that is registered under the Exchange Act within 90 days;
- a payment default has occurred and is continuing;
- in the event of a bankruptcy default, the issuer fails to make payment on the applicable notes when due; or
- the issuer shall have determined in its sole discretion that the applicable notes shall no longer be represented by global notes.

The Holder of a definitive note may transfer such note by surrendering it at the specified office of the Agent. Upon the transfer, exchange or replacement of definitive Rule 144A notes bearing the applicable legend set forth under "Transfer Restrictions", or upon specific request for removal of such legend on a definitive note, the issuer will deliver only definitive notes that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the issuer and the Agent such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the issuer, that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

Each such definitive note will include terms substantially in the form of those set forth in the FPAA. Except as set forth herein, no global note may be exchanged in whole or in part for definitive notes.

**Clearing and Settlement**

The information set out below in connection with DTC is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC currently in effect. The information about DTC set forth below has been obtained from sources that the issuer believes to be reliable, but none of the issuer or any of the initial purchasers takes any responsibility for the accuracy of the information. None of the issuer or any of the initial purchasers will have any responsibility or liability for any aspect of the records relating to, or payments made on account of interests in notes held through, the facilities of any clearing system, or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

DTC has advised the issuer as follows: DTC is a limited purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for DTC participants and to facilitate the clearance and settlement of transactions between DTC participants through electronic book entry changes in accounts of DTC participants, thereby eliminating the need for physical movement of certificates. DTC participants include certain of the initial purchasers, securities brokers and dealers, banks, trust companies, clearing corporations and may in the future include certain other organizations ("DTC participants"). Indirect access to the DTC system is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly ("indirect DTC participants").

Under the rules, regulations, and procedures creating and affecting DTC and its operations (the "Rules"), DTC is required to make book-entry transfers of notes among DTC participants on whose behalf it acts with respect to notes accepted into DTC's book-entry settlement system as described below (the "DTC notes") and to receive and transmit distributions of the nominal amount and interest on the DTC notes. DTC participants and indirect DTC participants with which beneficial owners of DTC notes ("Owners") have accounts with respect to the DTC notes similarly are required to make book-entry transfers and receive and transmit such payments on behalf of their respective Owners. Accordingly, although Owners who hold DTC notes through DTC participants or indirect DTC participants will not possess notes, the Rules, by virtue of the requirements described above, provide a mechanism by which such Owners will receive payments and will be able to transfer their interests with respect to the notes.

Transfers of ownership or other interests in the notes in DTC may be made only through DTC participants. Indirect DTC participants are required to effect transfers through a DTC participant. DTC has no knowledge of the actual beneficial owners of the notes. DTC's records reflect only the identity of the DTC participants to whose accounts the notes are credited, which may not be the beneficial owners. DTC participants will remain responsible for keeping account of their holdings on behalf of their customers and for forwarding all notices concerning the notes to their customers.

So long as DTC, or its nominee, is the registered holder of a global note, payments on the applicable notes will be made in immediately available funds to DTC. DTC's practice is to credit DTC participants' accounts on the applicable payment date in accordance with their respective holdings shown on its records, unless DTC has reason to believe that it will not receive payment on that date. Payments by DTC participants to beneficial owners will be governed by standing instructions and customary practices, and will be the responsibility of the DTC participants and not of DTC, or any other party, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment to DTC is the responsibility of the Agent. Disbursement of payments for DTC participants will be DTC's responsibility, and disbursement of payments to the beneficial owners will be the responsibility of DTC participants and indirect DTC participants.

Because DTC can only act on behalf of DTC participants, who in turn act on behalf of indirect DTC participants, and because owners of beneficial interests in the notes holding through DTC will hold interests in the notes through DTC participants or indirect DTC participants, the ability of the owners of the beneficial interests to pledge notes to persons or entities that do not participate in DTC, or otherwise take actions with respect to the notes, may be limited. DTC will take any action permitted to be taken by an Owner only at the direction of one or more DTC participants to whose account with DTC such Owner's DTC notes are credited. Additionally, DTC has advised the issuer that it will take such actions with respect to any percentage of the beneficial interest of Owners who hold notes through DTC participants or Indirect Participants only at the direction of and on behalf of DTC participants whose account holders include undivided interests that satisfy any such percentage.

To the extent permitted under applicable law and regulations, DTC may take conflicting actions with respect to other undivided interests to the extent that such actions are taken on behalf of DTC participants whose account holders include such undivided interests.

Ownership of interests in the Rule 144A global notes and the Regulation S global notes will be shown on, and the transfer of that ownership will be effected only through records maintained by, DTC, the DTC participants and the indirect DTC participants, including Euroclear and Clearstream. Transfers between participants in DTC, as well as transfers between participants in Euroclear and Clearstream will be effected in the ordinary way in accordance with DTC rules.

Subject to compliance with the transfer restrictions applicable to the notes, cross-market transfers between DTC, on the one hand, and participants in Euroclear or Clearstream on the other hand, will be effected in DTC in accordance with DTC rules on behalf of Euroclear or Clearstream as the case may be. Such cross-market transactions, however, will require delivery of instructions to Euroclear or Clearstream, as the case may be, by the counterparty in such system in accordance with its rules and procedures and within its established deadlines. Euroclear or Clearstream, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to DTC to take action to effect final settlement on its behalf by delivering or receiving payment in accordance with DTC's Same-Day Funds Settlement System.

According to DTC, the foregoing information with respect to DTC has been provided to the industry for informational purposes only and is not intended to serve as a representation, warranty or contract modification of any kind. Although DTC, Euroclear and Clearstream have agreed to the foregoing procedures in order to facilitate transfers of interests in the global notes among participants of DTC, Euroclear and Clearstream they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at anytime. Neither the issuer nor the Agent will have any responsibility for the performance by DTC, Euroclear or Clearstream or their respective participants or indirect participants, of their respective obligations under the rules and procedures governing their operations.

**Initial Settlement in Relation to DTC Notes**

Upon the issue of a Regulation S global note and/or a Rule 144A global note (a “DTC note”) deposited with DTC or a custodian therefor, DTC or its custodian, as the case may be, will credit, on its internal system, the respective nominal amount of the individual beneficial interest represented by such relevant DTC note or notes to the accounts of persons who have accounts with DTC. Such accounts initially will be designated by or on behalf of the relevant initial purchasers. Ownership of beneficial interest in a DTC note will be limited to DTC participants, including Euroclear and Clearstream or indirect DTC participants. Ownership of beneficial interests in DTC notes will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of DTC participants) and the records of DTC participants (with respect to interests of indirect DTC participants). Investors that hold their interests in a DTC note will follow the settlement procedures applicable to global bond issues. Investors’ securities custody accounts will be credited with their holdings against payment in same-day funds on the settlement date.

**Secondary Market Trading in Relation to DTC Notes**

Since the purchaser determines the place of delivery, it is important to establish at the time of the trade where both the purchaser’s and seller’s accounts are located to ensure that settlement can be made on the desired value date. Although DTC has agreed to the following procedures in order to facilitate transfers of interests in global notes deposited with DTC or a custodian therefor among participants of DTC, DTC is under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the issuer nor any agent of the issuer will have any responsibility for the performance by DTC or its participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

Secondary market trading between DTC participants will be settled using the procedures applicable to global bond issues in same-day funds.

**Payments**

So long as any of the notes remains outstanding, the issuer will maintain in London, England, so long as the notes are admitted to trading on the London Stock Exchange Professional Securities Market, an office or agency (a) where the applicable notes may be presented for payment, (b) in the case of the issuer, where the applicable notes may be presented for registration of transfer and for exchange and (c) where notices and demands to or upon the issuer in respect of the notes or the FPAA may be served. The issuer will give the Agent written notice of the location of any such office or agency and of any change of location thereof. The issuer will initially designate the Agent for such purposes. The issuer may also from time to time designate one or more other offices or agencies where the notes may be presented or surrendered for any or all such purposes or where such notices or demands may be served and may from time to time rescind such designations; *provided*, *however*, that no such designation or rescission shall in any manner relieve the issuer of any obligation to maintain an office or agency in London, England for such purposes; and *provided* further, however, that the issuer will, to the extent possible as a matter of law, maintain a paying agent with a specified office in a Member State of the EU that will not be obligated to withhold or deduct tax pursuant to EU Directive 2003/48/EC on the taxation of savings or any law implementing or complying with, or introduced in order to conform to, the Directive. The issuer shall give written notice to the Agent of any such designation or rescission and of any such change in the location of any other office or agency.

A Holder of notes may transfer or exchange notes in accordance with their terms. The Agent will not be required to accept for registration or transfer any notes, except upon presentation of satisfactory evidence (which may include legal opinions) that the restrictions on transfer have been complied with, all in accordance with such reasonable regulations as the issuer may from time to time agree with such Agent.

Notwithstanding any statement herein, the issuer reserves the right to impose or remove such transfer, certification, substitution or other requirements, and to require such restrictive legends on the notes, as they may determine are necessary to ensure compliance with the securities laws of the United States and the states therein and any other applicable laws or as may be required by any stock exchange on which the notes are listed. The issuer may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with any exchange or registration of transfer of notes and any other expenses (including the fees and expenses of the Agent). No service charge will be made for any such transaction.

The Agent will not be required to exchange or register a transfer of (i) any notes for a period of 15 days ending the due date for any payment of principal in respect of the notes or the first mailing of any notice of redemption of notes to be redeemed or (ii) any notes selected, called or being called for redemption.

The notes will be issued in registered form without coupons and transferable in denominations of $100,000 and integral multiples of $1,000 in excess thereof.

The laws of some jurisdictions require that certain persons take physical delivery in definitive form of securities which they own. Consequently, the ability to transfer beneficial interests in the global notes is limited to such extent.

## TAX CONSIDERATIONS

*The following summary of material U.S. federal income and United Kingdom tax considerations is based upon laws, regulations, decrees, rulings, administrative practice and judicial decisions in effect at the date of this prospectus. Legislative, judicial or administrative changes or interpretations may, however, be forthcoming. Any such changes or interpretations could affect the tax consequences to holders of the notes, possibly on a retroactive basis, and could alter or modify the statements and conclusions set forth herein. This summary does not purport to be a legal opinion or to address all tax aspects that may be relevant to a holder of the notes. Prospective purchasers of the notes are advised to consult their own tax advisers as to the tax consequences, under the tax laws of the country of which they are resident, of a purchase of notes including, without limitation, the consequences of the receipt of interest and (if applicable) any premium on, and of the sale or redemption of, the notes or any interest therein.*

### Certain United States Federal Income Tax Considerations

**This summary has been written in connection with the marketing of the notes. It was not intended or written to be used, and cannot be used by any taxpayer, for the purpose of avoiding U.S. federal income tax penalties. Investors should consult their own tax advisors in determining the tax consequences to them of investing in the notes, including the application to their particular situation of the U.S. federal income tax considerations discussed below, as well as the application of state, local, foreign or other tax laws**.

The following is a summary of certain U.S. federal income tax considerations that may be relevant to a beneficial owner of the notes that is a citizen or resident of the U.S. or a domestic corporation or that otherwise is subject to U.S. federal income taxation on a net income basis in respect of the notes (a "U.S. holder"). This summary is based on laws, regulations, rulings and decisions now in effect, all of which are subject to change. This summary deals only with U.S. holders that will hold the notes as capital assets and that will purchase the notes in the initial offering at the issue price (i.e., the first price at which a substantial amount of the notes is sold for money, other than to bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers). It does not address tax considerations applicable to investors that may be subject to special tax rules, such as banks, tax-exempt entities, insurance companies, dealers in securities or currencies, traders in securities electing to mark to market, certain short-term holders of the notes, persons that hedge their exposure in the notes or will hold notes as a position in a straddle or conversion transaction, or as part of a synthetic security or other integrated financial transaction or persons that have a functional currency other than the U.S. dollar. U.S. holders should be aware that the U.S. federal income tax consequences of holding the notes may be materially different for investors described in the prior sentence.

#### *Taxation of Interest*

Payments of interest on the notes (including any payment of Additional Amounts) will be taxable to a U.S. holder as ordinary interest income at the time that such payments are accrued or are received in accordance with the U.S. holder's method of tax accounting.

Interest paid on a note (including a payment of any Additional Amounts) generally will constitute foreign-source "passive category income" or, in the case of certain U.S. holders, "general category income" for purposes of computing the U.S. holder's foreign tax credit allowable under U.S. federal income tax laws. The calculation of foreign tax credits (and, in the case of a U.S. holder that elects to deduct foreign taxes, the availability of such deduction) involves the application of rules that depend on a U.S. holder's particular circumstances. U.S. holders should consult their own tax advisors regarding the availability of foreign tax credits and the treatment of Additional Amounts.

#### *Taxation of Capital Gains*

Upon the sale, exchange or retirement of a note, a U.S. holder generally will recognize capital gain or loss equal to the difference between the amount realized on the sale, exchange or retirement (less any accrued interest, which will be taxable as such) and the U.S. holder's tax basis in such note (generally its cost less any principal payments previously received). Any such capital gain or loss generally will be U.S.-source capital gain or loss and will be long-term capital gain or loss, subject to taxation at reduced rates for non-corporate taxpayers, if the note was held for more than one year. The deductibility of capital losses is subject to limitations.

#### *Information Reporting and Backup Withholding*

Interest on the notes, and payments of the proceeds of a sale of notes, that are paid within the U.S. or through certain U.S.-related financial intermediaries generally are subject to information reporting and may be subject to backup withholding unless (i) the holder is a corporation or other exempt recipient or (ii) provides a taxpayer identification number and certifies that no loss of exemption has occurred. Holders of the notes who are not U.S. holders may be required to comply with applicable certification procedures to establish that they are not U.S. holders (generally by furnishing Form W-8BEN) in order to avoid the application of such information reporting requirements and backup withholding tax. Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against a holder's U.S. federal income tax liability. A holder may obtain a refund of any excess amounts withheld under the backup withholding rules by timely filing the appropriate claim for refund with the Internal Revenue Service and furnishing any required information.

### Certain United Kingdom Tax Considerations

#### *General*

The following summary is a general description of the principal U.K. tax consequences of an investment in the notes by certain investors who are neither resident nor (in the case of individuals) ordinarily resident in the United Kingdom ("non-U.K. investors"). It is based on the issuer's understanding of current U.K. tax law and H.M. Revenue & Customs ("HMRC") practice. Such law may be repealed, revoked or modified (possibly with retrospective effect) and such practice may change, resulting in U.K. tax consequences different from those discussed below. The summary below does not purport to be a complete analysis of all U.K. tax considerations relating to the notes for non-U.K. investors. The comments relate only to the position of non-U.K. investors who are absolute beneficial owners of notes and some aspects do not apply to certain classes of taxpayer, such as dealers in securities or persons who are connected with the issuer for tax purposes, to whom special rules may apply.

**Prospective investors should consult their own professional advisers as to the tax consequences of the purchase, ownership and disposal of notes in light of their own particular circumstances, including the effect of any state, local or other national laws. No representations with respect to the tax consequences for any particular investor of notes are made below.**

#### *Interest on the notes*

The references to "interest" in the following summary mean "interest" as understood in U.K. tax law. No account is taken in any of the following statements of any different definitions of "interest" or "principal" which may prevail under any other law or which may be created by the terms and conditions of the notes or any related documentation.

##### *Withholding tax*

So long as the notes are and continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the "Act"), they will constitute "quoted Eurobonds" within the meaning of section 987 of the Act. In the case of notes to be traded on the London Stock Exchange, which is a "recognised stock exchange" within the meaning of section 1005 of the Act, this condition will be satisfied if the notes are listed on the Official List and admitted to trading on the London Stock Exchange. Accordingly, payments of interest on the notes may be made without withholding or deduction for or on account of U.K. income tax provided the notes remain so listed and admitted at the time of payment.

In other cases, interest on the notes will be paid under deduction on account of U.K. income tax at the lower rate (currently 20%), subject to any direction to the contrary from HMRC in respect of such relief as may be available pursuant to the provisions of any applicable double taxation treaty and subject to any other exemption which may apply.

If interest is paid under deduction of U.K. income tax, non-U.K. investors may be able to recover all or part of the U.K. tax deducted if there is an appropriate provision in an applicable double taxation treaty. For example, certain residents of the United States may qualify for benefits under the income and capital gains tax convention between the United States and the United Kingdom that was signed on 24 July 2001 (and amended by a Protocol signed on 19 July 2002).

*Direct assessment*

Interest paid on the notes will have a U.K. source and accordingly may be chargeable to U.K. tax by direct assessment. Where the interest is paid without withholding or deduction for or on account of U.K. income tax, the interest will not be assessed to U.K. tax in the hands of non-U.K. investors, except where such persons carry on a trade, profession or vocation in the United Kingdom through a U.K. branch or agency (in the case of an individual) or a permanent establishment (in the case of a company) in connection with which the interest is received or to which the notes are attributable. In such a case, U.K. tax may (subject to exemptions for interest received by certain categories of agent) be levied on the U.K. branch or agency or permanent establishment.

The provisions relating to Additional Amounts referred to in "Description of the Notes — Payment of Additional Amounts" would not apply if HMRC sought to assess directly the person entitled to the relevant interest to U.K. tax. However exemption from, or reduction of, such U.K. tax liability might be available under an applicable double taxation treaty.

*Provision of information*

Persons in the United Kingdom (including the issuer) by or through whom interest is paid to, or by whom interest is received on behalf of, an individual (whether resident in the United Kingdom or elsewhere) may be required to provide certain information to HMRC regarding the payment and the identity of the payee or person entitled to the interest. In certain circumstances, such information may be exchanged with tax authorities in other jurisdictions.

*EU Directive on the Taxation of Savings Income*

Under European Council Directive 2003/48/EC on the taxation of savings income, each Member State of the European Union is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to an individual resident in that other Member State; however, for a transitional period, Austria, Belgium and Luxembourg will instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35 per cent, unless during such period they elect otherwise.

A number of non-EU countries, and certain dependent or associated territories of certain Member States, have agreed to adopt similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to an individual resident in a Member State. In addition, the Member States have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to an individual resident in one of those territories.

***Disposal (including redemption) of the notes***

Non-U.K. investors will not be liable to U.K. taxation in relation to any profits or gains realized on the sale or other disposal or redemption of notes unless they carry on a trade, profession or vacation in the United Kingdom through a U.K. branch or agency (in the case of an individual) or a U.K. permanent establishment (in the case of a corporate investor) and such notes are or have been used or acquired for the purposes of such trade, profession or vocation, or such branch or agency or permanent establishment.

***Stamp duty/stamp duty reserve tax***

No U.K. stamp duty or stamp duty reserve tax is payable on the issue of the notes or on a transfer of the notes.

## PLAN OF DISTRIBUTION

Pursuant to a purchase agreement dated October 29, 2007 (the "purchase agreement"), the initial purchasers have severally agreed with the issuer, subject to the satisfaction of certain conditions, to purchase $850 million principal amount of the 2017 notes and $1.15 billion principal amount of the 2037 notes. The respective principal amount of 2017 notes and 2037 notes to be purchased by each of the initial purchasers from the issuer is set forth opposite their respective names below:

| Initial Purchaser | Principal Amount of 2017 notes | Principal Amount of 2037 notes |
|---|---|---|
| Citigroup Global Markets Inc. | $ 425,000,000 | $ 575,000,000 |
| J.P. Morgan Securities Inc. | 255,000,000 | 345,000,000 |
| BNP Paribas Securities Corp. | 170,000,000 | 230,000,000 |
| Total | $ 850,000,000 | $ 1,150,000,000 |

The purchase agreement entitles the initial purchasers to terminate the purchase of the notes in certain circumstances prior to payment to the issuer. The issuer has agreed to indemnify the initial purchasers against certain liabilities in connection with the offer and sale of the notes and may be required to contribute to payments the initial purchasers may be required to make in respect thereof.

The initial purchasers initially propose to offer part or all of the notes at the offering prices set forth on the cover page hereof. After the initial offering of the notes, the offering prices may from time to time be varied by the initial purchasers.

The issuer will not for a period of 15 days following the date of the purchase agreement, without the prior written consent of Citigroup Global Markets Inc. offer, sell, contract to sell, pledge, otherwise dispose of, or enter into any transaction which is designed to, or might reasonably be expected to, result in the disposition (whether by actual disposition or effective economic disposition due to cash settlement or otherwise) by the issuer or any affiliate of the issuer or any person in privity with the issuer or any affiliate of the issuer), directly or indirectly, or announce the offering, of any debt securities issued or guaranteed by the issuer (other than the notes) that are denominated in U.S. dollars, sold primarily in the U.S. market and issued in an aggregate principal amount of $250 million or more.

The notes are new issues of securities with no established trading market. The notes are expected to be admitted to trading on the London Stock Exchange Professional Securities Market. The initial purchasers are not obligated to make a market in the notes and accordingly no assurance can be given as to the liquidity of, or trading market for, the notes. In connection with the offering, Citigroup Global Markets Inc. and J.P. Morgan Securities Inc. (the "representatives") may purchase and sell notes in the open market. These transactions may include over-allotment, syndicate covering transactions and stabilizing transactions. Over-allotment involves syndicate sales of notes in excess of the principal amount of the notes to be purchased by the representatives in the offering, which creates a syndicate short position. Syndicate covering transactions involve purchases of the notes in the open market after the distribution has been completed in order to cover syndicate short positions. Stabilizing transactions consist of certain bids or purchases of notes made for the purpose of pegging, fixing or maintaining the price of the notes.

The representatives may impose a penalty bid. Penalty bids permit the representatives to reclaim selling concessions from a syndicate member when they, in covering syndicate positions or making stabilizing purchases, repurchase notes originally sold by that syndicate member.

Any of these activities may cause the price of the notes to be higher than the price that otherwise would exist in the open market in the absence of such transactions. These transactions may be effected in the over-the-counter market or otherwise and, if commenced, may be discontinued at any time at the sole discretion of the representatives, as applicable.

No action has been or will be taken in any jurisdiction that would permit a public offering of the notes or the possession, circulation or distribution of any material relating to the issuer in any jurisdiction where action for such purpose is required. Accordingly, the notes may not be offered or sold, directly or indirectly, nor may any offering material or advertisement in connection with the notes (including this document and any amendment or supplement hereto) be distributed or published, in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

The initial purchasers and their affiliates have performed certain investment and commercial banking or financial advisory services for us and our affiliates from time to time, for which they have received customary fees and commissions, and they expect to provide these services to us and our affiliates in the future, for which they expect to receive customary fees and commissions. In addition, affiliates of some of the initial purchasers are lenders under certain of our credit facilities. Citibank, N.A., London Branch, acting as the Agent and the Custodian, is an affiliate of Citigroup Global Markets Inc.

**United States**

The notes have not been and will not be registered under the Securities Act and may not be offered or sold within the U.S. or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act Accordingly, the notes are being offered and sold only (i) outside the U.S. in reliance on Regulation S under the Securities Act and (ii) within the U.S. to QIBs in accordance with Rule 144A.

Each initial purchaser has represented and agreed with the issuer that, except as permitted by the purchase agreement, (i) it has not offered or sold, and will not offer or sell, any notes within the United States as part of their distribution at any time except (x) to those it reasonably believes to be "qualified institutional buyers" (as defined in Rule 144A under the Act) or (y) in accordance with Rule 903 of Regulation S, (ii) neither it nor any person acting on its behalf has made or will make offers or sales of the notes in the United States by means of any form of general solicitation or general advertising (within the meaning of Regulation D) in the United States, (iii) in connection with each sale pursuant to (i)(x), it has taken or will take reasonable steps to ensure that the purchaser of such notes is aware that such sale may be made in reliance on Rule 144A, (iv) neither it, nor any of its affiliates nor any person acting on its or their behalf has engaged or will engage in any directed selling efforts (within the meaning of Regulation S) with respect to the notes and (v) it is an "accredited investor" (as defined in Rule 501(a) of Regulation D);

Terms used in the preceding two paragraphs have the meanings ascribed to them by Regulation S under the Securities Act.

In addition, until 40 days after the commencement of the offering of the notes, an offer or sale of notes within the U.S. by any dealer (whether or not participating in the offering of the notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the Securities Act.

The purchase agreement also provides that the initial purchasers or their affiliates may arrange for the placing of a portion of the notes to persons reasonably believed to be QIBs pursuant to Rule 144A under the Securities Act.

**United Kingdom**

Each initial purchaser has represented and agreed with the issuer that:

- it has communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "FSMA") received by it in connection with the issue or sale of any notes in circumstances in which section 2(1) of the FSMA does not apply to the issuer; and
- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the notes in, from or otherwise involving the United Kingdom.

### Other

Each initial purchaser has represented and agreed with the issuer that it will, to the best of its knowledge, comply with all relevant laws, regulations and directives in each jurisdiction in which it purchases, offers, sells or delivers notes or has in its possession or distributes this prospectus or any amendment or supplement thereto, in so far as such laws, regulations and directives relate to the purchase, offer, sale or delivery of the notes or the possession or distribution of this prospectus or any amendment or supplement thereto.

## NOTICE TO INVESTORS

The notes have not been registered under the Securities Act or any state securities laws and, unless so registered, may not be offered or sold except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the notes offered hereby are being offered and sold only to qualified institutional buyers (as defined in Rule 144A under the Securities Act) in reliance on Rule 144A under the Securities Act and in offshore transactions in reliance on Regulation S under the Securities Act.

Each purchaser of notes, by its acceptance thereof, will be deemed to have acknowledged, represented to and agreed with us and the initial purchasers as follows:

1. It understands and acknowledges that the notes have not been registered under the Securities Act or any other applicable securities law, are being offered for resale in transactions not requiring registration under the Securities Act or any other securities law, including sales pursuant to Rule 144A under the Securities Act, and may not be offered, sold or otherwise transferred except in compliance with the registration requirements of the Securities Act or any other applicable securities law, pursuant to an exemption therefrom or in any transaction not subject thereto and in each case in compliance with the conditions for transfer set forth in paragraphs (4) and (5) below.

2. It is not an "affiliate" (as defined in Rule 144 under the Securities Act) of ours or acting on our behalf and it is either:

   (i) a qualified institutional buyer, or QIB, within the meaning of Rule 144A under the Securities Act and is aware that any sale of notes to it will be made in reliance on Rule 144A under the Securities Act, of which the acquisition will be for its own account or for the account of another QIB; or

   (ii) is purchasing the notes in an offshore transaction in accordance with Regulation S under the Securities Act.

3. It acknowledges that neither we nor the initial purchasers, nor any person representing us, our subsidiaries or the initial purchasers, has made any representation to it with respect to the offering or sale of any notes, other than the information contained in this prospectus, which prospectus has been delivered to it and upon which it is relying in making its investment decision with respect to the notes. It has had access to such financial and other information concerning us and the notes as it has deemed necessary in connection with its decision to purchase any of the notes.

4. It is purchasing the notes for its own account, or for one or more investor accounts for which it is acting as a fiduciary or agent, in each case for investment, and not with a view to, or for offer or sale in connection with, any distribution thereof in violation of the Securities Act or any state securities laws, subject to any requirement of law that the disposition of its property or the property of such investor account or accounts be at all times within its or their control and subject to its or their ability to resell such notes pursuant to Rule 144A, Regulation S or any other exemption from registration available under the Securities Act.

5. If such a purchaser is a purchaser of notes issued in reliance on Rule 144A ("Rule 144A notes") it agrees on its own behalf and on behalf of any investor account for which it is purchasing the notes, and each subsequent holder of the notes by its acceptance thereof will be deemed to agree, to offer, sell or otherwise transfer such notes prior to the date (the "Resale Restriction Termination Date") that is two years after the later of the date of the original issue and the last date on which we or any of our affiliates was the owner of such notes (or any predecessor thereto) only (i) to us, (ii) pursuant to a registration statement that has been declared effective under the Securities Act, (iii) for so long as the notes are eligible pursuant to Rule 144A under the Securities Act, to a person it reasonably believes is a QIB that purchases for its own account or for the account of a QIB to whom notice is given that

the transfer is being made in reliance on Rule 144A under the Securities Act, (iv) pursuant to offers and sales that occur outside the U.S. in compliance with Regulation S under the Securities Act or (v) pursuant to any other available exemption from the registration requirements of the Securities Act, subject in each of the foregoing cases to any requirement of law that the disposition of its property or the property of such investor account or accounts be at all times within its or their control and in compliance with any applicable state securities laws, and any applicable local laws and regulations, and further subject to our and the fiscal agent's rights prior to any such offer, sale or transfer (I) pursuant to clause (v) to require the delivery of an opinion of counsel, certification and/or other information satisfactory to each of them and (II) in each of the foregoing cases, to require that a certificate of transfer in the form appearing on the other side of the security is completed and delivered by the transferor to the fiscal agent. The foregoing restrictions on resale will not apply subsequent to the Resale Restriction Termination Date.

Each purchaser acknowledges that each Rule 144A note will contain a legend substantially to the following effect:

THIS SECURITY HAS NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR ANY STATE SECURITIES LAWS. NEITHER THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN MAY BE REOFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION OR UNLESS SUCH TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. THE HOLDER OF THIS SECURITY BY ITS ACCEPTANCE HEREOF AGREES TO OFFER, SELL OR OTHERWISE TRANSFER SUCH SECURITY, PRIOR TO THE DATE WHICH IS TWO YEARS AFTER THE LATER OF THE ORIGINAL ISSUE DATE HEREOF AND THE LAST DATE ON WHICH THE ISSUER OR ANY AFFILIATE OF THE ISSUER WAS THE OWNER OF THIS SECURITY (OR ANY PREDECESSOR OF THIS SECURITY) ONLY (A) TO THE ISSUER, (B) PURSUANT TO A REGISTRATION STATEMENT WHICH HAS BEEN DECLARED EFFECTIVE UNDER THE SECURITIES ACT, (C) FOR SO LONG AS THE SECURITIES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A UNDER THE SECURITIES ACT ("RULE 144A"), TO A PERSON IT REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" AS DEFINED IN RULE 144A THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (D) PURSUANT TO OFFERS AND SALES THAT OCCUR OUTSIDE THE UNITED STATES IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT OR (E) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, SUBJECT IN EACH OF THE FOREGOING CASES TO ANY REQUIREMENT OF LAW THAT THE DISPOSITION OF ITS PROPERTY OR THE PROPERTY OF SUCH INVESTOR ACCOUNT OR ACCOUNTS BE AT ALL TIMES WITHIN ITS OR THEIR CONTROL AND IN COMPLIANCE WITH ANY APPLICABLE STATE SECURITIES LAWS, AND ANY APPLICABLE LOCAL LAWS AND REGULATIONS AND FURTHER SUBJECT TO THE ISSUER'S AND THE FISCAL AGENT'S RIGHTS PRIOR TO ANY SUCH OFFER, SALE OR TRANSFER (I) PURSUANT TO CLAUSE (E) TO REQUIRE THE DELIVERY OF AN OPINION OF COUNSEL, CERTIFICATION AND/OR OTHER INFORMATION SATISFACTORY TO EACH OF THEM AND (II) IN EACH OF THE FOREGOING CASES, TO REQUIRE THAT A CERTIFICATE OF TRANSFER IN THE FORM APPEARING ON THE OTHER SIDE OF THIS SECURITY IS COMPLETED AND DELIVERED BY THE TRANSFEROR TO THE FISCAL AGENT. THE FOREGOING RESTRICTIONS ON RESALE WILL NOT APPLY SUBSEQUENT TO THE RESALE RESTRICTION TERMINATION DATE.

6. It agrees that it will give to each person to whom it transfers the notes notice of any restrictions on transfer of such notes.

7. It acknowledges that until 40 days after the commencement of the offering, any offer or sale of the notes within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the Securities Act.

8. It acknowledges that the fiscal agent will not be required to accept for registration of transfer any notes except upon presentation of evidence satisfactory to us and the fiscal agent that the restrictions set forth therein have been complied with.

9. It acknowledges that we, the initial purchasers and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations, warranties and agreements and agrees that if any of the acknowledgements, representations, warranties and agreements deemed to have been made by its purchase of the notes are no longer accurate, it shall promptly notify the initial purchasers. If it is acquiring any notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each such investor account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such investor account.

## SERVICE OF PROCESS AND ENFORCEABILITY OF CIVIL LIABILITIES

We are a public limited company organized under the laws of England and Wales. The documents governing the notes will be governed by the laws of England and Wales.

Almost all of our directors and key managers reside outside the United States and all or a substantial portion of the assets of such persons and our assets are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon our directors or key managers named in this prospectus or enforce, in the U.S. courts, judgments obtained outside U.S. courts against our directors and key managers in any action.

### England

The United States and England currently do not have a treaty providing for the reciprocal recognition and enforcement of judgments (other than arbitration awards) in civil and commercial matters. Consequently, a final judgment for payment rendered by any federal or state court in the United States based on civil liability, whether or not predicated solely upon U.S. federal securities laws, would not automatically be enforceable in England. In order to enforce any judgment of a U.S. court in England, proceedings must be initiated by way of an action on the judgment of the U.S. court under common law before a court of competent jurisdiction in England. In such an action, an English court generally will not (subject to the following sentence) re-examine the merits of the original matter decided by a U.S. court and will order summary judgment on the basis that there is no reasonable prospect of a defense to the claim for payment. The entry of an enforcement order by an English court is typically conditional upon the following:

- the U.S. court having had jurisdiction over the original proceedings according to English conflict of law rules;
- the judgment of the U.S. court being final and conclusive on the merits in the court in which the judgment was pronounced;
- the judgment of the U.S. court being for a definite sum of money;
- the judgment of the U.S. court not being for a sum payable in respect of a tax or other charge, or in respect of a fine or other penalty;
- the judgment of the U.S. court not being for multiple damages arrived at by doubling, trebling or otherwise multiplying a sum assessed as compensation for the loss or damage sustained;
- the judgment not having been obtained by the fraud of the party benefiting from it nor having been affected by any fraud of the U.S. court itself;
- the judgment not having been obtained in proceedings which breached principles of natural justice; and
- the judgment of the U.S. court not otherwise contravening English public policy.

Subject to the foregoing, investors may be able to enforce in England judgments in civil and commercial matters obtained from U.S. federal or state courts. However, we cannot assure you that those judgments will be enforceable. In addition, it is doubtful whether an English court would accept jurisdiction and impose civil liability in an original action commenced in England and predicted solely upon U.S. federal securities laws.

## INDEPENDENT AUDITORS

The consolidated financial statements of Tesco plc as of and for the fiscal years ended February 24, 2007 and February 25, 2006 have been audited by PricewaterhouseCoopers LLP, Chartered Accountants and Registered Auditors, One Embankment Place, London WC2N 6RH, United Kingdom, the Group's independent auditors.

In the April 16, 2007 and April 24, 2006 reports of PricewaterhouseCoopers LLP, with respect to such audited consolidated financial statements, our auditors, in accordance with guidance issued by The Institute of Chartered Accountants in England and Wales, state: "This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing." Investors in the notes should understand these statements are intended to disclaim any liability to parties (such as the purchasers of the notes) other than the issuer and its shareholders with respect to those reports. In the context of the offering of the notes, our auditors have reconfirmed to us that they do not intend their duty of care to extend to any party other than those to whom their reports were originally addressed (i.e., the issuer and its shareholders).

The SEC would not permit the language quoted in the above paragraph to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act or in a report filed under the Exchange Act. The effect of such language is untested by a U.S. court (or any other court) and thus may or may not be effective to limit the direct liability of the auditors under U.S. law or under any other law to persons such as investors in the notes.

## LEGAL MATTERS

Certain legal matters with respect to the notes offered hereby will be passed on for us by Cleary Gottlieb Steen & Hamilton LLP, English and U.S. counsel. Certain legal matters with respect to the notes will be passed upon for the initial purchasers by Davis Polk & Wardwell, U.S. counsel.

## ADDITIONAL INFORMATION

We are not currently subject to the periodic reporting and other information requirements of the U.S. Exchange Act.

If you purchase the notes from the initial purchasers you will be furnished with a copy of this prospectus and, to the extent provided by us to the initial purchasers for such purposes, any related amendments or supplement to this prospectus. Where you receive this prospectus you acknowledge that:

1) you have been afforded an opportunity to request from us, and to review and have received, all additional information considered by you to be necessary to verify the accuracy and completeness of the information herein;

2) you have not relied on the initial purchasers or any person affiliated with the initial purchasers in connection with your investigation of the accuracy of such information or your investment decision; and

3) except as provided pursuant to (1) above, no person has been authorized to give any information or to make any representation concerning the notes offered hereby other than those contained herein and, if given or made, such other information or representation should not be relied upon as having been authorized by us or the initial purchasers.

While any notes remain outstanding, we will make available, upon request, to any holder and any prospective purchaser of notes, any information required pursuant to Rule 144A(d)(4) under the Securities Act in order to permit sales under Rule 144A, if, at the time of such request, we are neither a reporting company pursuant to the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), nor exempt from reporting under the Exchange Act pursuant to Rule 12g3-2(b) thereunder. Any such request should be directed to us at Tesco House, Delamare Road, Cheshunt, Hertfordshire EN8 9SL, United Kingdom, attention: Company Secretary, telephone no: +44 (0) 1992 632222.

# LISTING AND GENERAL INFORMATION

## The Issuer

The issuer, Tesco plc, a public limited company incorporated under the laws of England and Wales, was incorporated on November 27, 1947 under registration number 445790.

The issuer's registered address is Tesco House, Delamare Road, Cheshunt, Hertfordshire EN8 9SL, and its telephone number is +44 (0) 1992 632222.

### *Business*

The issuer is a holding company within our group and does not conduct any revenue-generating operations of its own. Its sole purpose is the holding of the shares in its subsidiaries.

### *Share capital*

As of October 9, 2007 the issued share capital of the issuer was £392,577,321 divided into 7,851,546,419 shares with a par value of 5p per share. The creation and issuance of the notes have been authorized by a resolution of the issuer's board of directors dated September 10, 2007 and a resolution of a special committee of the issuer's board of directors dated October 10, 2007.

### *Directors' interests*

None of the directors of the issuer has any conflict of interest between any of their respective duties to the issuer and their respective private interests and/or other duties.

As a matter of English law, each director of the issuer is under a duty to act honestly and in good faith with regard to the best interests of the issuer, regardless of any other directorships such director may hold.

### *Financial statements and auditors' report*

The issuer's statutory annual financial statements are prepared on the basis of a financial year ended on the last Saturday in February, with the last fiscal year ending on February 24, 2007.

The issuer's audited annual financial statements will be available free of charge at the issuer's website at www.tesco.com.

## General Information

There has been no material adverse change in the issuer's prospects since February 24, 2007, the date of the last published audited financial statements.

There has been no significant change in the financial or trading position of the issuer since August 25, 2007, the end of the last financial period for which interim financial information has been published.

For the avoidance of doubt, any website referred to in this prospectus does not form part of the prospectus prepared in connection with the proposed offering of the notes.

## Listing

It is expected that listing of the notes on the Official List of the U.K. Listing Authority and admission of the notes to trading on the London Stock Exchange Professional Securities Market, an exchange-regulated market will be granted on or about November 5, 2007, subject only to the issue of the notes. Prior to such official listing and admission to trading, however, the London Stock Exchange will permit dealings in the notes in accordance with its rules. We expect that the total fees and commissions and expenses related to the listing and admission of the notes to trading will be approximately $14.2 million.

### Clearing Systems

We expect that the global notes sold pursuant to Regulation S will be accepted for clearance through the facilities of Euroclear and Clearstream Luxembourg. The ISIN number for the 2017 notes sold pursuant to Regulation S is USG87621AK79 and the ISIN number for the 2037 notes sold pursuant to Regulation S is USG87621AL52. We expect that the global notes sold pursuant to Rule 144A will be accepted for clearance through the facilities of DTC. The ISIN number for the 2017 notes sold pursuant to Rule 144A is US881575AA22 and the ISIN number for the 2037 notes sold pursuant to Rule 144A is US881575AC87. The CUSIP number for the 2017 notes sold pursuant to Regulation S is G87621AK7 and the CUSIP number for the 2037 notes sold pursuant to Regulation S is G87621AL5. The CUSIP number for the 2017 notes sold pursuant to Rule 144A is 881575AA2 and the CUSIP number for the 2037 notes sold pursuant to Rule 144A is 881575AC8.

### Credit Rating

As of October 12, 2007, our credit rating was A1 from Moody's Investors Service, Inc. and A+ from Standard & Poor's, a division of the McGraw-Hill Companies, Inc and A+ from Fitch Ratings Ltd.

### Consents and Authorizations

By the consummation of the offering of the notes, we expect to have obtained all necessary consents, approvals and authorizations in the jurisdiction of our incorporation in connection with the issue and performance of the notes. The creation and issuance of the notes was authorized by a resolution of the issuer's board of directors dated on September 10, 2007 and a resolution of a special committee of the issuer's board of directors dated October 10, 2007.

### Documents on Display

Copies of the following documents may be inspected at our offices at Tesco House, Delamare Road, Cheshunt, Hertfordshire EN8 9SL during usual business hours on any week day (Saturday, Sunday and public holidays excepted) for the life of this prospectus:

(a) our memorandum and articles of association;

(b) our consolidated financial statements as of and for the fiscal years ended February 24, 2007 and February 25, 2006 and the audit reports thereon, and our unaudited interim financial statements as of and for the 26-week periods ended August 26, 2006 and August 25, 2007;

(c) the fiscal and paying agency agreement expected to be dated as of November 5, 2007, between the issuer and Citibank, N.A., London Branch, as fiscal agent, paying agent, transfer agent and registrar governing the notes.

# INDEX TO FINANCIAL STATEMENTS

**TESCO PLC**

## UNAUDITED INTERIM GROUP INCOME STATEMENT

26 weeks ended 25 August 2007

| | Notes | 2007 £m | 2006 £m | Increase % |
|---|---|---|---|---|
| **Continuing operations** | | | | |
| **Revenue (sales excluding VAT)** | 2 | **22,631** | **20,735** | **9.1** |
| Cost of sales | | (21,017) | (19,296) | |
| **Gross profit** | | **1,614** | **1,439** | **12.2** |
| Administrative expenses | | (424) | (376) | |
| Profit arising on property-related items | | 119 | 38 | |
| **Operating profit** | 2 | **1,309** | **1,101** | **18.9** |
| Share of post-tax profits of joint ventures and associates (including £nil of property-related items (2006: £36m)) | | 32 | 60 | |
| Finance income | | 52 | 54 | |
| Finance costs | | (104) | (123) | |
| **Profit before tax** | | **1,289** | **1,092** | **18.0** |
| Taxation | 3 | (351) | (317) | |
| **Profit for the period from continuing operations** | | **938** | **775** | **21.0** |
| **Discontinued operation** | | | | |
| Profit for the period from discontinued operation | | — | 16 | |
| **Profit for the period** | | 938 | 791 | 18.6 |
| **Attributable to:** | | | | |
| Equity holders of the parent | | 936 | 788 | |
| Minority interests | | 2 | 3 | |
| | | 938 | 791 | |
| **Earnings per share from continuing and discontinued operations** | | | | |
| Basic | 5 | 11.83p | 9.95p | 18.9 |
| Diluted | 5 | 11.65p | 9.81p | 18.8 |
| **Earnings per share from continuing operations** | | | | |
| Basic | 5 | 11.83p | 9.75p | 21.3 |
| Diluted | 5 | 11.65p | 9.61p | 21.2 |
| **Non-GAAP measure: underlying profit before tax** | 1 | | | |
| Profit before tax (excluding discontinued operation) | | 1,289 | 1,092 | 18.0 |
| Adjustments for: | | | | |
| IAS 32 and IAS 39 'Financial Instruments' – Fair value remeasurements | | (7) | 5 | |
| Total IAS 19 Income Statement charge for pensions | 6 | 190 | 210 | |
| 'Normal' cash contributions for pensions | 6 | (155) | (155) | |
| **Underlying profit before tax** | | **1,317** | **1,152** | **14.3** |
| Underlying diluted earnings per share | 5 | 11.90p | 10.15p | 17.2 |
| Proposed interim dividend per share (pence) | 4 | 3.20p | 2.81p | 13.9 |

## UNAUDITED INTERIM GROUP STATEMENT OF RECOGNISED INCOME AND EXPENSE

26 weeks ended 25 August 2007

| | Notes | 2007 £m | 2006 £m |
|---|---|---|---|
| Loss on revaluation of available-for-sale investments | | (2) | (1) |
| Foreign currency translation differences | | (27) | (85) |
| Actuarial gain on defined benefit pension schemes | 6 | 250 | 123 |
| Gain/(loss) on cash flow hedges | | 11 | (15) |
| Tax on items taken directly to equity | | (105) | (59) |
| **Net income/(expense) recognised directly in equity** | | **127** | **(37)** |
| Profit for the period | | 938 | 791 |
| **Total recognised income and expense for the period** | | **1,065** | **754** |
| Attributable to: | | | |
| Equity holders of the parent | 9 | 1,063 | 755 |
| Minority interests | | 2 | (1) |
| | | 1,065 | 754 |

## UNAUDITED INTERIM GROUP BALANCE SHEET

As at 25 August 2007

| | Notes | 25 August 2007 £m | 24 February 2007 £m | 26 August 2006 £m |
|---|---|---|---|---|
| **Non-current assets** | | | | |
| Goodwill and other intangible assets | | 2,141 | 2,045 | 1,552 |
| Property, plant and equipment | | 18,161 | 16,976 | 16,467 |
| Investment property | | 924 | 856 | 789 |
| Investments in joint ventures and associates | | 363 | 314 | 452 |
| Other investments | | 6 | 8 | 3 |
| Deferred tax assets | | 28 | 32 | 12 |
| | | 21,623 | 20,231 | 19,275 |
| **Current assets** | | | | |
| Inventories | | 2,091 | 1,931 | 1,559 |
| Trade and other receivables | | 1,213 | 1,079 | 1,036 |
| Derivative financial instruments | | 98 | 108 | 189 |
| Current tax assets | | 6 | 8 | — |
| Cash and cash equivalents | | 1,389 | 1,042 | 1,390 |
| | | 4,797 | 4,168 | 4,174 |
| Non-current assets classified as held for sale | | 13 | 408 | 57 |
| | | 4,810 | 4,576 | 4,231 |
| **Current liabilities** | | | | |
| Trade and other payables | | (6,647) | (6,046) | (5,567) |
| Financial liabilities | | | | |
| – Borrowings | | (1,937) | (1,554) | (1,326) |
| – Derivative financial instruments and other liabilities | | (96) | (87) | (149) |
| Current tax liabilities | | (574) | (461) | (472) |
| Provisions | | (4) | (4) | (1) |
| | | (9,258) | (8,152) | (7,515) |
| **Net current liabilities** | | (4,448) | (3,576) | (3,284) |
| **Non-current liabilities** | | | | |
| Financial liabilities | | | | |
| – Borrowings | | (4,588) | (4,146) | (4,181) |
| – Derivative financial instruments and other liabilities | | (390) | (399) | (329) |
| Post-employment benefit obligations | 6 | (736) | (950) | (1,157) |
| Other non-current liabilities | | (30) | (29) | (28) |
| Deferred tax liabilities | | (651) | (535) | (382) |
| Provisions | | (26) | (25) | (4) |
| | | (6,421) | (6,084) | (6,081) |
| **Net assets** | | 10,754 | 10,571 | 9,910 |

## UNAUDITED INTERIM GROUP BALANCE SHEET (continued)
As at 25 August 2007

| | Notes | 25 August 2007 £m | 24 February 2007 £m | 26 August 2006 £m |
|---|---|---|---|---|
| **Equity** | | | | |
| Share capital | | 394 | 397 | 399 |
| Share premium account | | 4,425 | 4,376 | 4,292 |
| Other reserves | | 40 | 40 | 40 |
| Retained earnings | | 5,836 | 5,693 | 5,115 |
| **Equity attributable to equity holders of the parent** | | 10,695 | 10,506 | 9,846 |
| Minority interests | | 59 | 65 | 64 |
| **Total equity** | 9 | 10,754 | 10,571 | 9,910 |

**TESCO PLC**

**UNAUDITED INTERIM GROUP CASH FLOW STATEMENT**
26 weeks ended 25 August 2007

| | Notes | 2007 £m | 2006 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from operations | 7 | 1,916 | 1,787 |
| Interest paid | | (155) | (168) |
| Corporation tax paid | | (202) | (300) |
| **Net cash from operating activities** | | **1,559** | **1,319** |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiaries, net of cash acquired | | (100) | (71) |
| Proceeds from sale of subsidiary, net of cash disposed | | — | 20 |
| Purchase of property, plant and equipment and investment property | | (1,580) | (1,241) |
| Proceeds from sale of property, plant and equipment | | 761 | 146 |
| Proceeds from sale of intangible assets | | 2 | — |
| Purchase of intangible assets | | (67) | (77) |
| Net (increase)/decrease in loans to joint ventures | | (26) | 3 |
| Invested in joint ventures and associates | | (60) | (15) |
| Dividends received | | 39 | 72 |
| Interest received | | 29 | 54 |
| **Net cash used in investing activities** | | **(1,002)** | **(1,109)** |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of ordinary share capital | | 50 | 70 |
| Increase in borrowings | | 1,421 | 2,107 |
| Repayment of borrowings | | (711) | (1,998) |
| New finance leases | | 119 | 99 |
| Repayments of obligations under finance leases | | (16) | (13) |
| Dividends paid | | (541) | (237) |
| Own shares purchased | | (534) | (152) |
| **Net cash used in financing activities** | | **(212)** | **(124)** |
| **Net increase in cash and cash equivalents** | | **345** | **86** |
| **Cash and cash equivalents at beginning of period** | | **1,042** | **1,325** |
| Effect of foreign exchange rate changes | | 2 | (21) |
| **Cash and cash equivalents at end of period** | | **1,389** | **1,390** |

## UNAUDITED INTERIM RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

26 weeks ended 25 August 2007

| | Notes | 2007 £m | 2006 £m |
|---|---|---|---|
| Net increase in cash and cash equivalents | | 345 | 86 |
| Net cash inflow from debt and lease financing | | (813) | (195) |
| Other non-cash movements | | 3 | 227 |
| (Increase)/decrease in net debt in the period | | (465) | 118 |
| Opening net debt | | (5,024) | (4,509) |
| Adjustment for joint venture loan receivables[1] | | 163 | 125 |
| Adjusted opening net debt | | (4,861) | (4,384) |
| **Closing net debt** | 8 | **(5,326)** | **(4,266)** |

NB: The reconciliation of net cash flow to movement in net debt is not a primary statement and does not form part of the cash flow statement.

1 The measurement of net debt has been revised to include loans receivable from joint ventures. Going forward net debt will be stated inclusive of the loan receivables from joint ventures.

## NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

The interim consolidated financial information for the 26 weeks ended 25 August 2007 was approved by the Directors on 1 October 2007.

### NOTE 1 Basis of preparation

This interim consolidated financial information has been prepared in accordance with the Disclosure and Transparency Rules of the UK Financial Services Authority and International Financial Reporting Standards (IFRS), as endorsed by the European Union (EU). The accounting policies applied are consistent with those described in the Annual Report and Financial Statements 2007.

This interim consolidated financial information is not audited and does not constitute statutory financial statements as defined in section 240 of the Companies Act 1985. Comparative figures for the year ended 24 February 2007 have been extracted from the Group Financial Statements, on which the auditors gave an unqualified opinion and did not include a statement under section 237(2) or (3) of the Companies Act 1985. The Group Financial Statements for the year ended 24 February 2007 have been filed with the Registrar of Companies. The auditors independent review report on the consolidated interim financial information is included in the interim report which will be made available to shareholders.

### Use of non-GAAP profit measures

*Underlying profit*

The Directors believe that underlying profit and underlying diluted earnings per share measures provide additional useful information for shareholders on underlying trends and performance. These measures are used for internal performance analysis. Underlying profit is not defined by IFRS and therefore may not be directly comparable with other companies' adjusted profit measures. It is not intended to be a substitute for, or superior to, IFRS measurements of profit.

The adjustments made to reported profit before tax are:

- IAS 32 and IAS 39 'Financial Instruments' — fair value remeasurements — under IAS 32 and IAS 39, the Group applies hedge accounting to its various hedge relationships (principally interest rate swaps, cross currency swaps and forward exchange contracts and options) when it is allowed under the rules of IAS 39 and practical to do so. Sometimes, the Group is unable to apply hedge accounting to the arrangements, but continues to enter into these arrangements as they provide certainty or active management of the exchange rates and interest rates applicable to the Group. The Group believes these arrangements remain effective and economically and commercially viable hedges despite the inability to apply hedge accounting.

  Where hedge accounting is not applied to certain hedging arrangements, the reported results reflect the movement in fair value of related derivatives due to changes in foreign exchange and interest rates. In addition, at each period end, any gain or loss accruing on open contracts is recognised in the result for the period, regardless of the expected outcome of the hedging contract on termination. This may mean that the Income Statement charge is highly volatile, whilst the resulting cash flows may not be as volatile. The underlying profit measure removes this volatility to help better identify underlying business performance.

- IAS 19 Income Statement charge for pensions — Under IAS 19 'Employee Benefits', the cost of providing pension benefits in the future is discounted to a present value at the corporate bond yield rates applicable on the last day of the previous financial year. Corporate bond yields rates vary over time which in turn creates volatility in the Income Statement and

**NOTE 1 Basis of preparation (continued)**

Balance Sheet. IAS 19 also increases the charge for young pension schemes, such as Tesco's, by requiring the use of rates which do not take into account the future expected returns on the assets held in the pension scheme which will fund pension liabilities as they fall due. The sum of these two effects makes the IAS 19 charge disproportionately higher and more volatile than the cash contributions the Group is required to make in order to fund all future liabilities.

Therefore within underlying profit we have included the 'normal' cash contributions within the measure but excluded the volatile element of IAS 19 to represent what the group believes to be a fairer measure of the cost of providing post-employment benefits.

- Exceptional items — due to their significance and special nature, certain other items which do not reflect the Group's underlying performance are excluded from underlying profit. These gains or losses can have a significant impact on both absolute profit and profit trends, consequently, they are excluded from the underlying profit of the Group. In the Interim periods for 2006/07 and 2007/08 there are no such exceptional items.

*Segmental trading profit*

Segmental trading profit is an adjusted measure of operating profit, which measures the performance of each geographical segment before exceptional items, profit/(loss) arising on property-related items, and replaces the IAS 19 pension charge with the 'normal' cash contributions for pensions.

**TESCO PLC**

**NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS**

**NOTE 2 Segmental analysis**

The Board has determined that the primary segmental reporting format is geographical, based on the Group's management and internal reporting structure.

The Rest of Europe reporting segment includes the Republic of Ireland, Hungary, Poland, the Czech Republic, Slovakia and Turkey. The Asia reporting segment includes Thailand, South Korea, Malaysia, China and Japan. On 31 May 2006, the Taiwanese business of the Group (previously included in the Asia segment) was sold to the Carrefour Group, hence in 2006/07, the result of the Taiwanese business and the profit on disposal were included within discontinued operations. The UK reporting segment includes the start-up costs for establishing the operations in the United States of America.

| | 26 weeks ended 25 August 2007 | | | 26 weeks ended 26 August 2006 | | |
|---|---|---|---|---|---|---|
| | Sales including VAT £m | Revenue excluding VAT £m | Operating profit £m | Sales including VAT £m | Revenue excluding VAT £m | Operating profit £m |
| **Continuing operations** | | | | | | |
| UK | 18,329 | 16,854 | 1,041 | 17,398 | 15,967 | 872 |
| Rest of Europe | 3,558 | 3,121 | 147 | 2,994 | 2,638 | 124 |
| Asia | 2,862 | 2,656 | 121 | 2,269 | 2,130 | 105 |
| | 24,749 | 22,631 | 1,309 | 22,661 | 20,735 | 1,101 |
| Share of post-tax profit of joint ventures and associates | | | 32 | | | 60 |
| Net finance costs | | | (52) | | | (69) |
| Profit before tax | | | 1,289 | | | 1,092 |
| Taxation | | | (351) | | | (317) |
| **Profit for the period from continuing operations** | | | **938** | | | **775** |
| **Profit from discontinued operation** | | | **—** | | | **16** |
| **Profit for the period** | | | **938** | | | **791** |

The Group's activities are, to some extent, subject to seasonal fluctuations. Tesco generally experiences an increase in sales in the fourth quarter of the year due to holiday periods. Our sales are also influenced by seasonal weather conditions which can contribute towards higher sales in the summer months.

## NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

### NOTE 2 Segmental analysis (continued)

**Reconciliation of operating profit to trading profit — continuing operations**

| | 26 weeks ended 25 August 2007 | | | | 26 weeks ended 26 August 2006 | | | |
|---|---|---|---|---|---|---|---|---|
| | UK £m | Rest of Europe £m | Asia £m | Total £m | UK £m | Rest of Europe £m | Asia £m | Total £m |
| **Operating profit** | **1,041** | **147** | **121** | **1,309** | **872** | **124** | **105** | **1,101** |
| Adjustments: | | | | | | | | |
| (Profit)/loss arising on property-related items | (121) | — | 2 | (119) | (39) | 1 | — | (38) |
| IAS 19 Income Statement charge for pensions | 207 | 2 | 5 | 214 | 223 | 1 | 2 | 226 |
| 'Normal' cash contributions for pensions | (149) | (2) | (4) | (155) | (152) | (1) | (2) | (155) |
| **Trading profit** | **978** | **147** | **124** | **1,249** | **904** | **125** | **105** | **1,134** |
| **Trading margin** | 5.8% | 4.7% | 4.7% | 5.5% | 5.7% | 4.7% | 4.9% | 5.5% |

### NOTE 3 Taxation

| | 2007 £m | 2006 £m |
|---|---|---|
| UK | 298 | 259 |
| Overseas | 53 | 58 |
| | 351 | 317 |

### NOTE 4 Dividends

| | 2007 Pence/share | 2006 Pence/share | 2007 £m | 2006 £m |
|---|---|---|---|---|
| Amounts recognised as distributions to equity holders in the period: | | | | |
| Final dividend for the prior financial year | 6.83 | 6.10 | 541 | 482 |
| Proposed interim dividend for the current financial year | 3.20 | 2.81 | 252 | 224 |

The proposed interim dividend was approved by the Board on 1 October 2007 but has not been included as a liability as at 25 August 2007, in accordance with IAS 10 'Events after the balance sheet date'.

### NOTE 5 Earnings per share and diluted earnings per share

Basic earnings per share amounts are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares in issue during the period.

Diluted earnings per share amounts are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares in issue during the period (adjusted for the effects of dilutive options).

The dilution effect is calculated on the full exercise of all ordinary share options granted by the Group, including performance-based options which the Group considers to have been earned.

## NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

### NOTE 5 Earnings per share and diluted earnings per share (continued)

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Basic | Potentially dilutive share options | Diluted | Basic | Potentially dilutive share options | Diluted |
| **Profit (£m)** | | | | | | |
| Continuing operations | 936 | — | 936 | 772 | — | 772 |
| Discontinued operation | — | — | — | 16 | — | 16 |
| **Total** | 936 | — | 936 | 788 | — | 788 |
| **Weighted average number of shares (millions)** | 7,911 | 121 | 8,032 | 7,921 | 109 | 8,030 |
| **Earnings per share (pence)** | | | | | | |
| Continuing operations | 11.83 | (0.18) | 11.65 | 9.75 | (0.14) | 9.61 |
| Discontinued operation | — | — | — | 0.20 | — | 0.20 |
| **Total** | 11.83 | (0.18) | 11.65 | 9.95 | (0.14) | 9.81 |

**Continuing operations underlying diluted earnings per share reconciliation**

| | 2007 % | 2007 £m | 2006 % | 2006 £m |
|---|---|---|---|---|
| **Underlying profit before tax** | | 1,317 | | 1,152 |
| Effective tax rate on continuing operations | 27.23 | (359) | 29.03 | (334) |
| Minority interests | | (2) | | (3) |
| **Total** | | 956 | | 815 |
| **Underlying diluted earnings per share (pence)** | | 11.90p | | 10.15p |

### NOTE 6 Post-employment benefits

**Pensions**

The Group operates a variety of post-employment benefit arrangements covering both funded and unfunded defined benefit schemes and funded defined contribution schemes. The most significant are funded defined benefit pension schemes for the Group's employees in the UK and the Republic of Ireland.

**Principal Assumptions**

The valuations used for IAS 19 have been based on the most recent actuarial valuations and updated by Watson Wyatt Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 25 August 2007. The major assumptions, on a weighted average basis, used by the actuaries were as detailed below. The mortality assumptions remain consistent with those disclosed in the Group's 2006/07 Annual Report.

## NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

### NOTE 6 Post-employment benefits (continued)

| | 25 August 2007 % | 24 February 2007 % | 26 August 2006 % |
|---|---|---|---|
| Discount rate | 5.8 | 5.2 | 5.2 |
| Price inflation | 3.2 | 3.0 | 2.9 |
| Rate of increase in salaries | 4.7 | 4.5 | 4.2 |
| Rate of increase in pensions in payment | 3.2 | 3.0 | 2.9 |
| Rate of increase in deferred pensions | 3.2 | 3.0 | 2.9 |
| Rate of increase in career average benefits | 3.2 | 3.0 | 2.9 |

**Movement in the deficit during the period**

The movement in the deficit during the period was as follows:

| | 26 weeks ended 25 August 2007 £m | 52 weeks ended 24 February 2007 £m | 26 weeks ended 26 August 2006 £m |
|---|---|---|---|
| Deficit in schemes at the beginning of the period | **(950)** | **(1,211)** | **(1,211)** |
| Current service cost | (214) | (466) | (226) |
| Other finance income | 24 | 34 | 16 |
| Contributions | 155 | 321 | 141* |
| Actuarial gain and other movements | 250 | 114 | 123 |
| Past service gains (A-Day – Finance Act 2006) | — | 258 | — |
| Acquisition through business combinations | (1) | — | — |
| **Deficit in schemes at the end of the period** | **(736)** | **(950)** | **(1,157)** |

* Represents actual cash payments to pension schemes during the period. Cash contributions included in underlying profit also include contributions due, but not yet paid, to pension schemes at the balance sheet date and for that reason may differ to the figures shown above.

### NOTE 7 Reconciliation of profit before tax to net cash generated from operations

| | 2007 £m | 2006 £m |
|---|---|---|
| Profit before tax | 1,289 | 1,092 |
| Net finance costs | 52 | 69 |
| Share of post-tax profits of joint ventures and associates | (32) | (60) |
| Operating profit | 1,309 | 1,101 |
| Operating loss of discontinued operation | — | (4) |
| Depreciation and amortisation | 474 | 418 |
| Profit arising on property-related items | (119) | (38) |
| Adjustment for non-cash element of pensions charge | 59 | 85 |
| Share-based payments | 104 | 78 |
| Increase in inventories | (138) | (110) |
| Increase in trade and other receivables | (115) | (34) |
| Increase in trade and other payables | 342 | 291 |
| Decrease in working capital | 89 | 147 |
| **Cash generated from operations** | **1,916** | **1,787** |

## NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

### NOTE 8 Analysis of changes in net debt

| | At 24 February 2007 £m | Adjustment* £m | At 24 February 2007 (restated) £m | Cash flow £m | Other non-cash movements £m | At 25 August 2007 £m |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | 1,042 | — | 1,042 | 345 | 2 | 1,389 |
| Finance lease receivables | 12 | — | 12 | (4) | — | 8 |
| Joint venture loan receivables | — | 163 | 163 | 27 | — | 190 |
| Derivative financial instruments | 108 | — | 108 | (103) | 93 | 98 |
| **Cash and receivables** | **1,162** | **163** | **1,325** | **265** | **95** | **1,685** |
| Bank and other borrowings | (1,518) | — | (1,518) | 234 | (600) | (1,884) |
| Finance lease payables | (36) | — | (36) | 3 | (20) | (53) |
| Derivative financial instruments | (87) | — | (87) | 44 | (53) | (96) |
| **Debt due within one year** | **(1,641)** | **—** | **(1,641)** | **281** | **(673)** | **(2,033)** |
| Bank and other borrowings | (3,999) | — | (3,999) | (908) | 552 | (4,355) |
| Finance lease payables | (147) | — | (147) | (102) | 16 | (233) |
| Derivative financial instruments | (399) | — | (399) | (4) | 13 | (390) |
| **Debt due after one year** | **(4,545)** | **—** | **(4,545)** | **(1,014)** | **581** | **(4,978)** |
| | **(5,024)** | **163** | **(4,861)** | **(468)** | **3** | **(5,326)** |

* The measurement of net debt has been revised to include loans receivable from joint ventures. Going forward net debt will be stated inclusive of the loans receivables from joint ventures.

### NOTE 9 Reconciliation of movements in equity

| | 2007 £m | 2006 £m |
|---|---|---|
| **Equity attributable to equity holders of the parent:** | | |
| **At the beginning of the period** | 10,506 | 9,380 |
| Total recognised income and expense for the period | 1,063 | 755 |
| Share-based payments | 104 | 78 |
| Purchase of minority interest | 47 | — |
| Future purchases of minority interests | — | (42) |
| New share capital subscribed less expenses | 50 | 69 |
| Share buy backs | (422) | (56) |
| Increase in own shares held | (112) | (95) |
| Equity dividends authorised in the period | (541) | (482) |
| Payment of dividends by shares in lieu of cash | — | 239 |
| **At the end of the period** | 10,695 | 9,846 |
| Minority interests | 59 | 64 |
| **Total equity** | 10,754 | 9,910 |

### NOTE 10 Business Combinations

By 25 August 2007, the Group had acquired 58% of the share capital of Dobbies Garden Centres PLC, a 21-store garden centres business. The shares were acquired for cash consideration of £87m (including costs of acquisition). The provisional goodwill recognised is £62m. The Group has yet to finalise the fair values of the identifiable assets and liabilities acquired, as the acquisition was close to the balance sheet date.

Further shares were acquired in the second half of the financial year, prior to the closure of the Tesco offer for Dobbies shares on 14 September 2007. Following the closure of the offer, the Tesco Group owned 65.5% of the share capital of Dobbies Garden Centres PLC.

# Statement of Directors' responsibilities

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 of the Group for the financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with IFRS as adopted by the European Union (EU) and have elected to prepare the Company financial statements in accordance with UK Accounting Standards.

In preparing the Group and Company financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make reasonable and prudent judgements and estimates;
- for the Group financial statements, state whether they have been prepared in accordance with IFRS as adopted by the EU;
- for the Company financial statements state whether applicable UK Accounting Standards have been followed;
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time, the financial position of the Company and Group, and which enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 1985, and as regards the Group financial statements, Article 4 of the IAS Regulation.

The Directors are responsible for the maintenance and integrity of the Annual Review and Summary Financial Statement and Annual Report and Financial Statements published on the Group's corporate website. Legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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

# Independent auditors' report to the members of Tesco PLC

We have audited the Group financial statements of Tesco PLC for the year ended 24 February 2007 which comprise the Group Income Statement, the Group Balance Sheet, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expense and the related notes. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Parent Company financial statements of Tesco PLC for the year ended 24 February 2007 and on the information in the Directors' Remuneration Report that is described as having been audited.

## Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the Group financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the Combined Code (2003) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Directors' Report, the Operating and Financial Review and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group'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 Group 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 Group financial statements.

## Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 24 February 2007 and of its profit and cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London 16 April 2007

# Group income statement Year ended 24 February 2007

| | notes | 2007 £m | 2006* £m |
|---|---|---|---|
| **Continuing operations** | | | |
| **Revenue (sales excluding VAT)** | 2 | 42,641 | 39,454 |
| Cost of sales | | (39,401) | (36,426) |
| Pensions adjustment – Finance Act 2006 | 23 | 258 | – |
| Impairment of the Gerrards Cross site | | (35) | – |
| **Gross profit** | | 3,463 | 3,028 |
| Administrative expenses | | (907) | (825) |
| Profit arising on property-related items | 2/3 | 92 | 77 |
| **Operating profit** | 2 | 2,648 | 2,280 |
| Share of post-tax profits of joint ventures and associates (including £47m of property-related items (2005/06 – £nil)) | 13 | 106 | 82 |
| Profit on sale of investments in associates | 13 | 25 | – |
| Finance income | 5 | 90 | 114 |
| Finance costs | 5 | (216) | (241) |
| **Profit before tax** | 3 | 2,653 | 2,235 |
| Taxation | 6 | (772) | (649) |
| **Profit for the year from continuing operations** | | 1,881 | 1,586 |
| **Discontinued operation** | | | |
| Profit/(loss) for the year from discontinued operation | 7 | 18 | (10) |
| **Profit for the year** | | 1,899 | 1,576 |
| **Attributable to:** | | | |
| Equity holders of the parent | | 1,892 | 1,570 |
| Minority interests | | 7 | 6 |
| | | 1,899 | 1,576 |
| **Earnings per share from continuing and discontinued operations** | | | |
| Basic | 9 | 23.84p | 20.07p |
| Diluted | 9 | 23.54p | 19.79p |
| **Earnings per share from continuing operations** | | | |
| Basic | 9 | 23.61p | 20.20p |
| Diluted | 9 | 23.31p | 19.92p |

## Non-GAAP measure: underlying profit before tax

| | notes | 2007 £m | 2006* £m |
|---|---|---|---|
| Profit before tax (excluding discontinued operation) | | 2,653 | 2,235 |
| Adjustments for: | | | |
| IAS 32 and IAS 39 'Financial Instruments' – Fair value remeasurements | 5 | 4 | 9 |
| Total IAS 19 Income Statement charge for pensions | 23 | 432 | 303 |
| 'Normal' cash contributions for pensions | 23 | (321) | (270) |
| Exceptional items: | | | |
| Pensions adjustment – Finance Act 2006 | 23 | (258) | – |
| Impairment of the Gerrards Cross site | | 35 | – |
| **Underlying profit before tax** | 1 | 2,545 | 2,277 |

* Results for the year ended 25 February 2006 include 52 weeks for the UK and the Republic of Ireland and 14 months for the majority of the remaining International businesses.

The notes on pages 48 to 97 form part of these financial statements.

# Group statement of recognised income and expense Year ended 24 February 2007

| | notes | 2007 £m | 2006* £m |
|---|---|---|---|
| (Loss)/gain on revaluation of available-for-sale investments | 14 | (1) | 2 |
| Foreign currency translation differences | | (65) | 33 |
| Total gain/(loss) on defined benefit pension schemes | 23 | 114 | (443) |
| (Losses)/gains on cash flow hedges: | | | |
| – net fair value (losses)/gains | | (26) | 44 |
| – reclassified and reported in the Income Statement | | (12) | (5) |
| Tax on items taken directly to equity | 6 | 12 | 133 |
| **Net income/(expense) recognised directly in equity** | | 22 | (236) |
| Profit for the year | | 1,899 | 1,576 |
| **Total recognised income and expense for the year** | | 1,921 | 1,340 |
| Attributable to: | | | |
| Equity holders of the parent | | 1,920 | 1,327 |
| Minority interests | | 1 | 13 |
| | | 1,921 | 1,340 |

* Results for the year ended 25 February 2006 include 52 weeks for the UK and the Republic of Ireland and 14 months for the majority of the remaining International businesses.

# Group balance sheet 24 February 2007

| | notes | 2007 £m | 2006 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Goodwill and other intangible assets | 10 | 2,045 | 1,525 |
| Property, plant and equipment | 11 | 16,976 | 15,882 |
| Investment property | 12 | 856 | 745 |
| Investments in joint ventures and associates | 13 | 314 | 476 |
| Other investments | 14 | 8 | 4 |
| Deferred tax assets | 6 | 32 | 12 |
| | | 20,231 | 18,644 |
| **Current assets** | | | |
| Inventories | 15 | 1,931 | 1,464 |
| Trade and other receivables | 16 | 1,079 | 892 |
| Derivative financial instruments | 20 | 108 | 70 |
| Current tax assets | | 8 | – |
| Cash and cash equivalents | 17 | 1,042 | 1,325 |
| | | 4,168 | 3,751 |
| Non-current assets classified as held for sale and assets of the disposal group | 7 | 408 | 168 |
| | | 4,576 | 3,919 |
| **Current liabilities** | | | |
| Trade and other payables | 18 | (6,046) | (5,083) |
| Financial liabilities | | | |
| – Borrowings | 19 | (1,554) | (1,646) |
| – Derivative financial instruments and other liabilities | 20 | (87) | (239) |
| Current tax liabilities | | (461) | (462) |
| Provisions | 21 | (4) | (2) |
| | | (8,152) | (7,432) |
| Liabilities directly associated with the disposal group | 7 | – | (86) |
| | | (8,152) | (7,518) |
| **Net current liabilities** | | (3,576) | (3,599) |
| **Non-current liabilities** | | | |
| Financial liabilities | | | |
| – Borrowings | 19 | (4,146) | (3,742) |
| – Derivative financial instruments and other liabilities | 20 | (399) | (294) |
| Post-employment benefit obligations | 23 | (950) | (1,211) |
| Other non-current liabilities | 18 | (29) | (29) |
| Deferred tax liabilities | 6 | (535) | (320) |
| Provisions | 21 | (25) | (5) |
| | | (6,084) | (5,601) |
| **Net assets** | | 10,571 | 9,444 |
| **Equity** | | | |
| Share capital | 24/25 | 397 | 395 |
| Share premium account | 25 | 4,376 | 3,988 |
| Other reserves | 25 | 40 | 40 |
| Retained earnings | 25 | 5,693 | 4,957 |
| **Equity attributable to equity holders of the parent** | | 10,506 | 9,380 |
| Minority interests | 25 | 65 | 64 |
| **Total equity** | | 10,571 | 9,444 |

Sir Terry Leahy
Andrew Higginson
Directors
The financial statements on pages 44 to 97 were authorised for issue by the Directors on 16 April 2007 and are subject to the approval of the shareholders at the Annual General Meeting on 29 June 2007.

## Group cash flow statement Year ended 24 February 2007

| | notes | 2007 £m | 2006* £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from operations | 28 | 3,532 | 3,412 |
| Interest paid | | (376) | (364) |
| Corporation tax paid | | (545) | (429) |
| **Net cash from operating activities** | | 2,611 | 2,619 |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiaries, net of cash acquired | | (325) | (54) |
| Proceeds from sale of subsidiary, net of cash disposed | | 22 | – |
| Proceeds from sale of joint ventures and associates | | 41 | – |
| Purchase of property, plant and equipment and investment property | | (2,852) | (2,561) |
| Proceeds from sale of property, plant and equipment | | 809 | 664 |
| Purchase of intangible assets | | (174) | (139) |
| Net increase in loans to joint ventures | | (21) | (16) |
| Invested in joint ventures and associates | | (49) | (34) |
| Dividends received | | 124 | 82 |
| Interest received | | 82 | 96 |
| **Net cash used in investing activities** | | (2,343) | (1,962) |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of ordinary share capital | | 156 | 123 |
| Net increase in/(repayments of) borrowings | | 184 | (109) |
| New finance leases | | 99 | – |
| Repayment of obligations under finance leases | | (15) | (6) |
| Dividends paid | | (467) | (441) |
| Own shares purchased | | (490) | (59) |
| **Net cash used in financing activities** | | (533) | (492) |
| **Net (decrease)/increase in cash and cash equivalents** | | (265) | 165 |
| Cash and cash equivalents at beginning of year | | 1,325 | 1,146 |
| Effect of foreign exchange rate changes | | (18) | 16 |
| **Cash and cash equivalents at end of year** | | 1,042 | 1,327 |
| Less cash held in disposal group | | – | (2) |
| **Cash and cash equivalents not held in disposal group** | 17 | 1,042 | 1,325 |

* Results for the year ended 25 February 2006 include 52 weeks for the UK and the Republic of Ireland and 14 months for the majority of the remaining International businesses.

## Reconciliation of net cash flow to movement in net debt note

| | notes | 2007 £m | 2006 £m |
|---|---|---|---|
| Net (decrease)/increase in cash and cash equivalents | | (265) | 165 |
| Net cash (inflow)/outflow from debt and lease financing | | (268) | 115 |
| Net debt included within the disposal group | | – | 55 |
| Other non-cash movements | | 18 | (357) |
| **Increase in net debt in the year** | | (515) | (22) |
| Opening net debt | 29 | (4,509) | (4,487) |
| **Closing net debt** | 29 | (5,024) | (4,509) |

NB. The reconciliation of net cash flow to movement in net debt note is not a primary statement and does not form part of the cash flow statement.

# Notes to the Group financial statements

## Note 1 Accounting policies

### General information

Tesco PLC is a public limited company incorporated in the United Kingdom under the Companies Act 1985 (Registration number 445790). The address of the registered office is Tesco House, Delamare Road, Cheshunt, Hertfordshire, EN8 9SL, UK.

As described in the Directors' Report, the main activity of the Group is that of retailing and associated activities.

### Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretation Committee (IFRIC) interpretations as endorsed by the European Union, and those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

### Basis of preparation

The financial statements are presented in Pounds Sterling, rounded to the nearest million. They are prepared on the historical cost basis modified for the revaluation of certain financial instruments.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

### Basis of consolidation

The Group financial statements consist of the financial statements of the ultimate Parent Company (Tesco PLC), all entities controlled by the Company (its subsidiaries) and the Group's share of its interests in joint ventures and associates.

Where necessary, adjustments are made to the financial statements of subsidiaries, joint ventures and associates to bring the accounting policies used into line with those of the Group.

#### Subsidiaries

A subsidiary is an entity whose operating and financing policies are controlled, directly or indirectly, by Tesco PLC.

The accounts of the Parent Company's subsidiary undertakings are prepared to dates around the Group year end apart from Hymall, which for this reporting period have been prepared to 31 December 2006. Hymall has a different year end to the Group, as it is yet to be aligned with the Group year end following its acquisition in December 2006.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

#### Joint ventures and associates

A joint venture is an entity in which the Group holds an interest on a long-term basis and which is jointly controlled by the Group and one or more other venturers under a contractual agreement.

An associate is an undertaking, not being a subsidiary or joint venture, over which the Group has significant influence and can participate in the financial and operating policy decisions of the entity.

The Group's share of the results of joint ventures and associates is included in the Group Income Statement using the equity method of accounting. Investments in joint ventures and associates are carried in the Group Balance Sheet at cost plus post-acquisition changes in the Group's share of the net assets of the entity, less any impairment in value. The carrying values of investments in joint ventures and associates include acquired goodwill.

If the Group's share of losses in a joint venture or associate equals or exceeds its investment in the joint venture or associate, the Group does not recognise further losses, unless it has incurred obligations to do so or made payments on behalf of the joint venture or associate.

Unrealised gains arising from transactions with joint ventures and associates are eliminated to the extent of the Group's interest in the entity.

### Use of assumptions and estimates

The preparation of the consolidated financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical estimates and assumptions are made in particular with regard to establishing uniform depreciation and amortisation periods for the Group, impairment testing, assumptions for measuring pension provisions, determination of the fair value of obligations to purchase minority interests, classification of leases as operating leases versus finance leases (including on sale and leasebacks), the likelihood that tax assets can be realised and the classification of certain operations as held for sale.

**Revenue**
Revenue consists of sales through retail outlets.

Revenue is recorded net of returns, relevant vouchers/offers and value-added taxes, when the significant risks and rewards of ownership have been transferred to the buyer. Relevant vouchers/offers include: money-off coupons, conditional spend vouchers and offers such as buy one get one free (BOGOF) and 3 for 2.

Commission income is recorded based on the terms of the contracts.

**Clubcard and loyalty initiatives**
The cost of Clubcard is treated as a cost of sale, with an accrual equal to the estimated fair value of the points issued recognised when the original transaction occurs. On redemption, the cost of redemption is offset against the accrual.

The fair value of the points awarded is determined with reference to the cost of redemption and considers factors such as redemption via Clubcard deals versus money-off in store and redemption rate.

Computers for Schools and Sport for Schools and Clubs vouchers are issued by Tesco for redemption by participating schools/clubs and are part of our overall Community Plan. The cost of the redemption (i.e. meeting the obligation attached to the vouchers) is treated as a cost rather than as a deduction from sales.

**Other income**
Finance income is recognised in the period to which it relates on an accruals basis. Dividends are recognised when a legal entitlement to payment arises.

**Operating profit**
Operating profit is stated after profit arising on property-related items but before the share of results of joint ventures and associates, finance income and finance costs.

**Discontinued operations**
A discontinued operation is a component of the Group's business that represents a separate line of business or geographical area of operation. Classification as a discontinued operation occurs upon disposal or earlier, if the operation meets the criteria to be classified as held for sale, under IFRS 5 'Non-current assets held for sale'.

**Property, plant and equipment**
Property, plant and equipment assets are carried at cost less accumulated depreciation and any recognised impairment in value.

Property, plant and equipment assets are depreciated on a straight-line basis to their residual value over their anticipated useful economic lives.

The following depreciation rates are applied for the Group:

- Freehold and leasehold buildings with greater than 40 years unexpired – at 2.5% of cost
- Leasehold properties with less than 40 years unexpired are depreciated by equal annual instalments over the unexpired period of the lease
- Plant, equipment, fixtures and fittings and motor vehicles – at rates varying from 9% to 33%.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, when shorter, over the term of the relevant lease.

All tangible fixed assets are reviewed for impairment in accordance with IAS 36 'Impairment of Assets' when there are indications that the carrying value may not be recoverable.

**Borrowing costs**
Borrowing costs directly attributable to the acquisition or construction of qualifying assets are capitalised. Qualifying assets are those that necessarily take a substantial period of time to prepare for their intended use. All other borrowing costs are recognised in the Income Statement in the period in which they occur.

**Investment property**
Investment property is property held to earn rental income and/or for capital appreciation rather than for the purpose of Group operating activities. Investment property assets are carried at cost less accumulated depreciation and any recognised impairment in value. The depreciation policies for investment property are consistent with those described for owner-occupied property.

**Leasing**
Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as a lessor
Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment in the lease.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

**Note 1** **Accounting policies** continued

### The Group as a lessee

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the Balance Sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the Income Statement.

Rentals payable under operating leases are charged to the Income Statement on a straight-line basis over the term of the relevant lease.

### Sale and leaseback

A sale and leaseback transaction is one where a vendor sells an asset and immediately reacquires the use of that asset by entering into a lease with the buyer. The accounting treatment of the sale and leaseback depends upon the substance of the transaction (by applying the lease classification principles described above) and whether or not the sale was made at the asset's fair value.

For sale and finance leasebacks, any apparent profit or loss from the sale is deferred and amortised over the lease term. For sale and operating leasebacks, generally the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately.

Following initial recognition, the lease treatment is consistent with those principles described above.

**Business combinations and goodwill**

All business combinations are accounted for by applying the purchase method.

On acquisition, the assets and liabilities and contingent liabilities of an acquired entity are measured at their fair value. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognised.

Goodwill arising on consolidation represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary, joint venture or associate at the date of acquisition. If the cost of acquisition is less than the fair value of the Group's share of the net assets of the acquired entity (i.e. a discount on acquisition) then the difference is credited to the Income Statement in the period of acquisition.

At the acquisition date of a subsidiary, goodwill acquired is recognised as an asset and is allocated to each of the cash-generating units expected to benefit from the business combination's synergies and to the lowest level at which management monitors the goodwill. Goodwill arising on the acquisition of joint ventures and associates is included within the carrying value of the investment.

Goodwill is reviewed for impairment at least annually by assessing the recoverable amount of each cash-generating unit to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Any impairment is recognised immediately in the Income Statement and is not subsequently reversed.

On disposal of a subsidiary, joint venture or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before 29 February 2004 (the date of transition to IFRS) was retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been restated and will not be included in determining any subsequent profit or loss on disposal.

**Intangible assets**

### Acquired intangible assets

Acquired intangible assets, such as software or pharmacy licences, are measured initially at cost and are amortised on a straight-line basis over their estimated useful lives.

### Internally-generated intangible assets – Research and development expenditure

Research costs are expensed as incurred.

Development expenditure incurred on an individual project is carried forward only if all the criteria set out in IAS 38 'Intangible Assets' are met, namely:

- an asset is created that can be identified (such as software or new processes);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the project's estimated useful life, usually at 14%-25% of cost per annum.

**Impairment of tangible and intangible assets excluding goodwill**

At each Balance Sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of the recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately.

**Inventories**

Inventories comprise goods held for resale and properties held for, or in the course of, development and are valued at the lower of cost and fair value less costs to sell using the weighted average cost basis.

**Cash and cash equivalents**

Cash and cash equivalents in the Balance Sheet consist of cash at bank and in hand and short-term deposits with an original maturity of three months or less.

**Non-current assets held for sale**

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through sale rather than continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and it should be expected to be completed within one year from the date of classification.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

**Pensions and similar obligations**

The Group accounts for pensions and other post-employment benefits (principally private healthcare) under IAS 19 'Employee Benefits'.

In respect of defined benefit plans, obligations are measured at discounted present value (using the projected unit credit method) whilst plan assets are recorded at fair value. The operating and financing costs of such plans are recognised separately in the Income Statement; service costs are spread systematically over the expected service lives of employees and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised immediately in the Statement of Recognised Income and Expense.

Payments to defined contribution schemes are recognised as an expense as they fall due.

**Share-based payments**

Employees of the Group receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. In accordance with IFRS 2 'Share-based payment', the resulting cost is charged to the Income Statement over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

**Taxation**

The tax expense included in the Income Statement consists of current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted by the Balance Sheet date.

Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is provided using the Balance Sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

**Note 1 Accounting policies** continued

Deferred tax is calculated at the tax rates that have been enacted or substantively enacted by the Balance Sheet date. Deferred tax is charged or credited in the Income Statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also recognised in equity.

Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each Balance Sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset against each other when there is a legally enforceable right to set-off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

**Foreign currencies**

Transactions in foreign currencies are translated at the exchange rate on the date of the transaction. At each Balance Sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the Balance Sheet date. All differences are taken to the Income Statement for the period.

The financial statements of foreign subsidiaries are translated into Pounds Sterling according to the functional currency concept of IAS 21 'The Effects of Changes in Foreign Exchange Rates'. Since the majority of consolidated companies operate as independent entities within their local economic environment, their respective local currency is the functional currency. Therefore, assets and liabilities of overseas subsidiaries denominated in foreign currencies are translated at exchange rates prevailing at the date of the Group Balance Sheet; profits and losses are translated into Pounds Sterling at average exchange rates for the relevant accounting periods. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or expenses in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

**Financial instruments**

Financial assets and financial liabilities are recognised on the Group's Balance Sheet when the Group becomes a party to the contractual provisions of the instrument.

Trade receivables

Trade receivables are non interest-bearing and are recognised initially at fair value, and subsequently at amortised cost using the effective interest rate method, reduced by appropriate allowances for estimated irrecoverable amounts.

Investments

Investments are recognised at trade date. Investments are classified as either held for trading or available-for-sale, and are recognised at fair value.

For held for trading investments, gains and losses arising from changes in fair value are recognised in the Income Statement.

For available-for-sale investments, gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net result for the period. Interest calculated using the effective interest rate method is recognised in the Income Statement. Dividends on an available-for-sale equity instrument are recognised in the Income Statement when the entity's right to receive payment is established.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that gives a residual interest in the assets of the Group after deducting all of its liabilities.

Interest-bearing borrowings

Interest-bearing bank loans and overdrafts are initially recorded at fair value, net of attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the Income Statement over the period of the borrowings on an effective interest basis.

Trade payables

Trade payables are non interest-bearing and are stated at amortised cost.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

### Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operating, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes, however if derivatives do not qualify for hedge accounting they are accounted for as such.

Derivative financial instruments are recognised and stated at fair value. The fair value of derivative financial instruments is determined by reference to market values for similar financial instruments, by discounted cash flows, or by the use of option valuation models. Where derivatives do not qualify for hedge accounting, any gains or losses on remeasurement are immediately recognised in the Income Statement. Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the hedge relationship and the item being hedged.

In order to qualify for hedge accounting, the Group is required to document from inception the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is performed at each period end to ensure that the hedge remains highly effective.

Financial instruments with maturity dates of more than one year from the Balance Sheet date are disclosed as non-current.

### Fair value hedging

Derivative financial instruments are classified as fair value hedges when they hedge the Group's exposure to changes in the fair value of a recognised asset or liability. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement, together with any changes in the fair value of the hedged item that is attributable to the hedged risk.

Derivative financial instruments qualifying for fair value hedge accounting are principally interest rate swaps (including cross currency swaps).

### Cash flow hedging

Derivative financial instruments are classified as cash flow hedges when they hedge the Group's exposure to variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecasted transaction.

The effective element of any gain or loss from remeasuring the derivative instrument is recognised directly in equity.

The associated cumulative gain or loss is removed from equity and recognised in the Income Statement in the same period or periods during which the hedged transaction affects the Income Statement. The classification of the effective portion when recognised in the Income Statement is the same as the classification of the hedged transaction. Any element of the remeasurement of the derivative instrument which does not meet the criteria for an effective hedge is recognised immediately in the Income Statement within finance costs.

Derivative instruments qualifying for cash flow hedging are principally forward foreign exchange transactions and currency options.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Income Statement.

### Net investment hedging

Derivative financial instruments are classified as net investment hedges when they hedge the Group's net investment in an overseas operation. The effective element of any foreign exchange gain or loss from remeasuring the derivative is recognised directly in equity. Any ineffective element is recognised immediately in the Income Statement. Gains and losses accumulated in equity are included in the Income Statement when the foreign operation is disposed of.

Derivative instruments qualifying for net investment hedging are principally forward foreign exchange transactions and currency options.

**Treatment of agreements to acquire minority interests**

The Group has entered into a number of agreements to purchase the remaining shares of subsidiaries with minority shareholdings.

Under IAS 32 'Financial Instruments: Disclosures', the net present value of the expected future payments are shown as a financial liability. At the end of each period, the valuation of the liability is reassessed with any changes recognised in the Income Statement within finance costs for the year. Where the liability is in a currency other than Pounds Sterling, the liability has been designated as a net investment hedge. Any change in the value of the liability resulting from changes in exchange rates is recognised directly in equity.

**Provisions**

Provisions for onerous leases are recognised when the Group believes that the unavoidable costs of meeting the lease obligations exceed the economic benefits expected to be received under the lease.

**Recent accounting developments**

**Standards, amendments and interpretations effective for 2006/07 with no significant impact on the Group:**

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006, however, their implementation has not had a significant impact on the results or net assets of the Group:

- Amendment to IAS 21 'Net investment in foreign operation'
- Amendment to IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 4 'Insurance Contracts' on Financial Guarantee Contracts
- Amendment to IAS 39 on the fair value option
- Amendment to IAS 39 on cash flow hedge accounting of forecast intragroup transactions
- IFRIC 4 'Determining whether an arrangement contains a lease'
- IFRIC 5 'Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds'

**Standards, amendments and interpretations not yet effective but not expected to have a significant impact on the Group:**

- IFRS 7 'Financial Instruments: Disclosures' and amendments to IAS 1 'Presentation of Financial Statements – Capital Disclosures' were issued in August 2005 and are effective for accounting periods beginning on or after 1 January 2007. These amendments revise and enhance previous disclosures required by IAS 32 and IAS 30 'Disclosures in the Financial Statements of Banks and Similar Financial Institutions'. The adoption of IFRS 7 will have no impact on the results or net assets of the Group.
- IFRS 8 'Operating Segments' was issued in November 2006 and is effective for accounting periods beginning on or after 1 January 2009. This new standard replaces IAS 14 'Segment Reporting' and requires segmental information to be presented on the same basis that management uses to evaluate performance of its reporting segments in its management reporting. The adoption of IFRS 8 will have no impact upon the results or net assets of the Group.
- IFRIC 7 'Applying IAS 29 'Hyperinflationary accounting' for the first time'
- IFRIC 8 'Scope of IFRS 2'
- IFRIC 9 'Reassessment of embedded derivatives'
- IFRIC 10 'Interim financial reporting and impairment'
- IFRIC 12 'Service concession arrangements'

**Standards, amendments and interpretations not yet effective and under review as to their effect on the Group:**

- IFRIC 6 'Liabilities arising from participating in a specific market – waste electrical and electronic equipment (WEEE)' – effective from 1 July 2007 (date from which the WEEE Directive is applicable in the UK)
- IFRIC 11 'Scope of IFRS 2 – Group and treasury share transactions' – effective for periods beginning on or after 1 March 2007

**Use of non-GAAP profit measures – underlying profit before tax**

The Directors believe that underlying profit before tax and underlying diluted earnings per share measures provide additional useful information for shareholders on underlying trends and performance. These measures are used for internal performance analysis. Underlying profit is not defined by IFRS and therefore may not be directly comparable with other companies' adjusted profit measures. It is not intended to be a substitute for, or superior to IFRS measurements of profit.

The adjustments made to reported profit before tax are:

- IAS 32 and IAS 39 'Financial Instruments' – fair value remeasurements – under IAS 32 and IAS 39, the Group applies hedge accounting to its various hedge relationships when allowed under the rules of IAS 39 and when practical to do so. Sometimes the Group is unable to apply hedge accounting to the arrangements, but continues to enter into these arrangements as they provide certainty or active management of the exchange rates and interest rates applicable to the Group. The Group believes these arrangements remain effective and economically and commercially viable hedges despite the inability to apply hedge accounting.

Where hedge accounting is not applied to certain hedging arrangements, the reported results reflect the movement in fair value of related derivatives due to changes in foreign exchange and interest rates. In addition, at each period end, any gain or loss accruing on open contracts is recognised in the Income Statement for the period, regardless of the expected outcome of the hedging contract on termination. This may mean that the Income Statement charge is highly volatile, whilst the resulting cash flows may not be as volatile. The underlying profit measure removes this volatility to help better identify underlying business performance.

- IAS 19 Income Statement charge for pensions – Under IAS 19 'Employee Benefits', the cost of providing pension benefits in the future is discounted to a present value at the corporate bond yield rates applicable on the last day of the previous financial year. Corporate bond yield rates vary over time which in turn creates volatility in the Income Statement and Balance Sheet. IAS 19 also increases the charge for young pension schemes, such as Tesco's, by requiring the use of rates which do not take into account the future expected returns on the assets held in the pension scheme which will fund pension liabilities as they fall due. The sum of these two effects makes the IAS 19 charge disproportionately higher and more volatile than the cash contributions the Group is required to make in order to fund all future liabilities.

  Therefore, within underlying profit we have included the 'normal' cash contributions for pensions but excluded the volatile element of IAS 19 to represent what the Group believes to be a fairer measure of the cost of providing post-employment benefits.

- Exceptional items – due to their significance and special nature, certain other items which do not reflect the Group's underlying performance have been excluded from underlying profit. These gains or losses can have a significant impact on both absolute profit and profit trends, consequently, they are excluded from the underlying profit of the Group. In 2006/07, exceptional items are as follows:

  – Pensions adjustment relating to the Finance Act 2006 – Following changes introduced by the Finance Act with effect from April 2006 (Pensions A-Day), Tesco's UK approved pension schemes have implemented revised terms for members exchanging pension at retirement date, allowing them the option to commute (convert) a larger amount of their pension to a tax-free lump sum on retirement. Accordingly, the assumptions made in calculating the defined benefit pension liability have been revised, and a gain of £250m has been recognised in the Income Statement during the year. Changes to scheme rules in the Republic of Ireland affecting early retirement have reduced pension liabilities by a further £8m, which is also recognised in the Income Statement. Future revisions to the commutation assumption will be reflected within the Statement of Recognised Income and Expense.

  – Impairment of the Gerrards Cross site – As detailed in the 2006 Annual Report, the Group regards each individual store as a cash-generating unit, with each store tested for impairment if there are indications of impairment at the Balance Sheet date. We are facing continuing uncertainty in respect of our Gerrards Cross site as a result of the complex legal situation following the tunnel collapse. No decision has yet been taken about the future of this site. However, at year end we have written off the carrying value of our existing asset there (an impairment of £35m). We are not yet in a position to assess any recoveries or liabilities in respect of ongoing claims.

## Note 2 Segmental reporting

The Board has determined that the primary segmental reporting format is geographical, based on the Group's management and internal reporting structure. Secondary information is reported by a single business segment, retail and associated activities.

The Rest of Europe reporting segment includes the Republic of Ireland, Hungary, Poland, the Czech Republic, Slovakia and Turkey. The Asia reporting segment includes Thailand, South Korea, Malaysia, China and Japan. Following its disposal during the year, the Taiwanese business (previously included within the Asia segment) was classified as a discontinued operation in both the current and prior year.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly interest-bearing borrowings and taxation related assets/liabilities.

Inter-segment turnover between the geographical areas of business is not material.

### Geographical segments

| Year ended 24 February 2007 | UK £m | Rest of Europe £m | Asia £m | | Total £m |
|---|---|---|---|---|---|
| Continuing operations | | | | | |
| Revenue | | | | | |
| Sales (excluding VAT) to external customers | 32,665 | 5,559 | 4,417 | | 42,641 |
| Result | | | | | |
| Segment operating profit | 2,083 | 324 | 241 | | 2,648 |
| Share of post-tax profit/(losses) of joint ventures and associates | 111 | – | (5) | | 106 |
| Profit on sale of investments in associates | 25 | – | – | | 25 |
| Net finance costs | | | | | (126) |
| Profit before tax | | | | | 2,653 |
| Taxation | | | | | (772) |
| Profit for the year from continuing operations | | | | | 1,881 |
| Discontinued operation | | | | | |
| Profit for the year from discontinued operation | | | | | 18 |
| Profit for the year | | | | | 1,899 |

| | UK £m | Rest of Europe £m | Asia £m | Other/ unallocated £m | Total £m |
|---|---|---|---|---|---|
| Assets and liabilities | | | | | |
| Segment assets | 16,323 | 4,552 | 3,397 | 221 | 24,493 |
| Investments in joint ventures and associates | 307 | 2 | 5 | – | 314 |
| Total assets | 16,630 | 4,554 | 3,402 | 221 | 24,807 |
| Segment liabilities | (5,602) | (903) | (1,031) | (6,700) | (14,236) |
| Total net assets | | | | | 10,571 |
| Other segment information | | | | | |
| Capital expenditure (including acquisitions through business combinations): | | | | | |
| – Property, plant and equipment | 1,765 | 786 | 516 | – | 3,067 |
| – Investment property | – | 36 | 22 | – | 58 |
| – Goodwill and other intangible assets | 197 | 52 | 420 | – | 669* |
| Depreciation: | | | | | |
| – Property, plant and equipment | 520 | 155 | 99 | – | 774 |
| – Investment property | – | 7 | 4 | – | 11 |
| Amortisation of intangible assets | 79 | 8 | 6 | – | 93 |
| Impairment losses recognised in the Income Statement | (44) | (35) | (3) | – | (82) |
| Reversal of prior period impairment losses through the Income Statement | 17 | 46 | – | – | 63 |
| Profit/(loss) arising on property-related items | 98 | – | (6) | – | 92 |

* Includes £166m of goodwill transferred in from joint ventures, following the acquisition of additional shares in dunnhumby and Hymall.

Note 2 **Segmental reporting** continued

| Year ended 25 February 2006 | UK £m | Rest of Europe £m | Asia £m | Total £m |
|---|---|---|---|---|
| **Continuing operations** | | | | |
| **Revenue** | | | | |
| Sales (excluding VAT) to external customers | 29,990 | 5,095 | 4,369 | 39,454 |
| **Result** | | | | |
| Segment operating profit | 1,788 | 263 | 229 | 2,280 |
| Share of post-tax profit from joint ventures and associates | 78 | – | 4 | 82 |
| Net finance costs | | | | (127) |
| Profit before tax | | | | 2,235 |
| Taxation | | | | (649) |
| Profit for the year from continuing operations | | | | 1,586 |
| **Discontinued operation** | | | | |
| Loss for the year from discontinued operation | | | | (10) |
| Profit for the year | | | | 1,576 |

| | Continuing operations | | | | | | |
|---|---|---|---|---|---|---|---|
| | UK £m | Rest of Europe £m | Asia £m | Other/ unallocated £m | Total £m | Discontinued operation £m | Total £m |
| **Assets and liabilities** | | | | | | | |
| Segment assets | 14,906 | 3,888 | 3,012 | 167 | 21,973 | 114 | 22,087 |
| Investments in joint ventures and associates | 461 | 2 | 13 | – | 476 | – | 476 |
| Total assets | 15,367 | 3,890 | 3,025 | 167 | 22,449 | 114 | 22,563 |
| Segment liabilities | (5,025) | (708) | (692) | (6,608) | (13,033) | (86) | (13,119) |
| Total net assets | | | | | 9,416 | 28 | 9,444 |
| **Other segment information** | | | | | | | |
| Capital expenditure (including acquisitions through business combinations): | | | | | | | |
| – Property, plant and equipment | 1,673 | 549 | 440 | – | 2,662 | 3 | 2,665 |
| – Investment property | 1 | 10 | 10 | – | 21 | – | 21 |
| – Goodwill and other intangible assets | 126 | 12 | 28 | – | 166 | – | 166 |
| Depreciation: | | | | | | | |
| – Property, plant and equipment | 508 | 146 | 95 | – | 749 | 4 | 753 |
| – Investment property | – | 4 | 5 | – | 9 | – | 9 |
| Amortisation of intangible assets | 63 | 7 | 6 | – | 76 | – | 76 |
| Impairment losses recognised in the Income Statement | (29) | (18) | – | – | (47) | – | (47) |
| Reversal of prior period impairment losses through the Income Statement | 29 | 23 | – | – | 52 | – | 52 |
| Profit/(loss) arising on property-related items | 90 | (6) | (7) | – | 77 | – | 77 |

## Business segments

The Group has one business segment, retail and associated activities.

| | 2007 £m | 2006 £m |
|---|---|---|
| Revenue | 42,641 | 39,454 |
| Segment assets | 24,493 | 22,087 |
| Capital expenditure (including acquisitions through business combinations) | 3,794 | 2,852 |

**Note 3** **Income and expenses**

| From continuing operations | 2007 £m | 2006 £m |
|---|---|---|
| Profit before tax is stated after charging/(crediting) the following: | | |
| Profit arising on property-related items | (92) | (77) |
| Rental income, of which £166m (2006 – £140m) relates to investment properties | (210) | (175) |
| Direct operating expenses arising on rental earning investment properties | 47 | 46 |
| Costs of inventories recognised as an expense | 31,104 | 29,640 |
| Stock losses | 581 | 533 |
| Depreciation of property, plant and equipment and investment property | 785 | 758 |
| Net impairment/(reversal of impairment) of property, plant and equipment | 19 | (5) |
| Amortisation of internally-generated development intangible assets | 69 | 56 |
| Amortisation of other intangibles | 24 | 20 |
| Operating lease expenses (a) | 394 | 360 |

(a) Operating lease expenses include £89m (2006 – £71m) for hire of plant and machinery.

During the year, the Group (including its overseas subsidiaries) obtained the following services from the Group's auditor and network firms:

| | 2007 £m | 2006 £m |
|---|---|---|
| Audit services | | |
| Fees payable to the Company's auditor for the audit of the Parent Company and consolidated annual accounts | 0.6 | 0.4 |
| Non-audit services | | |
| Fees payable to the Company's auditor and network firms for other services: | | |
| – the audit of the accounts of the Company's subsidiaries pursuant to legislation | 2.3 | 2.3 |
| – other services pursuant to such legislation | 0.2 | 0.3 |
| – other services relating to taxation | 2.3 | 2.5 |
| – other services relating to corporate finance transactions | 0.2 | 0.3 |
| Total auditor remuneration | 5.6 | 5.8 |

In addition to the amounts shown above, the auditors received fees of £0.1m (2006 – £0.1m) for the audit of the main Group pension scheme.

A description of the work of the Audit Committee is set out in the Corporate Governance Report on pages 22 to 26 and includes an explanation of how objectivity and independence is safeguarded when non-audit services are provided by PricewaterhouseCoopers LLP.

## Note 4 Employment costs, including Directors' remuneration

| | 2007 £m | 2006 £m |
|---|---|---|
| Wages and salaries | 3,794 | 3,473 |
| Social security costs | 377 | 271 |
| Post-employment benefits | 215 | 335 |
| Share-based payments expense – equity settled | 209 | 190 |
| | 4,595 | 4,269 |

The average number of employees by geographical segment during the year was:

| | Average number of employees | | Average number of full-time equivalents | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| UK | 270,417 | 261,578 | 184,461 | 175,459 |
| Rest of Europe | 74,017 | 62,925 | 67,351 | 55,160 |
| Asia | 68,627 | 43,710 | 66,471 | 42,405 |
| Total | 413,061 | 368,213 | 318,283 | 273,024 |

## Note 5 Finance income and costs

| | 2007 £m | 2006 £m |
|---|---|---|
| **Finance income** | | |
| Bank interest receivable and similar income on cash and cash equivalents | 56 | 89 |
| Net pension finance income (note 23) | 34 | 25 |
| **Total finance income (on historical cost basis)** | 90 | 114 |
| **Finance costs** | | |
| Interest payable on short-term bank loans and overdrafts repayable within five years | (34) | (77) |
| Finance charges payable under finance leases and hire purchase contracts | (7) | (6) |
| 4% 125m GBP unsecured deep discount loan stock 2006 (a) | (5) | (12) |
| 6% 150m GBP Medium Term Note (MTN) 2006 | (7) | (9) |
| 0.7% 50bn JPY MTN 2006 | (1) | (2) |
| 7.5% 258m GBP MTN 2007 | (22) | (24) |
| 6% 125m GBP MTN 2008 | (11) | (15) |
| 5.25% 500m EUR MTN 2008 | (18) | (18) |
| 5.125% 192m GBP MTN 2009 | (13) | (18) |
| 6.625% 150m GBP MTN 2010 | (10) | (10) |
| 4.75% 750m EUR MTN 2010 | (25) | (25) |
| 3.875% 500m EUR MTN 2011 | (12) | – |
| 4% RPI GBP MTN 2016 (b) | (16) | (15) |
| 5.5% 350m GBP MTN 2019 | (19) | (19) |
| 5% 350m GBP MTN 2023 | (16) | – |
| 3.322% LPI GBP MTN 2025 (c) | (15) | (14) |
| 6% 200m GBP MTN 2029 | (12) | (12) |
| 5.5% 200m GBP MTN 2033 | (11) | (11) |
| 2% RPI GBP MTN 2036 (d) | (11) | – |
| 5% 300m GBP MTN 2042 | (14) | – |
| Other MTNs | (11) | (12) |
| Capitalised interest | 78 | 67 |
| **Total finance costs (on historical cost basis)** | (212) | (232) |
| IAS 32 and IAS 39 'Financial Instruments' – Fair value remeasurements | (4) | (9) |
| **Total finance costs** | (216) | (241) |

(a) Interest payable on the 4% GBP unsecured deep discount loan stock 2006 includes £3m (2006 – £7m) of discount amortisation.
(b) Interest payable on the 4% RPI GBP MTN 2016 includes £7m (2006 – £6m) of RPI related amortisation.
(c) Interest payable on the 3.322% LPI GBP MTN 2025 includes £7m (2006 – £7m) of RPI related amortisation.
(d) Interest payable on the 2% RPI GBP MTN 2036 includes £7m (2006 – £nil) of RPI related amortisation.

**Note 6** Taxation

### Recognised in the Income Statement

| | 2007 £m | 2006 £m |
|---|---|---|
| **Current tax expense** | | |
| UK corporation tax | 505 | 555 |
| Foreign tax | 88 | 59 |
| Adjustments in respect of prior years | (61) | 50 |
| | 532 | 664 |
| **Deferred tax expense** | | |
| Origination and reversal of temporary differences | 147 | (16) |
| Benefit of tax losses recognised | (2) | (2) |
| Benefit of tax losses recognised – adjustments in respect of prior years | – | (3) |
| Adjustments in respect of prior years | 95 | 7 |
| | 240 | (14) |
| Total income tax expense from continuing and discontinued operations | 772 | 650 |
| Income tax on discontinued operation (note 7) | – | (1) |
| Total income tax expense from continuing operations | 772 | 649 |

UK corporation tax is calculated at 30% (2006 – 30%) of the estimated assessable profit for the year. Taxation in other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

### Reconciliation of effective tax charge for continuing operations

| | 2007 £m | 2006 £m |
|---|---|---|
| Profit before tax | 2,653 | 2,235 |
| Effective tax charge at 30% | (796) | (670) |
| Effect of: | | |
| – (non-deductible expenses)/non-taxable income | (22) | 25 |
| – differences in overseas taxation rates | 48 | 26 |
| – adjustments in respect of prior years | (34) | (54) |
| – share of results of joint ventures and associates | 32 | 24 |
| Total income tax charge for the year from continuing operations | (772) | (649) |
| Effective tax rate | 29.1% | 29.0% |

In 2007, the UK government announced its intention to propose that Parliament reduce the UK corporate income tax rate from 30% to 28% with effect from 1 April 2008. As of 24 February 2007, the tax rate change was not substantively enacted. If this change had been substantively enacted, the deferred tax liability as at 24 February 2007 would have decreased by approximately £31m and the deferred tax expense by approximately £15m. This would have resulted in a decrease in the effective tax rate from 29.1% to 28.5%.

### Tax on items charged to equity

| | 2007 £m | 2006 £m |
|---|---|---|
| Current tax credit/(charge) on: | | |
| – foreign exchange movements | (20) | 2 |
| – IAS 32 and IAS 39 movement | – | (5) |
| – share-based payments | 19 | – |
| | (1) | (3) |
| Deferred tax credit/(charge) on: | | |
| – IAS 32 and IAS 39 movement | – | (6) |
| – share-based payments | 47 | 11 |
| – pensions | (34) | 131 |
| | 13 | 136 |
| Total tax on items credited to equity (note 25) | 12 | 133 |

## Note 6 Taxation continued

### Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior year:

| | Accelerated tax depreciation £m | Retirement benefit obligation £m | Share-based payments £m | Short-term timing differences £m | Tax losses £m | IAS 32 and IAS 39 £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 26 February 2005 | (798) | 214 | 72 | 27 | 3 | 28 | (454) |
| (Charge)/credit to the Income Statement | (35) | 19 | 22 | 3 | 5 | – | 14 |
| (Charge)/credit to equity | – | 131 | 11 | – | – | (6) | 136 |
| Disposal of subsidiary | – | – | – | 1 | – | – | 1 |
| Foreign exchange differences | (4) | – | – | 1 | – | – | (3) |
| | (837) | 364 | 105 | 32 | 8 | 22 | (306) |
| Discontinued operation | (2) | – | – | – | – | – | (2) |
| At 25 February 2006 | (839) | 364 | 105 | 32 | 8 | 22 | (308) |
| (Charge)/credit to the Income Statement | (193) | (46) | (16) | 17 | (1) | (1) | (240) |
| (Charge)/credit to equity | – | (34) | 47 | – | – | – | 13 |
| Acquisition of subsidiaries | 9 | – | – | 3 | 17 | – | 29 |
| Foreign exchange differences | 4 | – | – | (1) | – | – | 3 |
| At 24 February 2007 | (1,019) | 284 | 136 | 51 | 24 | 21 | (503) |

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

| | 2007 £m | 2006 £m |
|---|---|---|
| Deferred tax assets | 32 | 12 |
| Deferred tax liabilities | (535) | (320) |
| | (503) | (308) |

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries and joint ventures, because the earnings are continually reinvested by the Group and no tax is expected to be payable on them in the foreseeable future. The temporary difference unrecognised at the year end amounted to £565m (2006 – £461m).

### Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items, because it is not probable that future taxable profits will be available against which the Group can utilise the benefits.

| | 2007 £m | 2006 £m |
|---|---|---|
| Deductible temporary differences | 1 | 3 |
| Tax losses | 12 | 17 |
| | 13 | 20 |

At the Balance Sheet date, the Group has unused tax losses of £131m (2006 – £96m) available for offset against future profits. A deferred tax asset has been recognised in respect of £98m (2006 – £27m) of such losses. No deferred tax asset has been recognised in respect of the remaining £33m (2006 – £69m) due to the unpredictability of future profit streams. Included in unrecognised tax losses are losses of £10m (2006 – £nil) that will expire in 2011 and £22m (2006 – £nil) that will expire in 2027. Other losses will be carried forward indefinitely.

**Note 7** **Discontinued operation and assets classified as held for sale**

| | 2007 £m | 2006 £m |
|---|---|---|
| Assets of the disposal group | – | 114 |
| Non-current assets classified as held for sale | 408 | 54 |
| Total non-current assets classified as held for sale and assets of the disposal group | 408 | 168 |
| Total liabilities directly associated with the disposal group | – | (86) |
| Total net assets classified as held for sale | 408 | 82 |

**Discontinued operation**

On 31 May 2006, the Group sold its business operation in Taiwan to Carrefour as part of a transaction to acquire Carrefour's Czech business.

The net result of the Taiwanese business has been presented as a discontinued operation in the Income Statement for both the current and prior years, and the net assets of the business were classified as a disposal group on the Balance Sheet as at 25 February 2006.

The table below shows the results of the Taiwan business that are included in results of the Group for the current and prior periods included within discontinued operation.

Income Statement

| | 2007 £m | 2006 £m |
|---|---|---|
| Revenue | 46 | 134 |
| Cost of sales | (36) | (111) |
| Administrative expenses | (14) | (32) |
| Net finance costs | – | (1) |
| Share of profit of discontinued joint venture | – | 1 |
| Operating loss before tax of discontinued operation | (4) | (9) |
| Profit on disposal of discontinued operation | 22 | – |
| Profit/(loss) before tax of discontinued operation | 18 | (9) |
| Tax relating to operating loss | – | (1) |
| Profit/(loss) for the year from discontinued operation | 18 | (10) |

The table below shows the amounts relating to the discontinued operation that are included within the Group cash flows for the year.

Cash Flow Statement

| | 2007 £m | 2006 £m |
|---|---|---|
| Net cash flows from operating activities | (7) | (6) |
| Net cash flows from investing activities | (2) | (6) |
| Net cash flows from financing activities | 11 | 10 |
| | 2 | (2) |

Note 7 **Discontinued operation and assets classified as held for sale** continued

The table below shows the net assets disposed of and consideration received.

Balance Sheet

| | 31 May 2006 £m |
|---|---|
| Property, plant and equipment | 39 |
| Investment property | 17 |
| Investment in subsidiary | 4 |
| Investment in joint ventures and associates | 10 |
| Deferred tax asset | 2 |
| Inventories | 7 |
| Trade and other receivables | 6 |
| Cash and cash equivalents | 4 |
| Bank loans and overdrafts | (18) |
| Trade and other payables | (67) |
| Tax liabilities | (1) |
| Net identifiable assets and liabilities disposed of | 3 |
| Consideration received, satisfied in cash | 28 |
| Costs associated with disposal | (3) |
| Profit on disposal | 22 |

**Non-current assets classified as held for sale**

| | 2007 £m | 2006 £m |
|---|---|---|
| Non-current assets classified as held for sale | 408 | 54 |

The non-current assets classified as held for sale consist mainly of properties held for sale, including the UK assets disposed of as part of the post-balance sheet sale and leaseback transaction (see note 32).

**Note 8** Dividends

| | 2007 pence/share | 2006 pence/share | 2007 £m | 2006 £m |
|---|---|---|---|---|
| Amounts recognised as distributions to equity holders in the year: | | | | |
| Final dividend for the prior financial year | 6.10 | 5.27 | 482 | 410 |
| Interim dividend for the current financial year | 2.81 | 2.53 | 224 | 199 |
| | 8.91 | 7.80 | 706 | 609 |
| Proposed final dividend for the current financial year | 6.83 | 6.10 | 542 | 482 |

The proposed final dividend was approved by the Board of Directors on 16 April 2007 and is subject to the approval of shareholders at the Annual General Meeting. The proposed dividend has not been included as a liability as at 24 February 2007, in accordance with IAS 10 'Events after the balance sheet date'. It will be paid on 6 July 2007 to shareholders who are on the register of members on 27 April 2007.

**Note 9** Earnings per share and diluted earnings per share

Basic earnings per share amounts are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares in issue during the year.

Diluted earnings per share amounts are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares in issue during the year (adjusted for the effects of potentially dilutive options).

The dilution effect is calculated on the full exercise of all ordinary share options granted by the Group, including performance-based options which the Group considers to have been earned.

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Basic | Potentially dilutive share options | Diluted | Basic | Potentially dilutive share options | Diluted |
| **Profit (£m)** | | | | | | |
| Continuing operations | 1,874 | – | 1,874 | 1,580 | – | 1,580 |
| Discontinued operation | 18 | – | 18 | (10) | – | (10) |
| **Total** | 1,892 | – | 1,892 | 1,570 | – | 1,570 |
| **Weighted average number of shares (million)** | 7,936 | 102 | 8,038 | 7,823 | 109 | 7,932 |
| **Earnings per share (pence)** | | | | | | |
| Continuing operations | 23.61 | (0.30) | 23.31 | 20.20 | (0.28) | 19.92 |
| Discontinued operation | 0.23 | – | 0.23 | (0.13) | – | (0.13) |
| **Total** | 23.84 | (0.30) | 23.54 | 20.07 | (0.28) | 19.79 |

There have been no transactions involving ordinary shares between the reporting date and the date of approval of these financial statements which would significantly change the earnings per share calculations shown above.

**Reconciliation of non-GAAP underlying diluted earnings per share**

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | £m | pence/share | £m | pence/share |
| **Profit** | | | | |
| Earnings from continuing operations | 1,874 | 23.31 | 1,580 | 19.92 |
| Adjustments for: | | | | |
| IAS 32 and IAS 39 'Financial Instruments' – Fair value remeasurements | 4 | 0.05 | 9 | 0.11 |
| Total IAS 19 Income Statement charge for pensions | 432 | 5.37 | 303 | 3.82 |
| 'Normal' cash contributions for pensions | (321) | (3.99) | (270) | (3.40) |
| Pensions adjustment – Finance Act 2006 | (258) | (3.21) | – | – |
| Impairment of the Gerrards Cross site | 35 | 0.44 | – | – |
| Tax effect of adjustments at the effective rate of tax (2007 – 29.1%; 2006 – 29.0%) | 31 | 0.39 | (12) | (0.15) |
| **Underlying earnings from continuing operations** | 1,797 | 22.36 | 1,610 | 20.30 |

## Note 10 Goodwill and other intangible assets

| | Internally generated development costs £m | Pharmacy and software licences £m | Other intangible assets £m | Goodwill £m | Total £m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 25 February 2006 | 458 | 193 | 43 | 1,235 | 1,929 |
| Foreign currency translation | (2) | (2) | (3) | (44) | (51) |
| Additions | 129 | 44 | 1 | 1 | 175 |
| Acquisitions through business combinations | – | – | 1 | 493 | 494 |
| Reclassification across categories | (2) | 1 | (1) | – | (2) |
| Disposals | – | (3) | (2) | (1) | (6) |
| **At 24 February 2007** | 583 | 233 | 39 | 1,684 | 2,539 |
| **Accumulated amortisation and impairment losses** | | | | | |
| At 25 February 2006 | 194 | 109 | 3 | 98 | 404 |
| Foreign currency translation | – | (1) | – | – | (1) |
| Amortisation for the year | 69 | 22 | 2 | – | 93 |
| Disposals | – | (2) | – | – | (2) |
| **At 24 February 2007** | 263 | 128 | 5 | 98 | 494 |
| **Net carrying value** | | | | | |
| **At 24 February 2007** | 320 | 105 | 34 | 1,586 | 2,045 |
| At 25 February 2006 | 264 | 84 | 40 | 1,137 | 1,525 |
| **Cost** | | | | | |
| At 26 February 2005 | 393 | 144 | 59 | 1,192 | 1,788 |
| Foreign currency translation | 1 | 3 | 4 | 19 | 27 |
| Additions | 115 | 21 | 3 | – | 139 |
| Acquisitions through business combinations | – | – | – | 27 | 27 |
| Reclassification across categories | 1 | 27 | (23) | (2) | 3 |
| Disposals | (52) | (2) | – | (1) | (55) |
| **At 25 February 2006** | 458 | 193 | 43 | 1,235 | 1,929 |
| **Accumulated amortisation and impairment losses** | | | | | |
| At 26 February 2005 | 190 | 82 | 10 | 98 | 380 |
| Foreign currency translation | – | 2 | – | – | 2 |
| Amortisation for the year | 56 | 19 | 1 | – | 76 |
| Reclassification across categories | – | 8 | (8) | – | – |
| Disposals | (52) | (2) | – | – | (54) |
| **At 25 February 2006** | 194 | 109 | 3 | 98 | 404 |
| **Net carrying value** | | | | | |
| **At 25 February 2006** | 264 | 84 | 40 | 1,137 | 1,525 |
| At 26 February 2005 | 203 | 62 | 49 | 1,094 | 1,408 |

There are no intangible assets, other than goodwill, with indefinite useful lives.

**Note 10** Goodwill and other intangible assets continued

**Impairment of goodwill**

Goodwill arising on business combinations is not amortised but is reviewed for impairment on an annual basis or more frequently if there are indications that goodwill may be impaired. Goodwill acquired in a business combination is allocated to groups of cash-generating units according to the level at which management monitor that goodwill.

Recoverable amounts for cash-generating units are based on value in use, which is calculated from cash flow projections for five years using data from the Group's latest internal forecasts, the results of which are reviewed by the Board. The key assumptions for the value in use calculations are those regarding discount rates, growth rates and expected changes in margins. Management estimates discount rates using pre-tax rates that reflect the current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market.

The forecasts are extrapolated beyond five years based on estimated long-term average growth rates (generally 3%-4%).

The pre-tax discount rates used to calculate value in use range from 10%-17% (2006: 9%-11%). These discount rates are derived from the Group's post-tax weighted average cost of capital as adjusted for the specific risks relating to each geographical region.

In February 2007, 2006 and 2005 impairment reviews were performed by comparing the carrying value of goodwill with the recoverable amount of the cash-generating units to which goodwill has been allocated. Management determined that there has been no impairment.

The components of goodwill are as follows:

| | 2007 £m | 2006 £m | 2005 £m |
|---|---|---|---|
| UK | 501 | 466 | 463 |
| Thailand | 113 | 115 | 107 |
| South Korea | 29 | 32 | 10 |
| Japan | 115 | 133 | 135 |
| China | 346 | – | – |
| Malaysia | 64 | – | – |
| Poland | 322 | 331 | 323 |
| Czech Republic | 34 | – | – |
| Turkey | 47 | 55 | 49 |
| Other | 15 | 5 | 7 |
| | 1,586 | 1,137 | 1,094 |

## Note 11 Property, plant and equipment

| | Land and buildings £m | Other (a) £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 25 February 2006 | 15,563 | 4,707 | 20,270 |
| Foreign currency translation | (176) | (46) | (222) |
| Additions (b) | 1,925 | 864 | 2,789 |
| Acquisitions through business combinations | 247 | 31 | 278 |
| Reclassification across categories | (100) | 1 | (99) |
| Classified as held for sale | (391) | (13) | (404) |
| Disposals | (528) | (155) | (683) |
| **At 24 February 2007** | 16,540 | 5,389 | 21,929 |
| **Accumulated depreciation and impairment losses** | | | |
| At 25 February 2006 | 1,815 | 2,573 | 4,388 |
| Foreign currency translation | (8) | (17) | (25) |
| Charge for the year | 240 | 534 | 774 |
| Reclassification across categories | 2 | (3) | (1) |
| Classified as held for sale | (40) | (7) | (47) |
| Disposals | (86) | (69) | (155) |
| Impairment losses | 82 | – | 82 |
| Reversal of impairment losses | (63) | – | (63) |
| **At 24 February 2007** | 1,942 | 3,011 | 4,953 |
| **Net carrying value (c)(d)(e)** | | | |
| At 24 February 2007 | 14,598 | 2,378 | 16,976 |
| At 25 February 2006 | 13,748 | 2,134 | 15,882 |
| **Capital work in progress included above (f)** | | | |
| At 24 February 2007 | 872 | 158 | 1,030 |

(a) Other assets consist of plant, equipment, fixtures and fittings and motor vehicles.

(b) Includes £78m (2006 – £67m) in respect of interest capitalised, principally relating to land and building assets. The capitalisation rate used to determine the amount of finance costs capitalised during the year was 5.1% (2006 – 5.1%). Interest capitalised is deducted in determining taxable profit in the year in which it is incurred.

(c) Net carrying value includes:

(i) Capitalised interest at 24 February 2007 of £716m (2006 – £655m).

(ii) Assets held under finance leases which are analysed below:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Land and buildings £m | Other (a) £m | Land and buildings £m | Other (a) £m |
| Cost | 91 | 662 | 102 | 388 |
| Accumulated depreciation and impairment losses | (16) | (480) | (14) | (367) |
| Net carrying value | 75 | 182 | 88 | 21 |

These assets are pledged as security for the finance lease liabilities.

(d) The net carrying value of land and buildings comprises:

| | 2007 £m | 2006 £m |
|---|---|---|
| Freehold | 13,267 | 12,616 |
| Long leasehold – 50 years or more | 657 | 541 |
| Short leasehold – less than 50 years | 674 | 591 |
| Net carrying value | 14,598 | 13,748 |

(e) Carrying value of land and buildings includes £8m (2006 – £9m) relating to the prepayment of lease premiums.

(f) Capital work in progress does not include land.

**Note 11 Property, plant and equipment** continued

| | Land and buildings £m | Other (a) £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 26 February 2005 | 14,247 | 4,298 | 18,545 |
| Foreign currency translation | 198 | 45 | 243 |
| Additions (b) | 1,935 | 707 | 2,642 |
| Acquisitions through business combinations | 20 | 3 | 23 |
| Reclassification across categories | (208) | 11 | (197) |
| Classified as held for sale | (74) | (15) | (89) |
| Disposals | (555) | (342) | (897) |
| **At 25 February 2006** | 15,563 | 4,707 | 20,270 |
| **Accumulated depreciation and impairment losses** | | | |
| At 26 February 2005 | 1,705 | 2,319 | 4,024 |
| Foreign currency translation | 9 | 19 | 28 |
| Charge for the year | 250 | 503 | 753 |
| Reclassification across categories | (1) | 1 | – |
| Classified as held for sale | (5) | (6) | (11) |
| Disposals | (139) | (262) | (401) |
| Impairment losses | 40 | 7 | 47 |
| Reversal of impairment losses | (44) | (8) | (52) |
| **At 25 February 2006** | 1,815 | 2,573 | 4,388 |
| **Net carrying value (c)(d)(e)** | | | |
| **At 25 February 2006** | 13,748 | 2,134 | 15,882 |
| At 26 February 2005 | 12,542 | 1,979 | 14,521 |
| Capital work in progress included above (f) | | | |
| **At 25 February 2006** | 699 | 82 | 781 |

### Impairment of property, plant and equipment

The Group has determined that for the purposes of impairment testing, each store is a cash-generating unit. Cash-generating units are tested for impairment if there are indications of impairment at the Balance Sheet date.

Recoverable amounts for cash-generating units are based on value in use, which is calculated from cash flow projections for five years using data from the Group's latest internal forecasts, the results of which are reviewed by the Board. The key assumptions for the value in use calculations are those regarding discount rates, growth rates and expected changes in margins. Management estimates discount rates using pre-tax rates that reflect the current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market.

The forecasts are extrapolated beyond five years based on estimated long-term growth rates (generally 3%-4%).

The pre-tax discount rates used to calculate value in use range from 10%-17% (2006: 9%-11%) depending on the specific conditions in which each store operates. These discount rates are derived from the Group's post-tax weighted average cost of capital.

The following amounts have been (charged)/credited to operating costs in the Income Statement during the current and prior year.

| | 2007 £m | 2006 £m |
|---|---|---|
| Impairment losses | | |
| UK | (44) | (29) |
| Rest of Europe | (35) | (18) |
| Asia | (3) | – |
| | (82) | (47) |
| Reversal of impairment losses | | |
| UK | 17 | 29 |
| Rest of Europe | 46 | 23 |
| Asia | – | – |
| | 63 | 52 |
| Net (impairment)/reversal of impairment losses | (19) | 5 |

The impairment losses relate to stores whose recoverable amounts (either value in use or fair value less costs to sell) do not exceed the asset carrying values. In all cases, impairment losses arose due to stores performing below forecasted trading levels.

The reversal of previous impairment losses arose principally due to improvements in stores' performances over the last year which increased the net present value of future cash flows.

**Note 12** **Investment property**

| | 2007 £m | 2006 £m |
|---|---|---|
| **Cost** | | |
| At beginning of year | 785 | 595 |
| Foreign currency translation | (32) | 36 |
| Additions | 26 | 21 |
| Acquisitions through business combinations | 32 | – |
| Transfers | 101 | 194 |
| Classified as held for sale | (4) | (58) |
| Disposals | (2) | (3) |
| **At end of year** | 906 | 785 |
| **Accumulated depreciation and impairment losses** | | |
| At beginning of year | 40 | 30 |
| Foreign currency translation | (2) | 2 |
| Charge for the period | 11 | 9 |
| Classified as held for sale | – | (1) |
| Transfers | 1 | – |
| **At end of year** | 50 | 40 |
| **Net carrying value** | 856 | 745 |

The net carrying value at 26 February 2005 was £565m.

The estimated fair value of the Group's investment property is £1,522m (2006 – £1,373m). This value has been determined by applying an appropriate rental yield to the rentals earned by the investment property. A valuation has not been performed by an independent valuer.

**Note 13** Group entities

## Significant subsidiaries

The Group consolidates its subsidiary undertakings; the principal subsidiaries are:

| | Business activity | Share of issued ordinary share capital, and voting rights | Country of incorporation |
|---|---|---|---|
| Tesco Stores Limited* | Retail | 100% | England |
| Tesco Distribution Limited* | Distribution | 100% | England |
| Tesco Property Holdings Limited* | Property | 100% | England |
| Tesco Insurance Limited* | Self-insurance | 100% | Guernsey |
| Valiant Insurance Company Limited | Self-insurance | 100% | Republic of Ireland |
| One Stop Stores Limited | Retail | 100% | England |
| Tesco Ireland Limited* | Retail | 100% | Republic of Ireland |
| Tesco Global Aruhazak Rt.* | Retail | 99% | Hungary |
| Tesco Polska Sp. z o.o.* | Retail | 100% | Poland |
| Tesco Stores Č R a.s.* | Retail | 100% | Czech Republic |
| Tesco Stores S R a.s.* | Retail | 100% | Slovakia |
| Samsung Tesco Co. Limited* | Retail | 89% | South Korea |
| Ek-Chai Distribution System Co. Limited* | Retail | 99% | Thailand |
| Tesco Stores Malaysia Sdn Bhd* | Retail | 70% | Malaysia |
| Tesco Stores Hong Kong Limited* | Purchasing | 100% | Hong Kong |
| C Two-Network Co. Limited* | Retail | 100% | Japan |
| Hymall* | Retail | 90% | Republic of China |
| dunnhumby Limited* | Data Analysis | 84% | England |
| Tesco Kipa A.Ş. | Retail | 93% | Turkey |

* Held by an intermediate subsidiary.

All principal subsidiary undertakings operate in their country of incorporation.

The accounting period ends of the subsidiary undertakings consolidated in these financial statements are on or around 24 February 2007, with the exception of Hymall which has an accounting period end of 31 December 2006 owing to its acquisition by the Group at the end of Hymall's financial year.

A full list of the Group's subsidiary undertakings will be annexed to the next Annual Return filed at Companies House.

There are no significant restrictions on the ability of subsidiary undertakings to transfer funds to the parent, other than those imposed by the Companies Act 1985.

## Interests in joint ventures and associates

The Group uses the equity method of accounting for joint ventures and associates. The following table shows the aggregate movement in the Group's investment in joint ventures and associates:

| | Joint ventures £m | Associates £m | Total £m |
|---|---|---|---|
| At 26 February 2005 | 409 | 20 | 429 |
| Additions | 35 | 1 | 36 |
| Effect of change in foreign exchange rates | 19 | 1 | 20 |
| Share of profit/(loss) of joint ventures and associates | 85* | (2) | 83* |
| Income received from joint ventures and associates | (82) | – | (82) |
| Transferred to non-current assets held for sale | (10) | – | (10) |
| At 25 February 2006 | 456 | 20 | 476 |
| Additions | 47 | 3 | 50 |
| Effect of change in foreign exchange rates | (14) | – | (14) |
| Share of profit of joint ventures and associates | 104 | 2 | 106 |
| Income received from joint ventures and associates | (123) | (1) | (124) |
| Disposals (a) | – | (14) | (14) |
| Capital reduction | (6) | – | (6) |
| Transferred to subsidiary undertakings (b) | (160) | – | (160) |
| **At 24 February 2007** | 304 | 10 | 314 |

* Includes £1m profit on the discontinued joint venture, Taiwan Charn Yang Developments Limited.

**Note 13 Group entities** continued

(a) Disposals of associates

| | Groceryworks £m | Greenergy Fuels Limited £m | Total £m |
|---|---|---|---|
| Consideration received/value of assets exchanged | 35 | 4 | 39 |
| Carrying value of investment disposed of | (13) | (1) | (14) |
| Profit on sale of investments in associates | 22 | 3 | 25 |

The investment in Groceryworks was sold to its parent company, Safeway Inc.

During the year, the Group's investment in Greenergy Fuels Limited was subject to an exchange transaction, whereby the Group gave up its investment in Greenergy Fuels Limited and received a 21.3% investment in Greenergy Fuels Limited's parent company, Greenergy International Limited.

The transaction has been treated as an exchange of fair values and the profit on sale recognised on this transaction represents the difference between 3.7% of the net assets of Greenergy Fuels Limited given up and 21.3% of the additional net assets of Greenergy International Limited acquired. Overall, the transaction was cash neutral.

(b) During the year, the Group purchased additional share capital in three of its joint ventures, namely dunnhumby Limited, Tesco Home Shopping and Hymall, making them subsidiary entities which have been consolidated within the Group results from the date of acquisition onwards. For further details see note 26.

### Joint ventures

The Group's principal joint ventures are:

| | Business activity | Share of issued share capital, loan capital and debt securities | Country of incorporation and principal country of operation |
|---|---|---|---|
| Shopping Centres Limited | Property Investment | 50% | England |
| BLT Properties Limited | Property Investment | 50% | England |
| Tesco BL Holdings Limited | Property Investment | 50% | England |
| Tesco British Land Property Partnership† | Property Investment | 50% | England |
| Tesco Property Limited Partnership† | Property Investment | 50% | England |
| Arena (Jersey) Management Limited† | Property Investment | 50% | Jersey |
| The Tesco Property (No. 2) Limited Partnership† | Property Investment | 50% | Jersey |
| Tesco Red Limited Partnership† | Property Investment | 50% | England |
| Tesco Personal Finance Group Limited | Personal Finance | 50% | Scotland |
| Tesco Mobile Limited† | Telecommunications | 50% | England |
| Nutri Centres Limited† | Complementary Medicines | 50% | England |
| Retail Property Company Limited† | Property Investment | 50% | Thailand |
| Tesco Card Services Limited† | Personal Finance | 50% | Thailand |

† Held by an intermediate subsidiary.

The accounting period ends of the joint ventures consolidated in these financial statements range from 31 December 2006 to 28 February 2007. Accounting period end dates different from those of the Group arise for commercial reasons and depend upon the requirements of the joint venture partner as well as those of the Group.

**Note 13** Group entities continued

The share of the assets, liabilities, revenue and profit of the joint ventures, which are included in the consolidated financial statements, are as follows:

| | 2007 £m | 2006 £m |
|---|---|---|
| Non-current assets | 1,134 | 981 |
| Current assets | 3,956 | 4,033 |
| Current liabilities | (3,572) | (3,667) |
| Non-current liabilities | (1,225) | (1,082) |
| Goodwill | 4 | 185 |
| Cumulative unrecognised losses | 7 | 6 |
| | 304 | 456 |
| Revenue | 638 | 586 |
| Expenses | (534) | (501) |
| Profit for the year | 104 | 85 |

The unrecognised share of losses made by joint ventures in the year to 24 February 2007 was £1m (2006 – £3m).

### Associates

At the Balance Sheet date, the Group's principal associate is:

| | Business activity | Share of issued capital, loan capital and debt securities | Country of incorporation and principal country of operation |
|---|---|---|---|
| Greenergy International Limited | Fuel Supplier | 21% | England |

Although the Group only holds a 21.3% non-voting shareholding in Greenergy International Limited it is treated as an associate as the Board of Greenergy International Limited requires the consent of Tesco on certain reserve matters as specified in the company's Articles of Association.

The share of the assets, liabilities, revenue and profit of the Group's associates, which are included in the consolidated financial statements, are as follows:

| | 2007 £m | 2006 £m |
|---|---|---|
| Assets | 93 | 72 |
| Liabilities | (85) | (65) |
| Goodwill | 2 | 13 |
| | 10 | 20 |
| Revenue | 280 | 174 |
| Profit/(loss) for the year | 2 | (2) |

The accounting period ends of the associates consolidated in these financial statements range from 31 December 2006 to 31 January 2007. The accounting period end dates of the associates are different from those of the Group as they also depend upon the requirements of the parent companies of those entities.

There are no significant restrictions on the ability of associated undertakings to transfer funds to the parent, other than those imposed by the Companies Act 1985.

**Note 14** Other investments

| | 2007 £m | 2006 £m |
|---|---|---|
| Available-for-sale financial assets | 8 | 4 |

Other investments are available-for-sale financial assets consisting of ordinary shares, and therefore have no fixed maturity date or coupon rate.

The fair value of the unlisted available-for-sale investments has been estimated using a valuation technique based on assumptions that are not supported by observable market prices or rates. The fair value of the listed available-for-sale investments is based on quoted market prices at the Balance Sheet date.

The following table shows the aggregate movement in the Group's other investments during the year:

| | 2007 £m | 2006 £m |
|---|---|---|
| At beginning of year | 4 | – |
| Additions | 5 | 2 |
| Revaluation through equity | (1) | 2 |
| At end of year | 8 | 4 |

**Note 15** Inventories

| | 2007 £m | 2006 £m |
|---|---|---|
| Goods held for resale | 1,911 | 1,457 |
| Development properties | 20 | 7 |
| | 1,931 | 1,464 |

**Note 16** Trade and other receivables

| | 2007 £m | 2006 £m |
|---|---|---|
| Prepayments and accrued income | 128 | 86 |
| Finance lease receivables (note 31) | 12 | 17 |
| Other receivables | 771 | 648 |
| Amounts owed by joint ventures and associates | 168 | 141 |
| | 1,079 | 892 |

Included within trade and other receivables are the following amounts receivable after more than one year:

| | 2007 £m | 2006 £m |
|---|---|---|
| Prepayments and accrued income | 6 | – |
| Finance lease receivables (note 31) | 6 | 11 |
| Other receivables | 136 | 118 |
| Amounts owed by joint ventures and associates | 163 | 121 |
| | 311 | 250 |

## Note 17 Cash and cash equivalents

| | 2007 £m | 2006 £m |
|---|---|---|
| Cash at bank and in hand | 902 | 964 |
| Short-term deposits | 140 | 361 |
| | 1,042 | 1,325 |

The effective rate of interest on short-term deposits is 4.8% (2006 – 3.9%) and the average maturity term is 4 weeks (2006 – 2 weeks).

## Note 18 Trade and other payables

### Current

| | 2007 £m | 2006 £m |
|---|---|---|
| Trade payables | 3,317 | 2,832 |
| Other taxation and social security | 203 | 216 |
| Other payables | 1,329 | 1,257 |
| Amounts payable to joint ventures and associates | 128 | 79 |
| Accruals and deferred income | 1,062 | 693 |
| Dividends | 7 | 6 |
| | 6,046 | 5,083 |

### Non-current

| | 2007 £m | 2006 £m |
|---|---|---|
| Other payables | 29 | 29 |

## Note 19 Borrowings

### Current

| | Par value | Effective interest rate % | Effective interest rate after hedging transactions % | Maturity year | 2007 £m | 2006 £m |
|---|---|---|---|---|---|---|
| Bank loans and overdrafts | | 5.4 | 5.4 | 2007 | 1,052 | 1,004 |
| Loan from joint venture | | – | – | 2007 | 10 | 9 |
| 4% unsecured deep discount loan stock | £125m | – | – | 2006 | – | 122 |
| 6% Medium Term Note (MTN) | £150m | – | – | 2006 | – | 158 |
| 0.7% MTN | ¥50bn | – | – | 2006 | – | 247 |
| 7.5% MTN (a) | £258m | 7.6 | 5.8 | 2007 | 268 | – |
| Other MTNs | | 3.4 | 3.4 | – | 188 | 86 |
| Finance leases (note 31) | | 5.5 | 5.5 | – | 36 | 20 |
| | | | | | 1,554 | 1,646 |

(a) The par value has been reduced from £325m in 2006 to £258m in 2007 by a buyback of part of the MTN.

**Note 19** **Borrowings** continued

Non-current

| | Par value | Effective interest rate % | Effective interest rate after hedging transactions % | Maturity year | 2007 £m | 2006 £m |
|---|---|---|---|---|---|---|
| Finance leases (note 31) | – | 9.2 | 9.2 | – | 147 | 84 |
| 7.5% MTN | £325m | – | – | – | – | 344 |
| 6% MTN (b) | £125m | 6.0 | 5.9 | 2008 | 130 | 268 |
| 5.25% MTN | €500m | 5.3 | 6.0 | 2008 | 352 | 366 |
| 5.125% MTN (c) | £192m | 5.1 | 5.8 | 2009 | 190 | 355 |
| 6.625% MTN | £150m | 6.7 | 6.7 | 2010 | 153 | 153 |
| 4.75% MTN | €750m | 4.8 | 6.2 | 2010 | 525 | 548 |
| 3.875% MTN | €500m | 3.9 | 5.9 | 2011 | 340 | – |
| 4% RPI MTN (d) | £238m | 6.6 | 6.6 | 2016 | 244 | 236 |
| 5.5% MTN | £350m | 5.6 | 5.6 | 2019 | 349 | 349 |
| 5% MTN | £350m | 5.1 | 5.1 | 2023 | 361 | – |
| 3.322% LPI MTN (e) | £241m | 5.9 | 5.9 | 2025 | 243 | 236 |
| 6% MTN | £200m | 6.0 | 6.0 | 2029 | 198 | 214 |
| 5.5% MTN | £200m | 5.6 | 5.6 | 2033 | 197 | 213 |
| 2% RPI MTN | £204m | 4.6 | 4.6 | 2036 | 206 | – |
| 5% MTN | £300m | 5.1 | 5.1 | 2042 | 306 | – |
| Other MTNs | – | 2.2 | 2.2 | – | 176 | 278 |
| Other loans | – | 4.9 | 4.9 | 2008 | 29 | 98 |
| | | | | | 4,146 | 3,742 |

(b) The par value has been reduced from £250m in 2006 to £125m in 2007 by a buyback of part of the MTN.

(c) The par value has been reduced from £350m in 2006 to £192m in 2007 by a buyback of part of the MTN.

(d) The 4% RPI MTN is redeemable at par, indexed for increases in the Retail Price Index over the life of the MTN.

(e) The 3.322% LPI MTN is redeemable at par, indexed for increases in the RPI over the life of the MTN. The maximum indexation of the principal in any one year is 5%, with a minimum of 0%.

**Borrowing facilities**

The Group has the following undrawn committed facilities available at 24 February 2007, in respect of which all conditions precedent had been met as at that date:

| | 2007 £m | 2006 £m |
|---|---|---|
| Expiring within one year | – | – |
| Expiring between one and two years | – | – |
| Expiring in more than two years | 1,750 | 1,750 |
| | 1,750 | 1,750 |

All facilities incur commitment fees at market rates and would provide funding at floating rates.

## Note 20 Financial instruments

An explanation of the objectives and policies for holding and issuing financial instruments is set out in the Operating and Financial Review.

Carrying values of derivative financial instruments and other liabilities in the Balance Sheet:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Assets £m | Liabilities £m | Assets £m | Liabilities £m |
| **Current** | | | | |
| Interest rate swaps and similar instruments | 12 | (8) | 11 | (69) |
| Forward foreign currency contracts | 96 | (56) | 59 | (170) |
| Future purchases of minority interests | – | (23) | – | – |
| | 108 | (87) | 70 | (239) |
| **Non-current** | | | | |
| Interest rate swaps and similar instruments | – | (116) | – | (46) |
| Forward foreign currency contracts | – | – | – | (2) |
| Future purchases of minority interests | – | (283) | – | (246) |
| | – | (399) | – | (294) |

Amounts shown as liabilities for the future purchases of minority interests refer to Samsung Tesco – £220m (2006 – £246m); Hymall – £48m (2006 – £nil) and dunnhumby – £38m (2006 – £nil).

### Fair values

Fair values of financial assets and liabilities are disclosed below:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Carrying value £m | Fair value £m | Carrying value £m | Fair value £m |
| **Primary financial instruments held or issued to finance the Group's operations:** | | | | |
| Short-term borrowings | (1,518) | (1,509) | (1,626) | (1,641) |
| Long-term borrowings | (3,999) | (3,949) | (3,658) | (3,848) |
| Finance leases (Group as lessor – note 31) | 12 | 12 | 17 | 17 |
| Finance leases (Group as lessee – note 31) | (183) | (183) | (104) | (104) |
| Cash and cash equivalents | 1,042 | 1,042 | 1,325 | 1,325 |
| **Derivative financial instruments held to manage the interest rate and currency profile:** | | | | |
| Interest rate swaps and similar instruments | (112) | (112) | (104) | (104) |
| Forward foreign currency contracts | 40 | 40 | (113) | (113) |
| Future purchases of minority interests | (306) | (306) | (246) | (246) |
| | (5,024) | (4,965) | (4,509) | (4,714) |

The fair values of financial instruments and derivatives have been determined by reference to prices available from the markets on which the instruments are traded. The fair value of all other items have been calculated by discounting expected future cash flows at prevailing interest rates. The above table excludes trade and other receivables/payables, which have fair values equal to their carrying value.

**Note 20 Financial instruments** continued

### Analysis of interest rate exposure of financial assets and liabilities

By maturity date, the interest rate exposure of financial assets and liabilities of the Group, after taking into account the effect of interest rate swaps, was:

| As at 24 February 2007 | Within 1 year £m | 1-2 years £m | 2-3 years £m | 3-4 years £m | 4-5 years £m | More than 5 years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Fixed rate (fair value interest rate risk)** | | | | | | | |
| Finance lease receivables | 6 | 6 | – | – | – | – | 12 |
| Bank and other loans | (210) | (42) | (85) | (161) | (19) | (1,274) | (1,791) |
| Finance lease payables | (12) | (10) | (4) | (3) | (3) | (54) | (86) |
| **Floating rate (cash flow interest rate risk)** | | | | | | | |
| Cash and cash equivalents | 1,042 | – | – | – | – | – | 1,042 |
| Bank and other loans | (1,308) | (511) | (190) | (532) | (340) | (845) | (3,726) |
| Finance lease payables | (24) | (21) | (20) | (16) | (13) | (3) | (97) |

| As at 25 February 2006 | Within 1 year £m | 1-2 years £m | 2-3 years £m | 3-4 years £m | 4-5 years £m | More than 5 years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Fixed rate (fair value interest rate risk)** | | | | | | | |
| Finance lease receivables | 6 | 6 | 5 | – | – | – | 17 |
| Bank and other loans | (147) | (161) | – | (98) | (153) | (861) | (1,420) |
| Finance lease payables | (20) | (11) | (8) | (3) | (3) | (59) | (104) |
| **Floating rate (cash flow interest rate risk)** | | | | | | | |
| Cash and cash equivalents | 1,325 | – | – | – | – | – | 1,325 |
| Bank and other loans | (1,479) | (386) | (662) | (355) | (555) | (427) | (3,864) |

### Hedging activities

#### Fair value hedges

The Group uses interest rate swaps and cross-currency swaps to hedge the fair value of fixed rate bonds. The total notional amount of outstanding swaps used for fair value hedging is £2,203m with various maturities out to 2033 (2006 – £2,710m; maturities to 2033).

The fixed rate bonds are hedged against changes to their fair value resulting from changes in interest rates and foreign exchange rates.

The fair value of swaps used for fair value hedging at the Balance Sheet date was a liability of £107m (2006 – £100m liability).

#### Cash flow hedges

The Group uses forward foreign exchange contracts and currency options to hedge the cost of future purchases of goods for resale, where those purchases are denominated in a currency other than the functional currency of the purchasing company. The hedging instruments are primarily used to hedge purchases in Euros and US Dollars. The cash flows hedged will occur within one year of the Balance Sheet date.

At the Balance Sheet date, the total notional amount of outstanding forward foreign exchange contracts to which the Group has committed was £764m (2006 – £548m).

The fair value of currency derivatives that are designated as effective cash flow hedges was a liability of £24m (2006 – £4m asset). This amount has been deferred as a component of equity.

Also in place at the Balance Sheet date were interest rate swaps, designated as cash flow hedges, to hedge the interest cost of debt instruments issued in March 2007 (for details, see note 32). The fair value of the interest rate swaps designated as cash flow hedges was a liability of £8m (2006 – £nil). This amount has been deferred as a component of equity.

#### Net investment hedges

The Group uses forward foreign exchange contracts, currency denominated borrowings and currency options to hedge the exposure of a proportion of its non-Sterling denominated assets against changes in value due to changes in foreign exchange rates. The total notional amount of net investment hedging contracts at the Balance Sheet date was £4,250m (2006 – £3,463m).

The fair value of these instruments at the Balance Sheet date was an asset of £56m (2006 – £150m liability).

The Group has a Korean Won denominated liability relating to the future purchase of the minority shareholding of its subsidiary, Samsung Tesco Co. Limited. This liability has been designated as a net investment hedge of a proportion of the assets of Samsung Tesco Co. Limited. The carrying value of the liability at the Balance Sheet date was £220m (2006 – £246m).

**Note 20** **Financial instruments** continued

The Group has a Chinese Yuan denominated liability relating to the future purchase of the minority shareholding of its subsidiary, Hymall. This liability has been designated as a net investment hedge of a proportion of the assets of Hymall. The carrying value of the liability at the Balance Sheet date was £48m (2006 – £nil).

### Financial instruments not qualifying for hedge accounting

The Group has a number of financial instruments which do not meet the criteria for hedge accounting.

These instruments include forward foreign exchange contracts, currency options, caps, collars and interest rate swaps. The fair value of these instruments at the Balance Sheet date was a asset of £11m (2006 – £5m liability).

The Group has a liability relating to the future purchase of the minority shareholding of its subsidiary, dunnhumby Limited. The carrying value of the liability at the Balance Sheet date was £38m (2006 – £nil).

## Note 21 Provisions

| | Property provisions £m |
|---|---|
| At 25 February 2006 | 7 |
| Additions | – |
| Acquisitions through business combinations | 28 |
| Amount credited in the year | (6) |
| At 24 February 2007 | 29 |

Property provisions comprise future rents payable net of rents receivable on onerous and vacant property leases, provisions for terminal dilapidations and provisions for future rents above market value on unprofitable stores. The majority of the provision is expected to be utilised over the period to 2020.

The balances are analysed as follows:

| | 2007 £m | 2006 £m |
|---|---|---|
| Current | 4 | 2 |
| Non-current | 25 | 5 |
| | 29 | 7 |

**Note 22** Share-based payments

The Group has not taken advantage of the transitional provisions of IFRS 2 'Share-based payment' in respect of equity-settled awards but instead applied IFRS 2 retrospectively to all awards granted, but not vested, as at 28 February 2004.

The total Income Statement charge for the year recognised in respect of share-based payments is £209m (2006 – £190m) which is made up of share option schemes and share bonus payments.

**a) Share option schemes**

The Company had eight share option schemes in operation during the year, all of which are equity-settled schemes:

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 or five years with contributions from employees of an amount between £5 and £250 per four-weekly period. Options are capable of being exercised at the end of the three or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.

ii) The Irish savings-related share option scheme (2000) permits the grant to Irish employees of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three or five years with contributions from employees of an amount between €12 and €320 per four-weekly period. Options are capable of being exercised at the end of the three or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.

iii) The approved executive share option scheme (1994) was adopted on 17 October 1994. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the discretionary share option plan (2004). There were no discounted options granted under this scheme.

iv) The unapproved 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. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the discretionary share option plan (2004). There were no discounted options granted under this scheme.

v) The international executive share option scheme (1994) was adopted on 20 May 1994. This scheme permits the grant to selected non-UK executives of options to acquire ordinary shares on substantially the same basis as their UK counterparts. The exercise of options granted under this scheme will normally be conditional on the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the discretionary share option plan (2004). There were no discounted options granted under this scheme.

vi) The executive incentive plan (2004) was adopted on 4 July 2004. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from the date of grant for nil consideration.

vii) The performance share plan (2004) was adopted on 4 July 2004. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between four and ten years from the date of grant for nil consideration. The exercise of options will normally be conditional on the achievement of specified performance targets related to the return on capital employed over a three-year period.

viii) The discretionary share option plan (2004) was adopted on 4 July 2004. This scheme permits the grant of approved, unapproved and international options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from the date of grant at a price not less than the middle-market quotation or average middle-market quotations of an ordinary share for the dealing day or three dealing days preceding the date of grant. The exercise of options will normally be conditional on the achievement of a specified performance target related to the annual percentage growth in earnings per share over a three-year period. There will be no discounted options granted under this scheme.

**Note 22** Share-based payments continued

The following tables reconcile the number of share options outstanding and the weighted average exercise price (WAEP):

**For the year ended 24 February 2007**

| | Savings-related share option scheme | | Irish savings-related share option scheme | | Approved share option scheme | | Unapproved share option scheme | | International executive share option scheme | | Nil cost share options | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP |
| Outstanding at 25 February 2006 | 181,166,780 | 211.42 | 4,705,023 | 217.96 | 17,947,537 | 248.11 | 95,519,321 | 242.28 | 28,097,456 | 251.69 | 3,459,458 | 0.00 |
| Granted | 38,895,396 | 307.00 | 1,532,291 | 307.00 | 5,166,957 | 316.87 | 18,751,718 | 320.22 | 11,538,336 | 318.60 | 2,350,549 | 0.00 |
| Forfeited | (10,898,678) | 219.50 | (508,283) | 215.69 | (931,795) | 293.25 | (3,090,496) | 278.00 | (1,352,164) | 249.71 | – | – |
| Exercised | (36,060,390) | 193.52 | (801,622) | 190.99 | (5,327,666) | 220.10 | (28,653,628) | 216.21 | (5,155,523) | 221.25 | – | – |
| Outstanding at 24 February 2007 | 173,103,108 | 236.12 | 4,927,409 | 250.27 | 16,855,033 | 276.19 | 82,526,915 | 267.70 | 33,128,105 | 280.68 | 5,810,007 | 0.00 |
| Exercisable as at 24 February 2007 | 5,320,960 | 196.51 | 215,648 | 195.70 | 5,674,314 | 226.02 | 27,295,331 | 218.90 | 8,386,290 | 214.42 | – | – |
| Exercise price range (pence) | | 195.00 to 198.00 | | 195.00 to 198.00 | | 197.50 to 259.00 | | 164.00 to 259.00 | | 176.70 to 259.00 | | Nil |
| Weighted average remaining contractual life (years) | | 0.20 | | 0.20 | | 4.42 | | 4.73 | | 4.39 | | – |

**For the year ended 25 February 2006**

| | Savings-related share option scheme | | Irish savings-related share option scheme | | Approved share option scheme | | Unapproved share option scheme | | International executive share option scheme | | Nil cost share options | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP |
| Outstanding at 26 February 2005 | 186,022,500 | 194.78 | 4,895,103 | 190.80 | 21,290,693 | 222.10 | 97,695,342 | 227.08 | 23,025,502 | 227.10 | 1,126,257 | 0.00 |
| Granted | 44,347,668 | 248.00 | 1,673,357 | 248.00 | 4,401,080 | 312.75 | 17,483,188 | 312.75 | 8,989,071 | 309.54 | 2,333,201 | 0.00 |
| Forfeited | (11,451,171) | 200.07 | (416,444) | 192.11 | (1,316,210) | 233.62 | (4,543,756) | 239.06 | (1,086,847) | 240.94 | – | – |
| Exercised | (37,752,217) | 175.82 | (1,446,993) | 168.25 | (6,428,026) | 209.19 | (15,115,453) | 226.56 | (2,830,270) | 239.54 | – | – |
| Outstanding at 25 February 2006 | 181,166,780 | 211.42 | 4,705,023 | 217.96 | 17,947,537 | 248.11 | 95,519,321 | 242.28 | 28,097,456 | 251.69 | 3,459,458 | 0.00 |
| Exercisable as at 25 February 2006 | 5,904,791 | 196.90 | 227,107 | 169.95 | 7,721,660 | 231.70 | 28,646,347 | 232.85 | 7,958,413 | 224.75 | – | – |
| Exercise price range (pence) | | 159.00 to 198.00 | | 159.00 to 198.00 | | 205.00 to 259.00 | | 164.00 to 259.00 | | 176.70 to 259.00 | | Nil |
| Weighted average remaining contractual life (years) | | 0.19 | | 0.19 | | 5.02 | | 4.97 | | 4.73 | | – |

**Note 22 Share-based payments** continued

Share options were exercised on a regular basis throughout the year. The average share price during the year to 24 February 2007 was 369.70 pence (2006 – 317.79 pence).

The fair value of share options is estimated at the date of grant using the Black-Scholes option pricing model. The following table gives the assumptions applied to the options granted in the respective periods shown. No assumption has been made to incorporate the effects of expected early exercise.

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Savings-related share option schemes | Executive share option schemes | Nil cost option schemes | Savings-related share option schemes | Executive share option schemes | Nil cost option schemes |
| Expected dividend yield (%) | 2.7% | 3.0% | 2.7% | 3.0% | 3.0% | 3.0% |
| Expected volatility (%) | 28% | 28% | 28% | 28% | 28% | 28% |
| Risk-free interest rate (%) | 4.8% | 4.7% | 4.6% | 4.4% | 4.2% | 4.2% |
| Expected life of option (years) | 3 or 5 | 6 | 6 | 3 or 5 | 6 | 6 |
| Weighted average fair value of options granted (pence) | 122.02 | 81.63 | 282.97 | 93.55 | 77.24 | 256.75 |
| Probability of forfeiture (%) | 20-25% | 10% | 0% | 20-25% | 10% | 0% |
| Share price (pence) | 383.80 | 318.60 | 332.74 | 310.0 | 312.80 | 307.38 |
| Weighted average exercise price (pence) | 307.00 | 318.60 | 0.0 | 248.00 | 312.75 | 0.0 |

Volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in Tesco PLC option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. In estimating the future volatility of the Company's share price, the Board consider the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option, taking into account the remaining contractual life of the option.

**b) Share bonus schemes**

Eligible UK employees are able to participate in Shares in Success, an all-employee profit sharing scheme. Each year, shares are awarded as a percentage of earnings up to a statutory maximum of £3,000.

Senior management also participate in performance-related bonus schemes. The amount paid to employees is based on a percentage of salary and is paid partly in cash and partly in shares. Bonuses are awarded to eligible employees that have completed a required service period and depend on the achievement of corporate targets. The accrued cash element of the bonus at the Balance Sheet date is £17m.

The Executive Directors participate in short-term and long-term bonus schemes designed to align their interests with those of shareholders. Full details of these schemes can be found in the Directors' Remuneration Report.

The fair value of shares awarded under these schemes is their market value on the date of award. Expected dividends are not incorporated into the fair value.

The number and weighted average fair value (WAFV) of share bonuses awarded during the period was:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Shares Number | WAFV Pence | Shares Number | WAFV Pence |
| Shares in Success | 24,062,964 | 319.65 | 22,337,747 | 309.75 |
| Executive incentive scheme | 13,559,635 | 316.88 | 13,283,243 | 309.88 |

## Note 23 Post-employment benefits

### Pensions

The Group operates a variety of post-employment benefit arrangements, covering both funded defined contribution and funded and unfunded defined benefit schemes. The most significant of these are the funded defined benefit schemes for the Group's employees in the UK and the Republic of Ireland.

### Defined contribution plans

The contributions payable for defined contribution schemes of £7m (2006 – £7m) have been fully expensed against profits in the current year.

### Defined benefit plans

#### United Kingdom

The principal plan within the Group is the Tesco PLC Pension Scheme, which is a funded defined benefit pension scheme in the UK, the assets of which are held as a segregated fund and administered by trustees. Watson Wyatt Limited, an independent actuary, carried out the latest triennial actuarial assessment of the scheme as at 31 March 2005, using the projected unit method.

At the date of the last actuarial valuation the actuarial deficit was £153m. The market value of the schemes' assets was £2,632m and these assets represented 95% of the benefits that had accrued to members, after allowing for expected increases in earnings and pensions in payment.

The One Stop Senior Executive Pension Scheme is a funded defined benefit scheme open to senior executives and certain other employees at the invitation of the company. An independent actuary, using the projected unit method, carried out the latest actuarial assessment of the scheme as at 5 April 2004.

#### Overseas

The most significant overseas scheme is the funded defined benefit scheme which operates in the Republic of Ireland. An independent actuary, using the projected unit method, carried out the latest actuarial assessment of the scheme as at 1 April 2004.

The valuations used for IAS 19 have been based on the most recent actuarial valuations and updated by Watson Wyatt Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 24 February 2007. The schemes' assets are stated at their market values as at 24 February 2007. Buck Consultants (Ireland) Limited have updated the most recent Republic of Ireland valuation. The liabilities relating to retirement healthcare benefits have also been determined in accordance with IAS 19, and are incorporated in the following tables.

#### Principal assumptions

The valuations used have been based on the most recent actuarial valuations and updated by Watson Wyatt Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 24 February 2007. The major assumptions, on a weighted average basis, used by the actuaries were as follows:

| | 2007 % | 2006 % | 2005 % |
|---|---|---|---|
| Rate of increase in salaries | 4.5 | 4.0 | 3.9 |
| Rate of increase in pensions in payment | 3.0 | 2.7 | 2.6 |
| Rate of increase in deferred pensions | 3.0 | 2.7 | 2.6 |
| Rate of increase in career average benefits | 3.0 | 2.7 | 2.6 |
| Discount rate | 5.2 | 4.8 | 5.4 |
| Price inflation | 3.0 | 2.7 | 2.6 |

The main financial assumption is the real discount rate i.e. the excess of the discount rate over the rate of price inflation. If this assumption increased/decreased by 0.1%, the UK defined benefit obligation would decrease/increase by approximately £105m and the annual UK current service cost would decrease/increase by between £12m and £13m.

#### UK mortality assumptions

Following analysis of the mortality trends under the Tesco PLC Pension Scheme in the UK, which was carried out as part of the formal valuation of the Scheme as at 31 March 2005, it was decided to alter the mortality assumptions used in the formal valuation. The updated mortality tables as at 31 March 2005 were PMA92C00 for male members and PFA92C00 for female members. Similar to last year, this change has been carried through into the calculation of the pension liabilities in the Balance Sheet as at 24 February 2007 for the main UK fund.

**Note 23** **Post-employment benefits** continued

The following table illustrates the expectation of life of an average member retiring at age 65 at the Balance Sheet date and a member reaching age 65 at the same date +25 years.

| | | At 24 Feb 2007 in years | At 25 Feb 2006 in years |
|---|---|---|---|
| Retiring at Reporting date at age 65: | Male | 17.5 | 17.5 |
| | Female | 21.9 | 21.8 |
| Retiring at Reporting date +25 years at age 65: | Male | 18.4 | 18.4 |
| | Female | 23.0 | 23.0 |

### Rates of return on scheme assets

The assets in the defined benefit pension schemes and the expected rates of return were:

| | 2007 | | 2006 | | 2005 | |
|---|---|---|---|---|---|---|
| | Long term rate of return % | Market value £m | Long term rate of return % | Market value £m | Long term rate of return % | Market value £m |
| Equities | 8.1 | 2,420 | 8.1 | 2,134 | 8.2 | 1,908 |
| Bonds | 5.2 | 812 | 4.8 | 656 | 5.4 | 560 |
| Property | 6.7 | 343 | 6.4 | 253 | 6.8 | 183 |
| Other (alternative assets) | 8.1 | 384 | 8.1 | 282 | – | – |
| Cash | 4.0 | 48 | 3.7 | 123 | 3.5 | 67 |
| Total market value of assets | | 4,007 | | 3,448 | | 2,718 |

The expected rate of return on assets is a weighted average based on the actual plan assets held and the respective returns expected on the separate asset classes. The expected rate of return on equities and cash have both been set with reference to the expected median return over a ten year period, as calculated by the Company's independent actuary. The median return over a longer period than ten years was not expected to be materially different. The expected rate of return on bonds was measured directly from actual market yields for gilts and corporate bond stocks. The rate above takes into account the actual mixture of UK gilts, UK corporate bonds and overseas bonds held at the Balance Sheet date.

### Movement in pension deficit during the year

Changes in the fair value of defined benefit pension plan assets are as follows:

| | 2007 £m | 2006 £m |
|---|---|---|
| Opening fair value of plan assets | 3,448 | 2,718 |
| Expected return | 255 | 209 |
| Actuarial gains | 82 | 309 |
| Contributions by employer | 321 | 270 |
| Actual member contributions | 7 | 6 |
| Foreign currency translation differences | (2) | – |
| Benefits paid | (104) | (64) |
| Closing fair value of plan assets | 4,007 | 3,448 |

## Note 23 Post-employment benefits continued

Changes in the present value of defined benefit obligations are as follows:

| | 2007 £m | 2006 £m |
|---|---|---|
| Opening defined benefit obligation | (4,659) | (3,453) |
| Current service cost | (466) | (328) |
| Interest cost | (221) | (184) |
| Gain/(loss) on change of assumptions | 71 | (727) |
| Experience losses | (41) | (24) |
| Foreign currency translation differences | 4 | (1) |
| Benefits paid | 104 | 64 |
| Actual member contributions | (7) | (6) |
| Past service gains | 258 | – |
| Closing defined benefit obligation | (4,957) | (4,659) |

The amounts that have been charged to the Income Statement and Statement of Recognised Income and Expense for the year ended 24 February 2007 are set out below:

| | 2007 £m | 2006 £m |
|---|---|---|
| **Analysis of the amount (charged)/credited to operating profit:** | | |
| Current service cost | (466) | (328) |
| Past service gains | 258 | – |
| Total charge to operating profit | (208) | (328) |
| **Analysis of the amount credited/(charged) to finance income:** | | |
| Expected return on pension schemes' assets | 255 | 209 |
| Interest on pension schemes' liabilities | (221) | (184) |
| Net pension finance income (note 5) | 34 | 25 |
| Total charge to the Income Statement | (174) | (303) |

In line with changes to the Finance Act 2006, the scheme rules were amended from 6 April 2006 to allow employees to commute (convert) a larger proportion of their pension for a cash lump sum at retirement. Accordingly, the assumptions made in calculating the Group's defined benefit pension liability have been revised, resulting in a gain of £250m being recognised in Group operating profit. Future revisions to this assumption will be reflected in the Statement of Recognised Income and Expense. Changes to scheme rules in the Republic of Ireland affecting early retirement have reduced pension liabilities by a further £8m, which is also shown as a past service gain in the Income Statement.

| | 2007 £m | 2006 £m | 2005 £m |
|---|---|---|---|
| **Analysis of the amount recognised in the Statement of Recognised Income and Expense:** | | | |
| Actual return less expected return on pension schemes' assets | 82 | 309 | 66 |
| Experience losses arising on the schemes' liabilities | (41) | (24) | (14) |
| Currency gain/(loss) | 2 | (1) | – |
| Changes in assumptions underlying the present value of the schemes' liabilities | 71 | (727) | (282) |
| Total gain/(loss) recognised in the Statement of Recognised Income and Expense | 114 | (443) | (230) |

The cumulative losses recognised through the Statement of Recognised Income and Expense since the date of transition to IFRS are £559m (2006 – £673m).

**Note 23 Post-employment benefits** continued

## Summary of movements in deficit during the year

| | 2007 £m | 2006 £m | 2005 £m |
|---|---|---|---|
| Deficit in schemes at beginning of the year | (1,211) | (735) | (674) |
| Current service cost | (466) | (328) | (272) |
| Past service gains | 258 | – | – |
| Other finance income | 34 | 25 | 4 |
| Contributions | 321 | 270 | 437* |
| Foreign currency translation differences | 2 | (1) | – |
| Actuarial gain/(loss) | 112 | (442) | (230) |
| Deficit in schemes at end of the year | (950) | (1,211) | (735) |

* Includes additional contribution of £200m paid in February 2005.

## History of movements

The historical movement in defined benefit pension schemes assets and liabilities and history of experience gains and losses are as follows:

| | 2007 £m | 2006 £m | 2005 £m | 2004 £m |
|---|---|---|---|---|
| Total market value of assets | 4,007 | 3,448 | 2,718 | 1,979 |
| Present value of liabilities relating to unfunded schemes | (27) | (17) | (12) | (5) |
| Present value of liabilities relating to partially funded schemes | (4,930) | (4,642) | (3,441) | (2,648) |
| Pension deficit | (950) | (1,211) | (735) | (674) |
| | | | | |
| Experience gains on scheme assets | 82 | 309 | 66 | 192 |
| Experience losses on plan liabilities | (41) | (24) | (14) | (48) |

**Post-employment benefits other than pensions**

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

The liability as at 24 February 2007 of £11m (2006 – £10m) was determined in accordance with the advice of independent actuaries. In 2006/07, £0.5m (2006 – £0.5m) has been charged to the Income Statement and £0.6m (2006 – £0.7m) of benefits were paid.

A change of 1.0% in assumed healthcare cost trend rates would have the following effect:

| | 2007 £m | 2006 £m |
|---|---|---|
| Effect on the annual service and interest cost | 0.1 | 0.1 |
| Effect on defined benefit obligations | 1.3 | 1.0 |

**Expected contributions**

The Group expects to make contributions of approximately £352m to defined benefit pension schemes in the year ending 23 February 2008.

**Note 24** Called up share capital

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Ordinary shares of 5p each | | Ordinary shares of 5p each | |
| | Number | £m | Number | £m |
| Authorised: | | | | |
| At beginning of year | 10,700,000,000 | 535 | 10,600,000,000 | 530 |
| Authorised during the year | 158,000,000 | 8 | 100,000,000 | 5 |
| At end of year | 10,858,000,000 | 543 | 10,700,000,000 | 535 |
| Allotted, called up and fully paid: | | | | |
| At beginning of year | 7,894,476,917 | 395 | 7,783,169,542 | 389 |
| Scrip dividend election | 75,205,082 | 3 | 53,639,219 | 3 |
| Share options | 75,994,892 | 4 | 57,668,156 | 3 |
| Share buyback | (98,327,333) | (5) | – | – |
| At end of year | 7,947,349,558 | 397 | 7,894,476,917 | 395 |

During the financial year, 151 million (2006 – 111 million) shares of 5p each were issued for aggregate consideration of £395m (2006 – £290m), which comprised £239m (2006 – £167m) for scrip dividend and £156m (2006 – £123m) for share options.

During the year, the Company purchased and subsequently cancelled 98,327,333 shares of 5p each (representing 1% of the called up share capital) at an average price of £3.89 per share. The total consideration, including expenses, was £385m. The excess of the consideration over the nominal value has been charged to retained earnings.

Between 25 February 2007 and 16 April 2007, options over 3,263,739 ordinary shares have been exercised under the terms of the savings-related share option scheme (1981) and the Irish savings-related share option scheme (2000). Between 25 February 2007 and 16 April 2007, options over 2,242,269 ordinary shares have been exercised under the terms of the executive share option schemes (1994 and 1996) and the discretionary share option plan (2004).

As at 24 February 2007, the Directors were authorised to purchase up to a maximum in aggregate of 790.5 million (2006 – 778.7 million) ordinary shares.

The holders of ordinary shares are entitled to receive dividends as declared from time-to-time and are entitled to one vote per share at the meetings of the Company.

**Share buyback liability**

Insider trading rules prevent the Group from buying back its own shares in the market during specified close periods (including the period between the year end and the annual results announcement). However, if an irrevocable agreement is signed beween the Group and a third party, they can continue to buy back shares on behalf of the Group. Two such arrangements were in place at the year end and in accordance with IAS 32, the Group has recognised a financial liability equal to the estimated value of the shares purchasable under these agreements. A liability of £90m (2006 – £nil) has been recognised within other creditors for this amount.

**Capital redemption reserve**

Upon cancellation of the shares purchased as part of the share buyback, a capital redemption reserve is created representing the nominal value of the shares cancelled. This is a non-distributable reserve.

## Note 25 Statement of changes in equity

| | | | Other reserves | Retained earnings | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Issued share capital £m | Share premium £m | Merger reserve £m | Capital redemption reserve £m | Hedging reserve £m | Translation reserve £m | Treasury shares £m | Retained earnings £m | Total equity attributable to equity holders of the parent £m | Minority interests £m | Total £m |
| At 25 February 2006 | 395 | 3,988 | 40 | – | 5 | 38 | (49) | 4,963 | 9,380 | 64 | 9,444 |
| Foreign currency translation differences | – | – | – | – | – | (59) | – | – | (59) | (6) | (65) |
| Actuarial gain on defined benefit schemes | – | – | – | – | – | 2 | – | 112 | 114 | – | 114 |
| Tax on items taken directly to or transferred from equity | – | – | – | – | – | (20) | – | 32 | 12 | – | 12 |
| Decrease in fair value of available-for-sale financial assets | – | – | – | – | – | – | – | (1) | (1) | – | (1) |
| Losses on cash flow hedges | – | – | – | – | (38) | – | – | – | (38) | – | (38) |
| Purchase of treasury shares | – | – | – | – | – | – | (105) | – | (105) | – | (105) |
| Share-based payments | – | – | – | – | – | – | – | 185 | 185 | – | 185 |
| Issue of shares | 7 | 388 | – | – | – | – | – | – | 395 | – | 395 |
| Share buyback | (5) | – | – | 5 | – | – | – | (475) | (475) | – | (475) |
| Future purchases of minority interests | – | – | – | – | – | – | – | (88) | (88) | – | (88) |
| Profit for the year | – | – | – | – | – | – | – | 1,892 | 1,892 | 7 | 1,899 |
| Equity dividends authorised in the year | – | – | – | – | – | – | – | (706) | (706) | – | (706) |
| **At 24 February 2007** | 397 | 4,376 | 40 | 5 | (33) | (39) | (154) | 5,914 | 10,506 | 65 | 10,571 |

| | | | Other reserves | Retained earnings | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Issued share capital £m | Share premium £m | Merger reserve £m | Hedging reserve £m | Translation reserve £m | Treasury shares £m | Retained earnings £m | Total equity attributable to equity holders of the parent £m | Minority interests £m | Total £m |
| At 26 February 2005 | 389 | 3,704 | 40 | (34) | 11 | (87) | 4,266 | 8,289 | 51 | 8,340 |
| Foreign currency translation differences | – | – | – | – | 26 | – | – | 26 | 7 | 33 |
| Actuarial loss on defined benefit schemes | – | – | – | – | (1) | – | (442) | (443) | – | (443) |
| Tax on items taken directly to or transferred from equity | – | – | – | – | 2 | – | 131 | 133 | – | 133 |
| Increase in fair value of available-for-sale financial assets | – | – | – | – | – | – | 2 | 2 | – | 2 |
| Gains on cash flow hedges | – | – | – | 39 | – | – | – | 39 | – | 39 |
| Net movement relating to share-based payments | – | – | – | – | – | 38 | 45 | 83 | – | 83 |
| Issue of shares | 6 | 284 | – | – | – | – | – | 290 | – | 290 |
| Profit for the year | – | – | – | – | – | – | 1,570 | 1,570 | 6 | 1,576 |
| Equity dividends authorised in the year | – | – | – | – | – | – | (609) | (609) | – | (609) |
| **At 25 February 2006** | 395 | 3,988 | 40 | 5 | 38 | (49) | 4,963 | 9,380 | 64 | 9,444 |

**Note 25** Statement of changes in equity continued

**Share premium account**

The share premium account is used to record amounts received in excess of the nominal value of shares on issue of new shares.

**Translation reserve**

The translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. It is also used to record the movements in net investment hedges.

**Treasury shares**

During the year, the qualifying employee share ownership trust (QUEST) subscribed for 1.5 million shares from the Company, a negligible percentage of called-up share capital as at 24 February 2007 (2006 – 10 million, 0.1%). There were no contributions (2006 – £12m) to the QUEST from subsidiary undertakings.

The employee benefit trusts hold shares in Tesco PLC for the purpose of the various executive share incentive and profit share schemes. At 24 February 2007, the trusts held 57.0 million shares (2006 – 48.4 million), which cost £184m (2006 – £140m) and had a market value of £254m (2006 – £163m).

**Merger reserve**

The merger reserve arose on the acquisition of Hillards PLC in 1987.

**Other**

The cumulative goodwill written-off against the reserves of the Group as at 24 February 2007 amounted to £718m (2006 – £718m).

## Note 26 Business combinations

The Group has made a number of acquisitions in the year, of which the material acquisitions have been disclosed separately and the remainder shown in aggregate.

The net assets and results of the acquired business are included in the consolidated accounts of the Group from the date of acquisition. Acquisition accounting has been applied and the goodwill arising has been capitalised and is subject to annual impairment testing.

The goodwill acquired in the business combinations listed below has been allocated to the single group of cash-generating units represented by the acquired businesses, as this is the lowest level within the Group at which the goodwill is monitored internally. Goodwill arising on acquisitions in the year is attributable mainly to customer loyalty, the assembled workforce and the synergies expected to be achieved.

The fair values currently established for acquisitions made in the year to 24 February 2007 are provisional. Fair values will be reviewed based on additional information up to one year from the date of acquisition. The Directors do not believe that any net adjustments resulting from such a review would have a material effect on the Group.

Had all the combinations listed below taken place at the beginning of the financial year, the operating profit of the Group would have been £2,626m and revenue from continuing operations would have been £43,306m. The pro forma information is provided for comparative purposes only and does not necessarily reflect the actual results that would have occurred, nor is it necessarily indicative of future results of operations of the combined companies.

### Carrefour Česká Republika s.r.o

On 31 May 2006, the Group acquired 100% of the share capital of Carrefour Česká Republika s.r.o, a retailer in the Czech Republic, as part of an asset swap deal for our Taiwanese business (see note 7).

The fair value of the identifiable assets and liabilities of Carrefour Česká Republika s.r.o as at the date of acquisition were:

| | Pre-acquisition carrying amounts £m | Fair value adjustments £m | Recognised values on acquisition £m |
|---|---|---|---|
| Property, plant and equipment | 88 | (3) | 85 |
| Investment property | 30 | – | 30 |
| Deferred tax asset | – | 18 | 18 |
| Inventories | 17 | (7) | 10 |
| Trade and other receivables | 69 | (5) | 64 |
| Cash and cash equivalents | 13 | – | 13 |
| Trade and other payables | (166) | (16) | (182) |
| Net assets acquired | 51 | (13) | 38 |
| Goodwill arising on acquisition | | | 32 |
| | | | 70 |
| Consideration: | | | |
| Cash consideration | | | 67 |
| Costs associated with the acquisition | | | 3 |
| Total consideration | | | 70 |

From the date of acquisition, the acquired business has contributed £151m to revenue and £8m of operating losses to the Group.

**Note 26** Business combinations continued

### Makro

On 24 January 2007, Tesco Stores Malaysia Sdn Bhd acquired 100% of the share capital of Makro Cash & Carry Distribution (M) Sdn Bhd, which operates a chain of eight stores in Malaysia.

The fair value of the identifiable assets and liabilities of Makro Cash & Carry Distribution (M) Sdn Bhd as at the date of acquisition were:

| | Pre-acquisition carrying amounts £m | Fair value adjustments £m | Recognised values on acquisition £m |
|---|---|---|---|
| Property, plant and equipment | 31 | (10) | 21 |
| Investment property | 2 | – | 2 |
| Inventories | 10 | (1) | 9 |
| Trade and other receivables | 5 | 6 | 11 |
| Trade and other payables | (32) | – | (32) |
| Provisions | (1) | – | (1) |
| Net assets acquired | 15 | (5) | 10 |
| Goodwill arising on acquisition | | | 63 |
| | | | 73 |
| Consideration: | | | |
| Cash consideration | | | 72 |
| Costs associated with the acquisition | | | 1 |
| Total consideration | | | 73 |

From the date of acquisition, the acquired business has contributed £12m to revenue and £nil to the operating profit of the Group.

### Hymall

On 12 December 2006, the Group acquired a further 40% of the share capital of its joint venture, Hymall, a retail chain in China, giving the Group control of the entity, making it a subsidiary entity.

On the same day, the minority shareholders of Hymall entered into an agreement to sell their remaining share of the business to Tesco by 2009. Under IAS 32, the net present value of the future payments are shown as a financial liability, the value of which was £48m at 24 February 2007.

The fair value of the identifiable assets and liabilities of Hymall as at the date of acquisition were:

| | Pre-acquisition carrying amounts £m | Fair value adjustments £m | Recognised values on acquisition £m |
|---|---|---|---|
| Property, plant and equipment | 95 | – | 95 |
| Deferred tax asset | 4 | – | 4 |
| Inventories | 39 | – | 39 |
| Trade and other receivables | 49 | – | 49 |
| Cash and cash equivalents | 33 | – | 33 |
| Trade and other payables | (219) | – | (219) |
| Provisions | (23) | – | (23) |
| Net liabilities | (22) | – | (22) |
| Minority interest | | | 2 |
| Transferred from investment in joint ventures | | | 11 |
| Net liabilities acquired | | | (9) |
| Goodwill arising on acquisition of additional shares (in addition to previously held goodwill of £156m) | | | 190 |
| | | | 181 |
| Consideration: | | | |
| Cash consideration | | | 180 |
| Costs associated with the acquisition | | | 1 |
| Total consideration | | | 181 |

As Hymall was acquired towards the end of their financial year, it has continued to be treated as a joint venture in 2006/07. However, the net liabilities of Hymall have been consolidated as a subsidiary within the Group Balance Sheet as at 24 February 2007. From the start of 2007/08, Hymall's net result will be consolidated with that of the Group.

**Note 26** **Business combinations** continued

**Leader Price**

On 30 November 2006, the Group acquired 100% of the share capital of Leader Price Polska Sp. z.o.o, which operates a chain of 146 stores in Poland.

The fair value of the identifiable assets and liabilities of Leader Price Polska Sp. z.o.o as at the date of acquisition were:

| | Pre-acquisition carrying amounts £m | Fair value adjustments £m | Recognised values on acquisition £m |
|---|---|---|---|
| Property, plant and equipment | 81 | (14) | 67 |
| Intangible assets | 1 | (1) | – |
| Deferred tax asset | – | 8 | 8 |
| Inventories | 10 | (2) | 8 |
| Trade and other receivables | 14 | (1) | 13 |
| Cash and cash equivalents | 4 | – | 4 |
| Trade and other payables | (83) | (7) | (90) |
| Provisions | – | (4) | (4) |
| Net assets acquired | 27 | (21) | 6 |
| Goodwill arising on acquisition | | | 4 |
| | | | 10 |
| Consideration: | | | |
| Cash consideration | | | 7 |
| Costs associated with the acquisition | | | 3 |
| Total consideration | | | 10 |

From the date of acquisition, the acquired business has contributed £31m to revenue and £4m of operating losses to the Group.

**Note 26** Business combinations continued

### dunnhumby Limited

On 19 April 2006, the Group acquired a further 31% of the share capital of one of its joint ventures, dunnhumby Limited, a data analysis group incorporated in the United Kingdom, making it a subsidiary entity.

On the same day, the minority shareholders of dunnhumby entered into an agreement to sell their remaining share of the business to Tesco in two tranches by 2011. The purchase price will reflect the valuation of these shares on the purchase dates. Under IAS 32, the net present value of the future payments are shown as a financial liability, the value of which was £38m at 24 February 2007.

The fair value of the identifiable assets and liabilities of dunnhumby Limited as at the date of acquisition were:

| | Pre-acquisition carrying amounts £m | Fair value adjustments £m | Recognised values on acquisition £m |
|---|---|---|---|
| Property, plant and equipment | 4 | – | 4 |
| Intangible assets | 1 | – | 1 |
| Investment in joint venture | 3 | – | 3 |
| Deferred income tax asset | 1 | – | 1 |
| Trade and other receivables | 16 | – | 16 |
| Cash and cash equivalents | 12 | – | 12 |
| Trade and other payables | (19) | – | (19) |
| Net assets | 18 | – | 18 |
| Minority interest | | | (3) |
| Transferred from investment in joint ventures | | | (10) |
| Net assets acquired | | | 5 |
| Goodwill arising on acquisition of additional shares (in addition to previously held goodwill of £10m) | | | 25 |
| | | | 30 |
| Consideration: | | | |
| Cash consideration | | | 30 |
| Costs associated with the acquisition | | | – |
| Total consideration | | | 30 |

From the date of acquisition, the acquired business has contributed £32m to revenue and £5m of operating profit to the Group.

### Other acquisitions

The other acquisitions in the year include the share capital or the trade and assets of Edeka, Hikso Limited, Maintenance One Limited and Tesco Home Shopping Limited. The companies acquired undertake activities including retailing, software development and maintenance services.

The book and fair values of the identifiable assets and liabilities as at the date of acquisition are disclosed in the table below:

| | Pre-acquisition carrying amounts £m | Fair value adjustments £m | Recognised values on acquisition £m |
|---|---|---|---|
| Property, plant and equipment | 6 | – | 6 |
| Inventories | 2 | – | 2 |
| Bank loans and overdrafts | (3) | – | (3) |
| Trade and other payables | (2) | – | (2) |
| Net assets | 3 | – | 3 |
| Transferred from investment in joint ventures | | | 2 |
| Net assets acquired | | | 5 |
| Goodwill arising on acquisition | | | 13 |
| | | | 18 |
| Consideration: | | | |
| Cash consideration | | | 18 |
| Costs associated with the acquisition | | | – |
| Total consideration | | | 18 |

The post-acquisition contribution of the other acquisitions to the Group was £33m to revenue and £2m of operating losses.

## Note 27 Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint ventures and associates are disclosed below:

### i) Trading transactions

| | Sales to related parties | | Purchases from related parties | | Amounts owed by related parties | | Amounts owed to related parties | |
|---|---|---|---|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Joint ventures | 144 | 95 | 190 | 195 | 5 | 19 | 45 | – |
| Associates | 3 | – | 658 | 502 | – | – | 83 | 79 |

Sales to related parties consists of services/management fees and loan interest.

Purchases from related parties include £107m (2006 – £104m) of rentals payable to the Group's joint ventures, including those joint ventures formed as part of the sale and leaseback programme.

### ii) Non-trading transactions

| | Sale and leaseback of assets | | Loans to related parties | | Loans from related parties | | Injection of equity funding | |
|---|---|---|---|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Joint ventures | 527 | 529 | 163 | 122 | 10 | 9 | 47 | 35 |
| Associates | – | – | – | – | – | – | 3 | 1 |

Transactions between the Group and the Group's pension plans are disclosed in note 23.

Tesco Stores Limited is a member of one or more partnerships to whom the provisions of the Partnerships and Unlimited Companies (Accounts) Regulations 1993 ('Regulations') apply. The accounts for those partnerships have been consolidated into these accounts pursuant to regulation 7 of the Regulations.

On 20 December 2006, the Group formed a property joint venture with British Airways Pension Fund. The limited partnership contains 16 superstores which have been sold from and leased back to Tesco. The Group sold assets for net proceeds of £454m (approximating to market value) to the joint venture which had a net book value of £233m. 50% of the resulting profit has been recognised within profit arising on property-related items with the remaining percentage deferred on the Balance Sheet in accordance with IAS 31 'Interests in Joint Ventures'. Another smaller transaction was completed during the year with Morley where £73m of assets were transferred.

### iii) Transactions with key management personnel

Only members of the Board of Directors of Tesco PLC are deemed to be key management personnel. It is the Board who have responsibility for planning, directing and controlling the activities of the Group. Key management personnel compensation is disclosed in the audited part of the Directors' Remuneration Report.

During the year, there were no other material transactions or balances between the Group and its key management personnel or members of their close family.

## Note 28 Reconciliation of profit before tax to net cash generated from operations

| | 2007 £m | 2006 £m |
|---|---|---|
| Profit before tax | 2,653 | 2,235 |
| Net finance costs | 126 | 127 |
| Share of post-tax profits of joint ventures and associates | (106) | (82) |
| Profit on sale of investments in associates | (25) | – |
| Operating profit | 2,648 | 2,280 |
| Operating loss of discontinued operation | (4) | (9) |
| Depreciation and amortisation | 878 | 838 |
| Profit arising on property-related items | (92) | (77) |
| Loss on disposal of non-property assets | – | 4 |
| Net impairment/(reversal of impairment) of property, plant and equipment | 19 | (5) |
| Adjustment for non-cash element of pensions charge | (113) | 58 |
| Share-based payments | 185 | 142 |
| Increase in inventories | (420) | (146) |
| Increase in trade and other receivables | (81) | (38) |
| Increase in trade and other payables | 512 | 365 |
| Decrease in working capital | 11 | 181 |
| Cash generated from operations | 3,532 | 3,412 |

## Note 29 Analysis of changes in net debt

| | At 25 Feb 2006 £m | Cash flow £m | Other non-cash movements £m | At 24 Feb 2007 £m |
|---|---|---|---|---|
| Cash and cash equivalents | 1,325 | (265) | (18) | 1,042 |
| Finance lease receivables | 17 | (5) | – | 12 |
| Derivative financial instruments | 70 | (61) | 99 | 108 |
| Cash and receivables | 1,412 | (331) | 81 | 1,162 |
| Bank and other borrowings | (1,626) | 442 | (334) | (1,518) |
| Finance lease payables | (20) | 7 | (23) | (36) |
| Derivative financial instruments and other liabilities | (239) | 232 | (80) | (87) |
| Debt due within one year | (1,885) | 681 | (437) | (1,641) |
| Bank and other borrowings | (3,658) | (819) | 478 | (3,999) |
| Finance lease payables | (84) | (86) | 23 | (147) |
| Derivative financial instruments and other liabilities | (294) | 22 | (127) | (399) |
| Debt due after one year | (4,036) | (883) | 374 | (4,545) |
| | (4,509) | (533) | 18 | (5,024) |

## Note 30 Commitments and contingencies

### Capital commitments

On 24 February 2007 there were commitments for capital expenditure contracted for, but not provided, of £2,003m (2006 – £1,578m), principally relating to the store development programme.

### Contingent liabilities

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.

Tesco Personal Finance, in which the Group owns a 50% joint venture share, has commitments, as described in its own financial statements as at 31 December 2006, of formal standby facilities, credit lines and other commitments to lend, totalling £5.5bn (2006 – £6.0bn). The amount is intended to provide an indication of the volume of business transacted and not of the underlying credit or other risks.

For details of assets held under finance leases, which are pledged as security for the finance lease liabilities, see note 11.

There are a number of contingent liabilities that arise in the normal course of business which if realised are not expected to result in a material liability to the Group. In connection with the railway tunnel collapse at Gerrards Cross, the Group is currently assessing a number of potential claims. Due to the nature of those claims it is not currently possible to assess any liabilities or potential recoveries, therefore no provision has been made. The final outcome is not expected to be material to the Group.

## Note 31 Leasing commitments

### Finance lease commitments – Group as lessee

The Group has finance leases for various items of plant, equipment, fixtures and fittings. There are also a small number of buildings which are held under finance leases. The fair value of the Group's lease obligations approximate to their carrying value.

Future minimum lease payments under finance leases and hire purchase contracts, together with the present value of the net minimum lease payments are as follows:

| | Minimum lease payments | | Present value of minimum lease payments | |
|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Within one year | 38 | 23 | 36 | 20 |
| Greater than one year but less than five years | 109 | 37 | 90 | 27 |
| After five years | 130 | 132 | 57 | 57 |
| Total minimum lease payments | 277 | 192 | 183 | 104 |
| Less future finance charges | (94) | (88) | | |
| Present value of minimum lease payments | 183 | 104 | | |
| Analysed as: | | | | |
| Current finance lease payables | 36 | 20 | | |
| Non-current finance lease payables | 147 | 84 | | |
| | 183 | 104 | | |

### Finance lease receivables – Group as lessor

In 2006, the Group entered into finance leasing arrangements with UK staff for certain of its electronic equipment as part of the Computers for Staff scheme. The average term of finance leases entered into was three years. The interest rate inherent in the leases is fixed at the contract date for all of the lease term. The average effective interest rate contracted approximates to 4.0% (2006 – 4.6%) per annum. The fair value of the Group's finance lease receivables at 24 February 2007 is estimated at £12m (2006 – £17m).

**Note 31** Leasing commitments continued

Future minimum lease receivables under finance leases together with the present value of the net minimum lease receivables are as follows:

| | Minimum lease receivables | | Present value of minimum lease receivables | |
|---|---|---|---|---|
| | 2007 £m | 2006 £m | 2007 £m | 2006 £m |
| Within one year | 7 | 7 | 6 | 6 |
| Greater than one year but less than five years | 6 | 12 | 6 | 11 |
| Total minimum lease receivables | 13 | 19 | 12 | 17 |
| Less unearned finance income | (1) | (2) | | |
| Net lease receivables | 12 | 17 | | |
| Analysed as: | | | | |
| Current finance lease receivables | 6 | 6 | | |
| Non-current finance lease receivables | 6 | 11 | | |
| | 12 | 17 | | |

**Operating lease commitments – Group as lessee**

Future minimum rentals payable under non-cancellable operating leases are as follows:

| | 2007 £m | 2006 £m |
|---|---|---|
| Within one year | 379 | 315 |
| Greater than one year but less than five years | 1,444 | 1,105 |
| After five years | 4,838 | 3,795 |
| Total minimum lease payments | 6,661 | 5,215 |

Operating lease payments represent rentals payable by the Group for certain of its retail, distribution and office properties and other assets such as motor vehicles. The leases have varying terms, purchase options, escalation clauses and renewal rights.

Operating lease commitments with joint ventures

Since 1988, the Group has entered into several joint ventures and sold and leased back properties to and from these joint ventures. The terms of these sale and leasebacks vary, however, common factors include: the sale of the properties to the joint venture at market value, options at the end of the lease for the Group to repurchase the properties at market value, market rent reviews and 20-25 year lease terms. The Group reviews the substance as well as the form of the arrangements when making the judgement as to whether these leases are operating or finance leases; the majority of the leases under these arrangements are operating leases.

**Operating lease receivables – Group as lessor**

The Group both rents out its investment properties and also sub-lets various leased buildings under operating leases. At the Balance Sheet date, the following future minimum lease payments are contractually receivable from tenants:

| | 2007 £m | 2006 £m |
|---|---|---|
| Within one year | 123 | 84 |
| Greater than one year but less than five years | 260 | 234 |
| After five years | 268 | 283 |
| Total minimum lease payments | 651 | 601 |

**Note 32** Events after the balance sheet date

On 20 March 2007, the Group formed a property joint venture with The British Land Company PLC. The limited partnership contains 21 superstores which have been sold from and leased back to Tesco. The Group sold assets to the joint venture with a fair value of approximately £650m and a net book value of approximately £350m; 50% of the resulting profit will be recognised within profit arising on property-related items with the remaining percentage deferred on the Balance Sheet in accordance with IAS 31 'Interests in Joint Ventures'.

In March 2007, the Group issued two bonds: £500m paying interest at 5.2%, maturing in 2057 and €600m paying interest at 5.125%, maturing in 2047.

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## 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 of the Group for the financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with IFRSs as endorsed by the European Union (EU) and have elected to prepare the Company financial statements in accordance with UK Accounting Standards.

In preparing each of the Group and Company financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make reasonable and prudent judgements and estimates;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as endorsed by the EU;
- for the Company financial statements state whether applicable UK Accounting Standards have been followed.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time, the financial position of the Company and Group and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors are responsible for the maintenance and integrity of the Annual Review and Summary Financial Statement and Annual Report and Financial Statements published on the Group’s corporate website. Legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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

# Independent auditors' report to the members of Tesco PLC

We have audited the Group financial statements of Tesco PLC for the year ended 25 February 2006 which comprise the Group Income Statement, the Group Balance Sheet, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expense and the related notes. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Tesco PLC for the year ended 25 February 2006 and on the information in the Directors' remuneration report that is described as having been audited.

### Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' report is not consistent with the Group financial statements, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the annual report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Operating and financial review, the Directors' report, the Corporate governance statement and the unaudited information in the Directors' remuneration report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group'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 Group 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 Group financial statements.

### Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 25 February 2006 and of its profit and cash flows for the year then ended; and
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London 24 April 2006

# Group income statement Year ended 25 February 2006*

| | notes | 2006* £m | 2005 £m |
|---|---|---|---|
| **Continuing operations** | | | |
| **Revenue (Sales excluding VAT)** | 2 | 39,454 | 33,866 |
| Cost of sales | | (36,426) | (31,231) |
| **Gross profit** | | 3,028 | 2,635 |
| Administrative expenses | | (825) | (732) |
| Profit arising on property-related items | 2/3 | 77 | 49 |
| **Operating profit** | 2 | 2,280 | 1,952 |
| Share of post-tax profits of Joint ventures and Associates | 13 | 82 | 74 |
| Finance income | 5 | 114 | 103 |
| Finance costs | 5 | (241) | (235) |
| **Profit before tax** | 3 | 2,235 | 1,894 |
| Taxation | 6 | (649) | (541) |
| **Profit for the period from continuing operations** | | 1,586 | 1,353 |
| **Discontinuing operation** | | | |
| Loss for the period from discontinuing operation | 7 | (10) | (6) |
| **Profit for the year** | | 1,576 | 1,347 |
| **Attributable to:** | | | |
| Equity holders of the parent | | 1,570 | 1,344 |
| Minority interests | | 6 | 3 |
| | | 1,576 | 1,347 |
| **Earnings per share from continuing and discontinuing operations** | | | |
| Basic | 9 | 20.07p | 17.44p |
| Diluted | 9 | 19.79p | 17.22p |
| **Earnings per share from continuing operations** | | | |
| Basic | 9 | 20.20p | 17.52p |
| Diluted | 9 | 19.92p | 17.30p |

* Results for the year ended 25 February 2006 include 52 weeks for the UK and the Republic of Ireland and 14 months for the majority of the remaining International businesses.

## Group statement of recognised income and expense Year ended 25 February 2006*

| | notes | 2006 £m | 2005 £m |
|---|---|---|---|
| Gains on revaluation of available-for-sale investments | 14 | 2 | – |
| Foreign currency translation differences | | 25 | 11 |
| Actuarial losses on defined benefit pension schemes | 23 | (442) | (230) |
| Gains/(losses) on cash flow hedges: | | | |
| – net fair value gains | | 44 | – |
| – reclassified and reported in the Income Statement | | (5) | – |
| Tax on items taken directly to equity | 6 | 133 | 92 |
| **Net expense recognised directly in equity** | | (243) | (127) |
| Profit for the period | | 1,576 | 1,347 |
| **Total recognised income and expense for the period** | | 1,333 | 1,220 |
| Attributable to: | | | |
| Equity holders of the parent | | 1,327 | 1,217 |
| Minority interests | | 6 | 3 |
| | | 1,333 | 1,220 |

| | notes | 2006 £m |
|---|---|---|
| Effect of changes in accounting policy (adoption of IAS 32 and IAS 39): | 33 | |
| Equity holders of the parent | | (314) |
| Minority interests | | – |
| | | (314) |

* Results for the year ended 25 February 2006 include 52 weeks for the UK and the Republic of Ireland and 14 months for the majority of the remaining International businesses.

# Group balance sheet 25 February 2006

| | notes | 2006 £m | 2005 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Goodwill and intangible assets | 10 | 1,525 | 1,408 |
| Property, plant and equipment | 11 | 15,882 | 14,521 |
| Investment property | 12 | 745 | 565 |
| Investments in Joint ventures and Associates | 13 | 476 | 416 |
| Other investments | 14 | 4 | 7 |
| Deferred tax assets | 6 | 12 | 14 |
| | | 18,644 | 16,931 |
| **Current assets** | | | |
| Inventories | 15 | 1,464 | 1,309 |
| Trade and other receivables | 16 | 892 | 769 |
| Derivative financial instruments | 20 | 70 | – |
| Cash and cash equivalents | 17 | 1,325 | 1,146 |
| | | 3,751 | 3,224 |
| Non-current assets classified as held for sale and assets of the disposal group | 7 | 168 | – |
| | | 3,919 | 3,224 |
| **Current liabilities** | | | |
| Trade and other payables | 18 | (5,083) | (4,974) |
| Financial liabilities | | | |
| – Borrowings | 19 | (1,646) | (482) |
| – Derivative financial instruments | 20 | (239) | – |
| Current tax liabilities | | (462) | (221) |
| Provisions | 21 | (2) | (3) |
| | | (7,432) | (5,680) |
| Liabilities directly associated with the disposal group | 7 | (86) | – |
| | | (7,518) | (5,680) |
| **Net current liabilities** | | (3,599) | (2,456) |
| **Non-current liabilities** | | | |
| Financial liabilities | | | |
| – Borrowings | 19 | (3,742) | (4,563) |
| – Derivative financial instruments and other liabilities | 20 | (294) | – |
| Post-employment benefit obligations | 23 | (1,211) | (735) |
| Other non-current liabilities | 18 | (29) | (21) |
| Deferred tax liabilities | 6 | (320) | (496) |
| Provisions | 21 | (5) | (6) |
| | | (5,601) | (5,821) |
| **Net assets** | | 9,444 | 8,654 |
| **Equity** | | | |
| Share capital | 24/25 | 395 | 389 |
| Share premium account | 25 | 3,988 | 3,704 |
| Other reserves | 25 | 40 | 40 |
| Retained earnings | 25 | 4,957 | 4,470 |
| **Equity attributable to equity holders of the parent** | | 9,380 | 8,603 |
| Minority interests | 25 | 64 | 51 |
| **Total equity** | | 9,444 | 8,654 |

Terry Leahy
Andrew Higginson
Directors
The financial statements on pages 42 to 101 were authorised for issue by the Directors on 24 April 2006.

## Group cash flow statement Year ended 25 February 2006*

| | notes | 2006 £m | 2005 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from operations | 28 | 3,412 | 3,009 |
| Interest paid | | (364) | (350) |
| Corporation tax paid | | (429) | (483) |
| **Net cash from operating activities** | | 2,619 | 2,176 |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiaries, net of cash acquired | | (54) | (81) |
| Proceeds from sale of subsidiary, net of cash acquired | | – | 5 |
| Purchase of property, plant and equipment and investment properties | | (2,561) | (2,197) |
| Proceeds from sale of property, plant and equipment | | 664 | 823 |
| Purchase of intangible assets | | (139) | (107) |
| Net increase in loans to Joint ventures | | (16) | (10) |
| Equity investments made | | (34) | (152) |
| Dividends received | | 82 | 135 |
| Interest received | | 96 | 83 |
| **Net cash used in investing activities** | | (1,962) | (1,501) |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of ordinary share capital | | 123 | 146 |
| Repayments of borrowings | | (109) | (18) |
| New finance leases | | – | 161 |
| Repayments of obligations under finance leases | | (6) | (349) |
| Dividends paid | | (441) | (448) |
| Own shares purchased | | (59) | (143) |
| **Net cash used in financing activities** | | (492) | (651) |
| **Net increase in cash and cash equivalents** | | 165 | 24 |
| Cash and cash equivalents at beginning of year | | 1,146 | 1,100 |
| Effect of foreign exchange rate changes | | 16 | 22 |
| **Cash and cash equivalents at end of year** | | 1,327 | 1,146 |
| Less cash held in disposal group | 7 | (2) | – |
| **Cash and cash equivalents not held in disposal group** | 17 | 1,325 | 1,146 |

* Results for the year ended 25 February 2006 include 52 weeks for the UK and the Republic of Ireland and 14 months for the majority of the remaining International businesses.

## Reconciliation of net cash flow to movement in net debt

| | notes | 2006 £m | 2005 £m |
|---|---|---|---|
| Net increase in cash and cash equivalents | | 165 | 24 |
| Cash outflow from decrease in debt and lease financing | | 115 | 206 |
| Loans and finance leases acquired with subsidiaries | | – | (17) |
| Net debt included within the disposal group | | 55 | – |
| Other non-cash movements | | (357) | 11 |
| **(Increase)/decrease in net debt before the impact of IAS 32 and 39** | | (22) | 224 |
| IAS 32 and 39 adjustments to net debt | | (588) | – |
| (Increase)/decrease in net debt | | (610) | 224 |
| Opening net debt | 29 | (3,899) | (4,123) |
| **Closing net debt** | 29 | (4,509) | (3,899) |

NB. This is not a primary statement and does not form part of the cash flow statement.

# Notes to the financial statements

**Note 1** Accounting policies

**General information**

Tesco PLC is a public limited company incorporated in the United Kingdom under the Companies Act 1985 (Registration number 445790). The address of the registered office is New Tesco House, Delamare Road, Cheshunt, Hertfordshire, EN8 9SL, UK.

As described in the Operating and financial review, the main activity of the Group is that of retailing and associated activities.

**Statement of compliance**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretation Committee (IFRIC) interpretations as endorsed by the European Union, and those parts of the Companies Act 1985 applicable to companies reporting under IFRSs.

These are the Group's first consolidated financial statements prepared under IFRSs and IFRS 1 'First time adoption of IFRS' has been applied. An explanation of how the transition from UK Generally Accepted Accounting Principles (UK GAAP) to IFRSs has affected the reported financial position, financial performance and cash flows of the Group are provided in notes 32 and 33.

**Basis of preparation**

The financial statements are presented in Pounds Sterling, rounded to the nearest million. They are prepared on the historical cost basis modified for the revaluation of certain financial instruments.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and in preparing an opening IFRSs Balance Sheet at 29 February 2004 for the purposes of transition to IFRSs, with the exception of IAS 32* and IAS 39† for which a one-year exemption has been taken, as allowed by IFRS 1.

**Basis of consolidation**

The Group financial statements consist of the financial statements of the ultimate parent Company (Tesco PLC), entities controlled by the Company (its subsidiaries) and the Group's share of interests in joint ventures and associates.

Where necessary, adjustments are made to the financial statements of subsidiaries, joint ventures and associates to bring the accounting policies used into line with those of the Group.

Subsidiaries

A subsidiary is an entity whose operating and financing policies are controlled, directly or indirectly, by Tesco PLC.

The accounts of the parent Company's subsidiary undertakings are prepared to dates around the Group year end apart from Tesco Taiwan Co. Limited, which for this reporting period have been prepared to 31 December 2005. Tesco Taiwan Co. Limited has a different year end to the Group as a result of the pending asset swap transaction with the Carrefour Group; keeping the year end as 31 December will facilitate an easier integration into the Carrefour Group.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

Joint ventures and Associates

A joint venture is an entity in which the Group holds an interest on a long-term basis and which is jointly controlled by the Group and one or more other venturers under a contractual agreement.

An associate is an undertaking, not being a subsidiary or joint venture, over which the Group has significant influence and can participate in the financial and operating policy decisions of the entity.

The Group's share of the results of joint ventures and associates is included in the Group Income Statement using the equity method of accounting. Investments in joint ventures and associates are carried in the Group Balance Sheet at cost plus post-acquisition changes in the Group's share of the net assets of the entity, less any impairment in value. The carrying values of investments in joint ventures and associates include acquired goodwill.

If the Group's share of losses in a joint venture or associate equals or exceed its investment in the joint venture or associate, the Group does not recognise further losses, unless it has incurred obligations to do so or made payments on behalf of the joint venture or associate.

Unrealised gains arising from transactions with joint ventures and associates are eliminated to the extent of the Group's interest in the entity.

**Use of assumptions and estimates**

The preparation of the consolidated financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

* 'Financial Instruments: Disclosure and Presentation'.
† 'Financial Instruments: Recognition and measurement'.

Material estimates and assumptions are made in particular with regard to establishing uniform depreciation and amortisation periods for the Group, impairment testing, parameters for measuring pension provisions, determination of the fair value of obligations under put options, the likelihood that tax assets can be realised and the classification of certain operations as held for sale.

Following a review of useful economic lives and residual values the estimated economic life of land premia has been revised from 40 years to infinite. The impact on the current year Income Statement is to reduce the annual land premia amortisation charge from £21m to nil.

**Revenue**

Revenue consists of sales through retail outlets and sales of development properties.

Revenue is recorded net of returns, vouchers and value-added taxes, when the significant risks and rewards of ownership have been transferred to the buyer. Commission income is recorded based on the terms of the contracts.

**Other income**

Interest income is recognised for the period to which it relates on the accruals basis. Dividends are recognised when a legal entitlement to payment arises.

**Operating profit**

Operating profit is stated after profit or loss from property-related items but before the share of results of joint ventures and associates, finance income and finance costs.

**Discontinued operations**

A discontinued operation is a component of the Group's business that represents a separate line of business or geographical area of operations. Classification as a discontinued operation occurs upon disposal or earlier, if the operation meets the criteria to be classified as held for sale, under IFRS 5 'Non-current Assets held for sale'.

**Property, plant and equipment**

Property, plant and equipment assets are carried at cost less accumulated depreciation and any recognised impairment in value.

Depreciation is provided on a straight-line basis over the anticipated useful economic lives of the assets.

The following depreciation rates are applied for the Group:

- Freehold and leasehold buildings with greater than 40 years unexpired – at 2.5% of cost
- Leasehold properties with less than 40 years unexpired are depreciated 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%.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

All tangible fixed assets are reviewed for impairment in accordance with IAS 36 'Impairment of Assets' when there are indications that the carrying value may not be recoverable.

**Borrowing costs**

Borrowing costs directly attributable to the acquisition or construction of qualifying assets are capitalised. Qualifying assets are those that necessarily take a substantial period of time to prepare for their intended use. All other borrowing costs are recognised in the Income Statement in the period in which they occur.

**Investment property**

Investment property is property held to earn rental income and/or for capital appreciation rather than for the purpose of Group operating activities. Investment property assets are carried at cost less accumulated depreciation and any recognised impairment in value. The depreciation policies for Investment property are consistent with those described for owner-occupied property.

**Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as a lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment in the lease.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

The Group as a lessee

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the Balance Sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the Income Statement.

Rentals payable under operating leases are charged to the Income Statement on a straight-line basis over the term of the relevant lease.

**Note 1 Accounting policies** continued

### Sale and leaseback
A sale and leaseback transaction is one where a vendor sells an asset and immediately reacquires the use of that asset by entering into a lease with the buyer. The accounting treatment of the sale and leaseback depends upon the substance of the transaction (by applying the lease classification principles described above) and whether or not the sale was made at the asset's fair value.

For sale and finance leasebacks, any apparent profit or loss from the sale is deferred and amortised over the lease term. For sale and operating leasebacks, generally the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately.

Following initial recognition, the lease treatment is consistent with those principles described above.

**Business combinations and goodwill**
All business combinations are accounted for by applying the purchase method.

On acquisition, the assets and liabilities and contingent liabilities of an acquired entity are measured at their fair value. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognised.

Goodwill arising on consolidation represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary, joint venture or associate at the date of acquisition. If the cost of acquisition is less than the fair value of the Group's share of the net assets of the acquired entity (i.e. a discount on acquisition) then the difference is credited to the Income Statement in the period of acquisition.

At the acquisition date of a subsidiary, goodwill acquired is recognised as an asset and is allocated to each of the cash-generating units expected to benefit from the business combination's synergies and to the lowest level at which management monitors the goodwill. Goodwill arising on the acquisition of joint ventures and associates is included within the carrying value of the investment.

Goodwill is reviewed for impairment at least annually by assessing the recoverable amount of each cash-generating unit to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Any impairment is recognised immediately in the Income Statement and is not subsequently reversed.

On disposal of a subsidiary, joint venture or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before 29 February 2004 (the date of transition to IFRSs) has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been restated and will not be included in determining any subsequent profit or loss on disposal.

**Intangible assets**

### Acquired intangible assets
Acquired intangible assets, such as software or pharmacy licences, are measured initially at cost and are amortised on a straight-line basis over their estimated useful lives.

### Internally-generated intangible assets – Research and development expenditure
Research costs are expensed as incurred.

Development expenditure incurred on an individual project is carried forward only if all the criteria set out in IAS 38 'Intangible Assets' are met, namely:

- an asset is created that can be identified (such as software or new processes);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the project's estimated useful life, usually at 14%-25% of cost per annum.

**Impairment of tangible and intangible assets excluding goodwill**
At each Balance Sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of the recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately.

**Inventories**

Inventories comprise goods held for resale and properties held for, or in the course of, development and are valued at the lower of cost and fair value less costs to sell. Inventories are valued at retail prices and reduced by appropriate margins to take into account factors such as average cost, obsolescence, seasonality and damage.

**Cash and cash equivalents**

Cash and cash equivalents in the Balance Sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

**Non-current assets held for sale**

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through sale rather than continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and it should be expected to be completed within one year from the date of classification.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

**Pensions and similar obligations**

The Group accounts for pensions and other post-employment benefits (principally private healthcare) under IAS19 'Employee Benefits'.

In respect of defined benefit plans, obligations are measured at discounted present value (using the projected unit credit method) whilst plan assets are recorded at fair value. The operating and financing costs of such plans are recognised separately in the Income Statement; service costs are spread systematically over the expected service lives of employees and financing costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised immediately in the Statement of Recognised Income and Expense as allowed by the December 2004 amendment to IAS 19, which has been adopted early by the Group.

Payments to defined contribution schemes are recognised as an expense as they fall due.

**Share-based payments**

Employees (including Directors) of the Group receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. In accordance with IFRS 2 'Share-based payment', the resulting cost is charged to the Income Statement over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

**Income tax**

The tax expense included in the Income Statement comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted by the Balance Sheet date.

Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is provided using the Balance Sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

**Note 1 Accounting policies** continued

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the Income Statement, except when it relates to items charged or credited directly to equity, in which case deferred tax is also dealt with in equity.

Deferred tax liabilities and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each Balance Sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset against each other when they relate to income taxes levied by the same tax jurisdiction and when the Group intends to settle its current tax assets and liabilities on a net basis.

**Foreign currencies**

Transactions in foreign currencies are translated at the exchange rate on the date of the transaction. At each Balance Sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the Balance Sheet date. All differences are taken to the Income Statement for the period.

The financial statements of foreign subsidiaries are translated into Pounds Sterling according to the functional currency concept of IAS 21 'The Effects of Changes in Foreign Exchange Rates'. Since the majority of consolidated companies operate as independent entities within their local economic environment, their respective local currency is the functional currency. Therefore, assets and liabilities of overseas subsidiaries denominated in foreign currencies are translated at exchange rates prevailing at the date of the Group Balance Sheet; profits and losses are translated into Pounds Sterling at average exchange rates for the relevant accounting periods. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or expenses in the period in which the operation is disposed of.

The financial statements of foreign subsidiaries that report in the currency of a hyperinflationary economy are restated in terms of the measuring unit current at the Balance Sheet date before they are translated into Pounds Sterling.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

**Financial instruments**

Financial assets and financial liabilities are recognised on the Group's Balance Sheet when the Group becomes a party to the contractual provisions of the instrument.

Trade receivables

Trade receivables are not interest-bearing and are stated at their nominal value, reduced by appropriate allowances for estimated irrecoverable amounts.

Investments

Investments are classified as either held-for-trading or available-for-sale, and are measured at subsequent reporting dates at fair value. For available-for-sale investments, gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired; at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

Financial liabilities and Equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that gives a residual interest in the assets of the Group after deducting all of its liabilities.

Interest-bearing borrowings

Interest-bearing bank loans and overdrafts are initially recorded at the value of the amount received, net of attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the Income Statement over the period of the borrowings on an effective interest basis.

Trade payables

Trade payables are not interest-bearing and are stated at their nominal value.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

### Derivative financial instruments and hedge accounting – Accounting policy for year ended 25 February 2006

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes, however if derivatives do not qualify for hedge accounting they are accounted for as such.

Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The fair value of derivative financial instruments is determined by reference to market values for similar financial instruments, or by discounted cash flows or by the use of option valuation models. Where derivatives do not qualify for hedge accounting, any gains or losses on remeasurement are immediately recognised in the Income Statement. Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the hedge relationship and the item being hedged. To qualify for hedge accounting, the hedge relationship must be documented and tested for effectiveness.

In order to qualify for hedge accounting, the Group is required to document from inception the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is performed at each period end to ensure that the hedge remains highly effective.

### Fair value hedging

Derivative financial instruments are classified as fair value hedges when they hedge the Group's exposure to changes in the fair value of a recognised asset or liability. Any gain or loss from remeasuring the hedging instrument is recognised immediately in the Income Statement. Any change in the fair value of the hedged item, attributable to the hedged risk, is adjusted against the carrying value of the hedged item and recognised immediately in the Income Statement.

Derivative financial instruments qualifying for fair value hedge accounting are principally interest rate swaps.

### Cash flow hedging

Derivative financial instruments are classified as cash flow hedges when they hedge the Group's exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecasted transaction.

The effective element of any gain or loss from remeasuring the derivative instrument is recognised directly in equity.

The associated cumulative gain or loss is removed from equity and recognised in the Income Statement in the same period or periods during which the hedged transaction affects the Income Statement. Any element of the remeasurement of the derivative instrument which does not meet the criteria for an effective hedge is recognised immediately in the Income Statement.

Derivative instruments qualifying for cash flow hedging are principally forward foreign exchange transactions and currency options.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Income Statement.

### Net investment hedging

Derivative financial instruments are classified as net investment hedges when they hedge the Group's net investment in an overseas operation. The effective element of any gain or loss from remeasuring the derivative is recognised directly in equity. Any ineffective element is recognised immediately in the Income Statement. Gains and losses accumulated in equity are included in the Income Statement when the foreign operation is disposed of.

Derivative instruments qualifying for net investment hedging are principally forward foreign exchange transactions.

### Derivative financial instruments – Accounting policy for year ended 26 February 2005

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

**Note 1 Accounting policies** continued

Interest differentials on derivative instruments are recognised by adjusting net finance costs. Premia or discount on derivative instruments is amortised over the shorter of the life of the instrument or the underlying exposure.

Currency swap agreements are valued at closing rates of exchange. Forward exchange contracts are valued at discounted closing forward 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 or is extinguished.

Treatment of put option on minority interest

The Group has an agreement with the Samsung Corporation to purchase the remaining shares of Samsung Tesco Co. Ltd. These shares are expected to be purchased in three tranches in 2007, 2011 and 2012. The purchase price will reflect the market value of these shares at the date of acquisition.

Under IAS 32, the net present value of the expected future payments are shown as a financial liability. At the end of each period, the valuation of the liability is reassessed with any changes recognised in the profit or loss for the period.

**Provisions**

Provisions for onerous leases are recognised when the Group believes that the unavoidable costs of meeting the lease obligations exceed the economic benefits expected to be received under the lease.

**IFRSs transitional arrangements and early adoption**

The rules for first-time adoption of IFRSs are set out in IFRS 1, which requires that the Group establishes its IFRS accounting policies for the 2005/06 reporting date and, in general, apply these retrospectively.

The standard allows a number of optional exemptions on transition to help companies simplify the move to IFRSs. The exemptions selected by the Group are set out below:

Business Combinations (IFRS 3)

The Group has elected to apply IFRS 3 prospectively from the date of transition to IFRSs rather than to restate previous business combinations.

Employee Benefits (IAS 19) – Actuarial gains and losses on defined benefit pension schemes

The Group has chosen to recognise all cumulative actuarial gains and losses in respect of employee defined benefit plans in full through reserves at the date of transition to IFRSs. Post-transition, the Group is applying the rules of the amendment to IAS 19, recognising actuarial gains and losses immediately in the Statement of Recognised Income and Expense.

Cumulative translation differences (IAS 21)

Cumulative foreign exchange movements on translation of foreign entities on consolidation have been set to nil as at 29 February 2004.

Financial Instruments (IAS 32 and IAS 39)

The Group opted to take advantage of the one-year exemption for implementation of the Financial Instruments standards. Therefore, for the 2004/05 comparatives, financial instruments continue to be accounted for and presented in accordance with UK GAAP. For 2005/06 financial reporting, adjustments have been made as at 27 February 2005 to reflect the differences between UK GAAP and IAS 32 and IAS 39 (note 33).

**Recent accounting developments**

IFRS 7 'Financial Instruments: Disclosures' and amendments to IAS 1 'Presentation of Financial Statements – Capital Disclosures' were issued in August 2005 and are effective for accounting periods beginning on or after 1 January 2007. These amendments revise and enhance previous disclosures required by IAS 32 and IAS 30 'Disclosures in the Financial Statements of Banks and Similar Financial Institutions'. These changes are not expected to have a material effect on the results and net assets of the Group.

Other standards, amendments and interpretations not expected to have a significant effect on the Group include: IFRS 6 'Exploration for and evaluation of mineral resources', amendment to IAS 39 'Cash flow hedge accounting of forecast intragroup transactions', amendment to IFRS 1, amendment to IAS 39 and IFRS 4 'Insurance contracts', IFRIC 5 'Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds' and IFRIC 7 'Applying the restatement approach under IAS 29 'Hyperinflationary accounting'.

Standards, amendments and interpretations still under review as to their effect on the Group include: Amendment to IAS 21 'The effect of changes in foreign exchange rates: net investment in a foreign operation', IFRIC 4 'Determining whether an arrangement contains a lease', IFRIC 6 'Liabilities arising from participating in a specific market – waste electrical and electronic equipment', IFRIC 8 'Scope of IFRS 2' and IFRIC 9 'Re-assessment of embedded derivatives'.

## Note 2 Segmental reporting

The Board has determined that the primary segmental reporting format is geographical, based on the Group's management and internal reporting structure. Secondary information is reported by a single business segment, retail and associated activities.

The Rest of Europe reporting segment includes the Republic of Ireland, Hungary, Poland, the Czech Republic, Slovakia and Turkey. The Asia reporting segment includes Thailand, South Korea, Malaysia and Japan. Given its pending transfer to the Carrefour Group, our Taiwanese business (previously included within the Asia segment) has been classified as a discontinuing operation in both the current and prior year.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly interest-bearing borrowings and taxation related assets/liabilities.

Inter-segment turnover between the geographical areas of business is not material.

### Geographical segments

| | Continuing operations | | | | Discontinuing operation | Total Group |
|---|---|---|---|---|---|---|
| Year ended 25 February 2006 | UK £m | Rest of Europe £m | Asia £m | Total £m | £m | £m |
| Revenue | | | | | | |
| Sales (excluding VAT) to external customers | 29,990 | 5,095 | 4,369 | 39,454 | 134 | 39,588 |
| Result | | | | | | |
| Segment operating profit/(loss) | 1,788 | 263 | 229 | 2,280 | (9) | 2,271 |
| Share of post-tax profit from Joint ventures and Associates | 78 | – | 4 | 82 | 1 | 83 |
| Net finance costs | | | | (127) | (1) | (128) |
| Profit/(loss) before tax | | | | 2,235 | (9) | 2,226 |
| Taxation | | | | (649) | (1) | (650) |
| Profit/(loss) for the year | | | | 1,586 | (10) | 1,576 |

| | Continuing operations | | | | | Discontinuing operation | Total Group |
|---|---|---|---|---|---|---|---|
| | UK £m | Rest of Europe £m | Asia £m | Other/ unallocated £m | Total £m | £m | £m |
| Assets and liabilities | | | | | | | |
| Segment assets | 14,906 | 3,888 | 3,012 | 167 | 21,973 | 114 | 22,087 |
| Investments in Joint ventures and Associates | 461 | 2 | 13 | – | 476 | – | 476 |
| Total assets | 15,367 | 3,890 | 3,025 | 167 | 22,449 | 114 | 22,563 |
| Segment liabilities | (5,025) | (708) | (692) | (6,608) | (13,033) | (86) | (13,119) |
| Total net assets | | | | | 9,416 | 28 | 9,444 |
| Other segment information | | | | | | | |
| Capital expenditure: | | | | | | | |
| – Property, plant and equipment | 1,673 | 549 | 417 | – | 2,639 | 3 | 2,642 |
| – Investment property | 1 | 10 | 10 | – | 21 | – | 21 |
| – Intangible assets | 121 | 11 | 7 | – | 139 | – | 139 |
| Depreciation: | | | | | | | |
| – Property, plant and equipment | 508 | 146 | 95 | – | 749 | 4 | 753 |
| – Investment property | – | 4 | 5 | – | 9 | – | 9 |
| Amortisation of intangible assets | 63 | 7 | 6 | – | 76 | – | 76 |
| Impairment losses recognised in the Income Statement | (29) | (18) | – | – | (47) | – | (47) |
| Reversal of prior period impairment losses through the Income Statement | 29 | 23 | – | – | 52 | – | 52 |
| Profit/(loss) arising on property-related items | 90 | (6) | (7) | – | 77 | – | 77 |

**Note 2 Segmental reporting** continued

| Year ended 26 February 2005 | UK £m | Rest of Europe £m | Asia £m | Continuing operations Total £m | Discontinuing operation £m | Total Group £m |
|---|---|---|---|---|---|---|
| Revenue | | | | | | |
| Sales to external customers | 27,146 | 3,818 | 2,902 | 33,866 | 108 | 33,974 |
| Result | | | | | | |
| Segment operating profit/(loss) | 1,556 | 243 | 153 | 1,952 | (6) | 1,946 |
| Share of post-tax profit from Joint ventures and Associates | 72 | 1 | 1 | 74 | 1 | 75 |
| Net finance costs | | | | (132) | (1) | (133) |
| Profit/(loss) before tax | | | | 1,894 | (6) | 1,888 |
| Taxation | | | | (541) | – | (541) |
| Profit/(loss) for the year | | | | 1,353 | (6) | 1,347 |

| | Continuing operations | | | | | | |
|---|---|---|---|---|---|---|---|
| | UK £m | Rest of Europe £m | Asia £m | Other/ unallocated £m | Total £m | Discontinuing operation £m | Total Group £m |
| **Assets and liabilities** | | | | | | | |
| Segment assets | 13,206 | 3,755 | 2,486 | 214 | 19,661 | 78 | 19,739 |
| Investment in Joint ventures and Associates | 255 | 1 | 151 | – | 407 | 9 | 416 |
| Total assets | | | | | 20,068 | 87 | 20,155 |
| Segment liabilities | (4,030) | (788) | (565) | (6,092) | (11,475) | (26) | (11,501) |
| Total net assets | | | | | 8,593 | 61 | 8,654 |
| **Other segment information** | | | | | | | |
| Capital expenditure: | | | | | | | |
| – Property, plant and equipment | 1,637 | 358 | 247 | – | 2,242 | 5 | 2,247 |
| – Investment property | – | 88 | 7 | – | 95 | 1 | 96 |
| – Intangible assets | 90 | 9 | 8 | – | 107 | – | 107 |
| Depreciation: | | | | | | | |
| – Property, plant and equipment | 487 | 110 | 67 | – | 664 | 2 | 666 |
| – Investment property | – | 5 | 3 | – | 8 | – | 8 |
| Amortisation of intangible assets | 54 | 4 | 4 | – | 62 | – | 62 |
| Profit/(loss) arising on property-related items | 21 | 31 | (3) | – | 49 | – | 49 |

## Business segments

The Group has one business segment; retail.

| | 2006 £m | 2005 £m |
|---|---|---|
| Revenue | 39,588 | 33,974 |
| Segment assets | 22,087 | 19,739 |
| Capital expenditure | 2,802 | 2,450 |

**Note 3** Income and expenses

| From continuing operations | 2006 £m | 2005 £m |
|---|---|---|
| The profit before tax and finance costs is stated after charging/(crediting) the following: | | |
| **Other income** | | |
| Profit arising on property-related items | (77) | (49) |
| Rental income, of which £140m (2005 – £93m) relates to investment properties | (175) | (119) |
| **Other expenses** | | |
| Direct operating expenses arising on rental earning investment properties | 46 | 28 |
| **Cost of sales** | | |
| Costs of inventories recognised as an expense | 29,640 | 25,268 |
| **Selling, general and administrative expenses** | | |
| Depreciation of Property, plant and equipment and Investment property | 758 | 672 |
| Reversal of impairment of Property, plant and equipment | (5) | – |
| Amortisation of internally-generated development intangible assets | 56 | 46 |
| Amortisation of other intangibles | 20 | 16 |
| Operating lease expenses (a) | 360 | 283 |

(a) Operating lease expenses include £71m (2005 – £69m) for hire of plant and machinery.

| | 2006 £m | 2005 £m |
|---|---|---|
| **Auditors' remuneration** | | |
| Auditors' remuneration for audit services (see below) | 3 | 2 |

Amounts payable to PricewaterhouseCoopers LLP and their associates by the Group in respect of non-audit services were £3m (2005 – £2m).

A more detailed analysis of auditors' remuneration on a worldwide basis is provided below:

| | 2006 £m | 2005 £m |
|---|---|---|
| Audit services: | | |
| – statutory audit | 2.0 | 1.7 |
| – audit-related | 0.7 | 0.4 |
| | 2.7 | 2.1 |
| Further assurance services | 0.4 | 0.7 |
| Tax advisory services | 2.5 | 1.1 |
| Other services | 0.2 | 0.2 |
| | 3.1 | 2.0 |
| Total auditors' remuneration | 5.8 | 4.1 |

Fees for further assurance services principally comprise transactions support and accounting advice on treasury-related schemes.

In addition to the amounts shown above, the auditors received fees of £0.1m (2005 £0.1m) for the audit of the main Group pension scheme.

A description of the work of the Audit Committee is set out in the corporate governance report on pages 21 to 23 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by PricewaterhouseCoopers LLP.

**Note 4** **Employment costs, including Directors' remuneration**

| | 2006 £m | 2005 £m |
|---|---|---|
| Wages and salaries | 3,473 | 3,033 |
| Social security costs | 271 | 217 |
| Post-employment benefits | 335 | 273 |
| Share-based payments expense – equity settled | 190 | 173 |
| | 4,269 | 3,696 |

The average number of employees during the year was: UK 261,578 (2005 – 245,286), Rest of Europe 62,925 (2005 – 55,781), Asia 43,710 (2005 – 34,683) and the average number of full-time equivalents was: UK 175,459 (2005 – 163,006), Rest of Europe 55,160 (2005 – 47,204) and Asia 42,405 (2005 – 32,770).

**Note 5** **Finance income and costs**

| | 2006 £m | 2005 £m |
|---|---|---|
| Finance income | | |
| Bank interest receivable and similar income on cash and cash equivalents | 89 | 99 |
| Net pension finance income (note 23) | 25 | 4 |
| **Total finance income (on historical cost basis)** | 114 | 103 |
| Finance costs | | |
| Interest payable on short-term bank loans and overdrafts repayable within five years | (77) | (56) |
| Interest payable on long-term bank loans and overdrafts repayable after five years | – | (14) |
| Finance charges payable under finance leases and hire purchase contracts | (6) | (17) |
| 4% unsecured deep discount loan stock 2006 (a) | (12) | (11) |
| 0.7% 50bn JPY Medium Term Note (MTN) 2006 | (2) | (2) |
| 6% 150m GBP MTN 2006 | (9) | (9) |
| 7½% 325m GBP MTN 2007 | (24) | (24) |
| 5¼% 500m EUR MTN 2008 | (18) | (18) |
| 6% 250m GBP MTN 2008 | (15) | (15) |
| 5⅛% 350m GBP MTN 2009 | (18) | (18) |
| 4¾% 750m EUR MTN 2010 | (25) | (25) |
| 6⅝% 150m GBP MTN 2010 | (10) | (10) |
| 4% RPI GBP MTN 2016 (b) | (15) | (15) |
| 5½% 350m GBP MTN 2019 | (19) | (19) |
| 3.322% LPI GBP MTN 2025 (c) | (14) | (14) |
| 6% 200m GBP MTN 2025 | (12) | (12) |
| 5½% 200m GBP MTN 2033 | (11) | (11) |
| Other bonds | (12) | (8) |
| Capitalised interest | 67 | 63 |
| **Total finance costs (on historical cost basis)** | (232) | (235) |
| IAS 32 and IAS 39 unrealised finance costs | (9) | – |
| **Total finance costs** | (241) | (235) |

(a) Interest payable on the 4% unsecured deep discount loan stock 2006 includes £7m (2005 – £6m) of discount amortisation.
(b) Interest payable on the RPI GBP MTN 2016 includes £6m (2005 – £6m) of RPI related amortisation.
(c) Interest payable on the LPI GBP MTN 2025 includes £7m (2005 – £7m) of RPI related amortisation.

## Note 6 Taxation

### Recognised in the Income Statement

| | 2006 £m | 2005 £m |
|---|---|---|
| Current tax expense | | |
| UK corporation tax | 555 | 426 |
| Foreign tax | 59 | 56 |
| Adjustments in respect of prior years | 50 | (70) |
| | 664 | 412 |
| Deferred tax expense | | |
| Origination and reversal of temporary differences | (16) | 96 |
| Benefit of tax losses recognised | (2) | – |
| Benefit of tax losses recognised – adjustments in respect of prior years | (3) | – |
| Adjustments in respect of prior years | 7 | 33 |
| | (14) | 129 |
| Total income tax expense from continuing and discontinuing operations | 650 | 541 |
| Income tax on discontinuing operation (note 7) | (1) | – |
| Total income tax expense from continuing operations | 649 | 541 |

UK corporation tax is calculated at 30% (2005 – 30%) of the estimated assessable profit for the year. Taxation in other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

### Reconciliation of effective tax charge for continuing operations

| | 2006 £m | 2005 £m |
|---|---|---|
| Profit before tax | 2,235 | 1,894 |
| Effective tax charge at 30% | (670) | (568) |
| Effect of: | | |
| – non-taxable income/(non-deductible expenses) | 25 | (53) |
| – differences in overseas taxation rates | 26 | 22 |
| – adjustments in respect of prior years | (54) | 37 |
| – share of results of Joint ventures | 24 | 21 |
| Total income tax charge for the year from continuing operations | (649) | (541) |
| Effective tax rate | 29.0% | 28.6% |

### Tax on items charged to equity

| | 2006 £m | 2005 £m |
|---|---|---|
| Current tax credit/(charge) on: | | |
| – foreign exchange movements | 2 | 16 |
| – IAS 32 and IAS 39 movement | (5) | – |
| | (3) | 16 |
| Deferred tax credit/(charge) on: | | |
| – IAS 32 and IAS 39 movement | (6) | – |
| – share-based payments | 11 | 9 |
| – pensions | 131 | 67 |
| | 136 | 76 |
| Total tax on items charged to equity | 133 | 92 |

**Note 6 Taxation** continued

### Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior year:

| | Accelerated tax depreciation £m | Retirement benefit obligation £m | Share-based payments £m | Short-term timing differences £m | Tax losses £m | IAS 32 and IAS 39 £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 28 February 2004 | (694) | 202 | 40 | 21 | 5 | – | (426) |
| Charge to the Income Statement | (99) | (55) | 23 | 4 | (2) | – | (129) |
| Charge to equity | – | 67 | 9 | – | – | – | 76 |
| Foreign exchange differences | (5) | – | – | 2 | – | – | (3) |
| At 26 February 2005 | (798) | 214 | 72 | 27 | 3 | – | (482) |
| Adoption of IAS 32 and IAS 39 | – | – | – | – | – | 28 | 28 |
| Charge to the Income Statement | (35) | 19 | 22 | 3 | 5 | – | 14 |
| Charge to equity | – | 131 | 11 | – | – | (6) | 136 |
| Disposal of subsidiary | – | – | – | 1 | – | – | 1 |
| Foreign exchange differences | (4) | – | – | 1 | – | – | (3) |
| | (837) | 364 | 105 | 32 | 8 | 22 | (306) |
| Discontinuing operation | (2) | – | – | – | – | – | (2) |
| At 25 February 2006 | (839) | 364 | 105 | 32 | 8 | 22 | (308) |

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

| | 2006 £m | 2005 £m |
|---|---|---|
| Deferred tax assets | 12 | 14 |
| Deferred tax liabilities | (320) | (496) |
| | (308) | (482) |

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries and joint ventures, because the earnings are continually reinvested by the Group and no tax is expected to be payable on them in the foreseeable future. The temporary difference unrecognised at the year end amounted to £461m (2005 – £322m).

### Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items, because it is not probable that future taxable profits will be available against which the Group can utilise the benefits.

| | 2006 £m | 2005 £m |
|---|---|---|
| Deductible temporary differences | 3 | 1 |
| Tax losses (primarily discontinuing operation) | 17 | 16 |
| | 20 | 17 |

**Note 7 Discontinuing operation and assets classified as held for sale**

| | 2006 £m |
|---|---|
| Assets of the disposal group | 114 |
| Non-current assets classified as held for sale | 54 |
| Total non-current assets classified as held for sale and assets of the disposal group | 168 |
| Total liabilities directly associated with the disposal group | (86) |
| Total net assets classified as held for sale | 82 |

## Discontinuing operation and the assets of the disposal group

On 30 September 2005 the Group entered into an agreement to dispose of its operation in Taiwan to Carrefour as part of a transaction to acquire Carrefour's businesses in the Czech Republic and Slovakia. This operation, which is expected to be sold within twelve months of the Balance Sheet date, has been classified as a disposal group. The assets of the business are presented separately in the Balance Sheet, and the net result for the year presented within discontinuing operation in the Income Statement.

The proceeds of disposal are expected to exceed the carrying value of the related net assets and accordingly no further impairment losses have been recognised on the classification of these operations as held for sale.

The table below shows the results of the Taiwanese business that are included in the results of the total Group for the current and prior periods.

### Income Statement

| | 2006 £m | 2005 £m |
|---|---|---|
| Revenue | 134 | 108 |
| Cost of sales | (111) | (91) |
| Administrative expenses | (32) | (23) |
| Net finance costs | (1) | (1) |
| Share of profit of discontinuing joint venture | 1 | 1 |
| Loss before tax of discontinuing operation | (9) | (6) |
| Tax related to trading loss | (1) | – |
| | (10) | (6) |

The effect of the discontinuing operation on segment results is disclosed in note 2.

### Cash Flow Statement

| | 2006 £m | 2005 £m |
|---|---|---|
| Net cash flows from operating activities | (6) | 3 |
| Net cash flows from investing activities | (6) | (4) |
| Net cash flows from financing activities | 10 | 2 |
| | (2) | 1 |

### Balance Sheet

| | 2006 £m |
|---|---|
| Property, plant and equipment | 68 |
| Investment property | 18 |
| Investment in Joint venture | 10 |
| Inventories | 9 |
| Trade and other receivables | 7 |
| Cash and cash equivalents | 2 |
| Assets of the disposal group | 114 |
| Bank loans and overdrafts | (57) |
| Trade and other payables | (28) |
| Tax liabilities | (1) |
| Total liabilities directly associated with the disposal group | (86) |

## Non-current assets classified as held for sale

| | 2006 £m |
|---|---|
| Non-current assets classified as held for sale | 54 |

The non-current assets classified as held for sale consist mainly of investment property held for sale.

## Note 8 Dividends

| | 2006 pence/share | 2005 pence/share | 2006 £m | 2005 £m |
|---|---|---|---|---|
| Amounts recognised as distributions to equity holders in the year: | | | | |
| Final dividend for the year ended 26 February 2005 | 5.27 | 4.77 | 410 | 365 |
| Interim dividend for the year ended 25 February 2006 | 2.53 | 2.29 | 199 | 177 |
| | 7.80 | 7.06 | 609 | 542 |
| Proposed final dividend for the year ended 25 February 2006 | 6.10 | 5.27 | 482 | 410 |

The proposed final dividend was approved by the Board of Directors on 24 April 2006 and is subject to the approval of shareholders at the Annual General Meeting. The proposed dividend has not been included as a liability as at 25 February 2006, in accordance with IAS 10 'Events after the balance sheet date'. It will be paid on 14 July 2006 to shareholders who are on the register of members on 5 May 2006.

## Note 9 Earnings per share and diluted earnings per share

Basic earnings per share amounts are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares in issue during the year.

Diluted earnings per share amounts are calculated by dividing the profit attributable to equity holders of the parent by the weighted average number of ordinary shares in issue during the year (adjusted for the effects of potentially dilutive options).

The dilution effect is calculated on the full exercise of all ordinary share options granted by the Group, including performance-based options which the Group considers to have been earned.

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | Basic | Potentially dilutive share options | Diluted | Basic | Potentially dilutive share options | Diluted |
| **Profit (£m)** | | | | | | |
| Continuing operations | 1,580 | – | 1,580 | 1,350 | – | 1,350 |
| Discontinuing operation | (10) | – | (10) | (6) | – | (6) |
| **Total** | 1,570 | – | 1,570 | 1,344 | – | 1,344 |
| **Weighted average number of shares (million)** | 7,823 | 109 | 7,932 | 7,707 | 97 | 7,804 |
| **Earnings per share (pence)** | | | | | | |
| Continuing operations | 20.20 | (0.28) | 19.92 | 17.52 | (0.22) | 17.30 |
| Discontinuing operation | (0.13) | – | (0.13) | (0.08) | – | (0.08) |
| **Total** | 20.07 | (0.28) | 19.79 | 17.44 | (0.22) | 17.22 |

There have been no transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of approval of these financial statements which would significantly change the earnings per share calculations shown above.

**Note 10** Goodwill and intangible assets

| | Internally generated development costs £m | Pharmacy and software licences £m | Other intangible assets £m | Goodwill £m | Total £m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 26 February 2005 | 393 | 144 | 59 | 1,192 | 1,788 |
| Foreign currency translation | 1 | 3 | 4 | 19 | 27 |
| Additions | 115 | 21 | 3 | – | 139 |
| Acquisitions through business combinations | – | – | – | 27 | 27 |
| Reclassification across categories | 1 | 27 | (23) | (2) | 3 |
| Disposals | (52) | (2) | – | (1) | (55) |
| **At 25 February 2006** | 458 | 193 | 43 | 1,235 | 1,929 |
| **Accumulated amortisation and impairment losses** | | | | | |
| At 26 February 2005 | 190 | 82 | 10 | 98 | 380 |
| Foreign currency translation | – | 2 | – | – | 2 |
| Amortisation for the year | 56 | 19 | 1 | – | 76 |
| Reclassification across categories | – | 8 | (8) | – | – |
| Disposals | (52) | (2) | – | – | (54) |
| **At 25 February 2006** | 194 | 109 | 3 | 98 | 404 |
| **Net carrying value** | | | | | |
| **At 25 February 2006** | 264 | 84 | 40 | 1,137 | 1,525 |
| At 26 February 2005 | 203 | 62 | 49 | 1,094 | 1,408 |

| | | | | | |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 28 February 2004 | 315 | 129 | 45 | 1,048 | 1,537 |
| Foreign currency translation | – | 1 | 7 | 82 | 90 |
| Additions | 85 | 15 | 7 | 70 | 177 |
| Disposals | (7) | (1) | – | (8) | (16) |
| **At 26 February 2005** | 393 | 144 | 59 | 1,192 | 1,788 |
| **Accumulated amortisation and impairment losses** | | | | | |
| At 28 February 2004 | 150 | 72 | 4 | 91 | 317 |
| Foreign currency translation | (1) | (1) | 1 | 7 | 6 |
| Amortisation for the year | 46 | 11 | 5 | – | 62 |
| Disposals | (5) | – | – | – | (5) |
| **At 26 February 2005** | 190 | 82 | 10 | 98 | 380 |
| **Net carrying value** | | | | | |
| **At 26 February 2005** | 203 | 62 | 49 | 1,094 | 1,408 |
| At 28 February 2004 | 165 | 57 | 41 | 957 | 1,220 |

There are no intangible assets, other than goodwill, with indefinite useful lives.

**Note 10** **Goodwill and intangible assets** continued

**Impairment of goodwill**

Goodwill arising on business combinations is not amortised but is reviewed for impairment on an annual basis or more frequently if there are indications that goodwill may be impaired. Goodwill acquired in a business combination is allocated to groups of cash-generating units according to the level at which management monitor that goodwill.

Recoverable amounts for cash-generating units are based on value in use, which is calculated from cash flow projections for five years using data from the Group's latest internal forecasts, the results of which are reviewed by the Board. The key assumptions for the value in use calculations are those regarding discount rates, growth rates and expected changes in margins. Management estimates discount rates using pre-tax rates that reflect current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market.

The forecasts are extrapolated beyond five years based on estimated growth rates (generally 3%-4%).

The pre-tax discount rates used to calculate value in use range from 9%-11% (2005 and 2004: 10%-13%). This discount rate is derived from the Group's post-tax weighted average cost of capital as adjusted for the specific risks relating to each geographical region.

In February 2006, 2005 and 2004 impairment reviews were performed by comparing the carrying value of goodwill with the recoverable amount of the cash-generating units to which goodwill has been allocated. Management determined that there has been no impairment.

The components of goodwill are as follows:

| | 2006 £m | 2005 £m | 2004 £m |
|---|---|---|---|
| UK | 466 | 463 | 414 |
| Poland | 331 | 323 | 252 |
| Thailand | 115 | 107 | 109 |
| Japan | 133 | 135 | 121 |
| Turkey | 55 | 49 | 43 |
| South Korea | 32 | 10 | 8 |
| Other | 5 | 7 | 10 |
| | 1,137 | 1,094 | 957 |

## Note 11 Property, plant and equipment

| | Land and buildings £m | Plant, equipment, fixtures and fittings and motor vehicles £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 26 February 2005 | 14,247 | 4,298 | 18,545 |
| Foreign currency translation | 198 | 45 | 243 |
| Additions (a) | 1,935 | 707 | 2,642 |
| Acquisitions through business combinations | 20 | 3 | 23 |
| Reclassification across categories | (208) | 11 | (197) |
| Classified as held for sale | (74) | (15) | (89) |
| Disposals | (555) | (342) | (897) |
| **At 25 February 2006** | 15,563 | 4,707 | 20,270 |
| **Accumulated depreciation and impairment losses** | | | |
| At 26 February 2005 | 1,705 | 2,319 | 4,024 |
| Foreign currency translation | 9 | 19 | 28 |
| Charge for the year | 250 | 503 | 753 |
| Reclassification across categories | (1) | 1 | – |
| Classified as held for sale | (5) | (6) | (11) |
| Disposals | (139) | (262) | (401) |
| Impairment losses | 40 | 7 | 47 |
| Reversal of impairment losses | (44) | (8) | (52) |
| **At 25 February 2006** | 1,815 | 2,573 | 4,388 |
| **Net carrying value (b)(c)(d)** | | | |
| **At 25 February 2006** | 13,748 | 2,134 | 15,882 |
| At 26 February 2005 | 12,542 | 1,979 | 14,521 |
| Capital work in progress included above (e) | | | |
| At 25 February 2006 | 699 | 82 | 781 |

(a) Includes £67m (2005 – £63m) in respect of interest capitalised, principally relating to land and building assets. The capitalisation rate used to determine the amount of finance costs capitalised during the year was 5.1% (2005 – 5.7%). Interest capitalised is deducted in determining taxable profit in the year in which it is incurred.

(b) Net carrying value includes capitalised interest at 25 February 2006 of £655m (2005 – £597m).

The cost of land and buildings includes £102m (2005 – £85m) in respect of assets held under finance leases. The related accumulated depreciation at the end of the year was £14m (2005 – £10m). These assets are pledged as security for the finance lease liabilities.

The cost of plant, equipment, fixture and fittings and motor vehicles includes £388m (2005 – £392m) in respect of assets held under finance leases. The related accumulated depreciation at the end of the year was £367m (2005 – £354m).

(c) The net carrying value of land and buildings comprises:

| | 2006 £m | 2005 £m |
|---|---|---|
| Freehold | 12,616 | 11,485 |
| Long leasehold – 50 years or more | 541 | 520 |
| Short leasehold – less than 50 years | 591 | 537 |
| Net carrying value | 13,748 | 12,542 |

(d) Carrying value of land and buildings includes £9m (2005 – £13m) relating to the prepayment of lease premiums.

(e) Capital work in progress does not include land.

**Note 11 Property, plant and equipment** continued

| | Land and buildings £m | Plant, equipment, fixtures and fittings and motor vehicles £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 28 February 2004 | 13,094 | 4,002 | 17,096 |
| Foreign currency translation | 302 | 81 | 383 |
| Additions (a) | 1,655 | 592 | 2,247 |
| Acquisitions through business combinations | 46 | 2 | 48 |
| Reclassification across categories | (78) | 53 | (25) |
| Disposals | (772) | (432) | (1,204) |
| **At 26 February 2005** | 14,247 | 4,298 | 18,545 |
| **Accumulated depreciation and impairment losses** | | | |
| At 28 February 2004 | 1,619 | 2,224 | 3,843 |
| Foreign currency translation | 23 | 37 | 60 |
| Charge for the period | 223 | 443 | 666 |
| Reclassification across categories | 1 | 1 | 2 |
| Disposals | (161) | (386) | (547) |
| **At 26 February 2005** | 1,705 | 2,319 | 4,024 |
| **Net carrying value (b)(c)(d)** | | | |
| **At 26 February 2005** | 12,542 | 1,979 | 14,521 |
| At 28 February 2004 | 11,805 | 1,448 | 13,253 |
| Capital work in progress included above (e) | | | |
| At 26 February 2005 | 540 | 74 | 614 |

**Impairment of Property, plant and equipment**

The Group has determined that for the purposes of impairment testing, each store is a cash-generating unit. Cash-generating units are tested for impairment if there are indications of impairment at the Balance Sheet date.

Recoverable amounts for cash-generating units are based on value in use, which is calculated from cash flow projections for five years using data from the Group's latest internal forecasts, the results of which are reviewed by the Board. The key assumptions for the value in use calculations are those regarding discount rates, growth rates and expected changes in margins. Management estimates discount rates using pre-tax rates that reflect current market assessment of the time value of money and the risks specific to the cash-generating units. Changes in selling prices and direct costs are based on past experience and expectations of future changes in the market.

The forecasts are extrapolated beyond five years based on estimated long term growth rates (generally 3%-4%).

The pre-tax discount rates used to calculate value in use range from 9%-11% (2005 and 2004: 10%-13%) depending on the specific conditions in which each store operates. This discount rate is derived from the Group's post-tax weighted average cost of capital.

The Group's cash-generating units were reviewed for impairment on transition to IFRSs using the methodology and assumptions outlined above. This review resulted in impairment losses of £142m as at 29 February 2004. Due to movements in foreign exchange rates, the impairment losses increased to £152m as at 26 February 2005.

The following amounts have been (charged)/credited to operating costs in the Income Statement during the current and prior year.

| | 2006 £m | 2005 £m |
|---|---|---|
| Impairment losses | | |
| UK | (29) | – |
| Rest of Europe | (18) | – |
| Asia | – | – |
| | (47) | – |
| Reversal of impairment losses | | |
| UK | 29 | – |
| Rest of Europe | 23 | – |
| Asia | – | – |
| | 52 | – |
| Net reversal of impairment losses | 5 | – |

The impairment losses relate to stores whose recoverable amounts (either value in use or fair value less costs to sell) do not exceed the asset carrying values. In all cases, impairment losses arose due to stores performing below budgeted trading levels.

The reversal of previous impairment losses arose principally due to improvements in stores' performances over the last year and a reduction in the weighted average cost of capital, which increases the net present value of future cash flows.

In all cases, the impairment losses charged or reversed during the year have been measured relative to the value in use of the stores.

**Note 12 Investment property**

| | £m |
|---|---|
| **Cost** | |
| At 26 February 2005 | 595 |
| Foreign currency translation | 36 |
| Additions | 21 |
| Transfers | 194 |
| Classified as held for sale | (58) |
| Disposals | (3) |
| **At 25 February 2006** | 785 |
| **Accumulated depreciation and impairment losses** | |
| At 26 February 2005 | 30 |
| Foreign currency translation | 2 |
| Charge for the period | 9 |
| Classified as held for sale | (1) |
| **At 25 February 2006** | 40 |
| **Net carrying value** | |
| **At 25 February 2006** | 745 |
| At 26 February 2005 | 565 |

| | |
|---|---|
| **Cost** | |
| At 28 February 2004 | 491 |
| Foreign currency translation | 49 |
| Additions | 96 |
| Transfers | 14 |
| Disposals | (55) |
| **At 26 February 2005** | 595 |
| **Accumulated depreciation and impairment losses** | |
| At 28 February 2004 | 18 |
| Foreign currency translation | 6 |
| Charge for the period | 8 |
| Disposals | (2) |
| **At 26 February 2005** | 30 |
| **Net carrying value** | |
| **At 26 February 2005** | 565 |
| At 28 February 2004 | 473 |

The estimated fair value of the Group's Investment property is £1,373m (2005 – £899m). This value has been determined by applying an appropriate rental yield to the rentals earned by the Investment property. A valuation has not been performed by an independent valuer.

**Note 13** Group entities

**Significant subsidiaries**

The Group consolidates its subsidiary undertakings; the principal subsidiaries are:

| | Business activity | Share of issued ordinary share capital, and voting rights | Country of incorporation |
|---|---|---|---|
| Tesco Stores Limited* | Retail | 100% | England |
| Tesco Distribution Limited* | Distribution | 100% | England |
| Tesco Property Holdings Limited* | Property | 100% | England |
| Tesco Insurance Limited* | Insurance | 100% | Guernsey |
| Valiant Insurance Company Limited | Insurance | 100% | Republic of Ireland |
| One Stop Stores Limited (formerly T&S Stores Limited) | Retail | 100% | England |
| Tesco Ireland Limited* | Retail | 100% | Republic of Ireland |
| Tesco Global Aruhazak Rt.* | Retail | 99% | Hungary |
| Tesco Polska Sp. z o.o.* | Retail | 100% | Poland |
| Tesco Stores Č R a.s.* | Retail | 100% | Czech Republic |
| Tesco Stores S R a.s.* | Retail | 100% | Slovakia |
| Samsung Tesco Co. Limited* | Retail | 89% | South Korea |
| Ek-Chai Distribution System Co. Ltd* | Retail | 99% | Thailand |
| Tesco Taiwan Co. Limited* | Retail | 100% | Taiwan |
| Tesco Stores Malaysia Sdn Bhd* | Retail | 70% | Malaysia |
| Tesco Stores Hong Kong Limited* | Purchasing | 100% | Hong Kong |
| C Two-Network Co. Ltd* | Retail | 100% | Japan |
| Tesco Kipa A.Ş. | Retail | 93% | Turkey |

* Held by an intermediate subsidiary.

All principal subsidiary undertakings operate in their country of incorporation.

The accounting period-ends of the subsidiary undertakings consolidated in these financial statements are on or around 25 February 2006, with the exception of Tesco Taiwan Co. Ltd which has an accounting period end of 31 December 2005.

A full list of the Group's operating subsidiary undertakings will be annexed to the next Annual Return filed at Companies House.

There are no significant restrictions on the ability of subsidiary undertakings to transfer funds to the parent, other than those imposed by the Companies Act 1985.

**Note 13** **Group entities** continued

**Interests in Joint ventures and Associates**

The Group uses the equity method of accounting for joint ventures and associates. The following table shows the aggregate movement in the Group's investment in joint ventures and associates:

| | Joint ventures £m | Associates £m | Total £m |
|---|---|---|---|
| At 28 February 2004 | 310 | 21 | 331 |
| Additions | 148 | 5 | 153 |
| Effect of change in foreign exchange rates | (5) | (3) | (8) |
| Share of profit/(loss) of Joint ventures and Associates | 78* | (3) | 75* |
| Income received from Joint ventures and Associates | (135) | – | (135) |
| At 26 February 2005 | 396 | 20 | 416 |
| IAS 32 and IAS 39 restatement | 13 | – | 13 |
| Additions | 35 | 1 | 36 |
| Effect of change in foreign exchange rates | 19 | 1 | 20 |
| Share of profit/(loss) of Joint ventures and Associates | 85* | (2) | 83* |
| Income received from Joint ventures and Associates | (82) | – | (82) |
| Transferred to Non-current assets held for sale | (10) | – | (10) |
| At 25 February 2006 | 456 | 20 | 476 |

* Includes £1m profit on the discontinuing Joint venture, Taiwan Charn Yang Developments Limited.

### Joint ventures

The Group's principal joint ventures are:

| | Business activity | Share of issued share capital, loan capital and debt securities | Country of incorporation and principal country of incorporation |
|---|---|---|---|
| Shopping Centres Limited | Property Investment | 50% | England |
| BLT Properties Limited | Property Investment | 50% | England |
| Tesco BL Holdings Limited | Property Investment | 50% | England |
| Tesco British Land Property Partnership* | Property Investment | 50% | England |
| Tesco Property Limited Partnership* | Property Investment | 50% | England |
| Arena (Jersey) Management Limited* | Property Investment | 50% | Jersey |
| The Tesco Property (No. 2) Limited Partnership* | Property Investment | 50% | Jersey |
| Tesco Personal Finance Group Limited | Personal Finance | 50% | Scotland |
| Tesco Home Shopping Limited | Mail Order Retail | 60% | England |
| Tesco Mobile Limited* | Telecommunications | 50% | England |
| dunnhumby Limited* | Data Analysts | 53% | England |
| Nutri Centres Limited* | Complementary Medicines | 50% | England |
| Taiwan Charn Yang Developments Limited* | Property Investment | 50% | Taiwan |
| Hymall* | Retail | 50% | Republic of China |
| Retail Property Company Limited* | Property Investment | 50% | Thailand |
| Tesco Card Services Limited* | Personal Finance | 50% | Thailand |

* Held by an intermediate subsidiary.

The accounting period-ends of the joint ventures consolidated in these financial statements range from 31 December 2005 to 28 February 2006. Accounting period-end dates different from those of the Group arise for commercial reasons and depend upon the requirements of the joint venture partner as well as those of the Group.

**Note 13** Group entities continued

Although Tesco Home Shopping and dunnhumby are 60% and 53% owned, respectively, they are treated as joint ventures in the Group accounts because the parties to each of the ventures work together with equal powers to control the entities. Each venturer in the respective entity retain the power of veto and overall key strategic, operational and financial decisions require the consent of both parties.

The investment in Taiwan Charn Yang Developments Limited has been transferred to assets held for sale due to its impending transfer to Carrefour as part of the asset swap deal detailed in note 7.

The share of the assets, liabilities, revenue and profit of the joint ventures which are included in the consolidated financial statements, are as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Assets | 5,014 | 4,297 |
| Liabilities | (4,749) | (4,054) |
| Goodwill | 185 | 150 |
| Cumulative unrecognised losses | 6 | 3 |
| | 456 | 396 |
| Revenue | 586 | 379 |
| Profit for the period | 85 | 78 |

The unrecognised share of losses made by joint ventures in the year to 25 February 2006 was £3m (2005 – £2m).

### Associates

The Group's principal associates are:

| | Business activity | Share of issued capital, loan capital and debt securities | Country of incorporation and principal country of operation |
|---|---|---|---|
| Greenergy Fuels Limited | Fuel Supplier | 25% | England |
| GroceryWorks Holdings Inc | Internet Retailer | 38.5% | United States of America |

The share of the assets, liabilities, revenue and profit of the Group's associates, which are included in the consolidated financial statements, are as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Assets | 72 | 43 |
| Liabilities | (65) | (36) |
| Goodwill | 13 | 13 |
| | 20 | 20 |
| Revenue | 174 | 103 |
| Loss for the period | (2) | (3) |

The accounting period end of the associates consolidated in these financial statements range from 31 December 2005 to 28 February 2006.

There are no significant restrictions on the ability of associated undertakings to transfer funds to the parent, other than those imposed by the Companies Act 1985.

**Note 14** Other investments

| | 2006 £m | 2005 £m |
|---|---|---|
| Shares – unlisted | – | 7 |
| Shares – listed | 4 | – |
| | 4 | 7 |

Other investments are available-for-sale financial assets consisting of ordinary shares, and therefore have no fixed maturity date or coupon rate.

The fair value of the unlisted available-for-sale investments has been estimated using a valuation technique based on assumptions that are not supported by observable market prices or rates. The fair value of the listed available-for-sale investments is based on quoted market prices at the Balance Sheet date.

The following table shows the aggregate movement in the Group's Other investments during the year:

| | £m |
|---|---|
| At 26 February 2005 | 7 |
| Restatement as at 27 February 2005 under IAS 39 | (7) |
| At 27 February 2005 – restated | – |
| Additions | 2 |
| Revaluation through equity | 2 |
| At 25 February 2006 | 4 |

**Note 15** Inventories

| | 2006 £m | 2005 £m |
|---|---|---|
| Goods held for resale | 1,457 | 1,306 |
| Development properties | 7 | 3 |
| | 1,464 | 1,309 |

Accumulated capitalised interest within development properties at 25 February 2006 was £0.4m (2005 – £0.6m).

**Note 16** Trade and other receivables

| | 2006 £m | 2005 £m |
|---|---|---|
| Prepayments and accrued income | 86 | 48 |
| Finance lease receivables (note 31) | 17 | – |
| Other receivables | 648 | 585 |
| Amounts owed by Joint ventures and Associates | 141 | 136 |
| | 892 | 769 |

Included within Trade and other receivables are the following amounts receivable after more than one year:

| | 2006 £m | 2005 £m |
|---|---|---|
| Prepayments and accrued income | – | 2 |
| Finance lease receivables | 11 | – |
| Other receivables | 118 | 60 |
| Amounts owed by Joint ventures and Associates | 121 | 126 |
| | 250 | 188 |

## Note 17 Cash and cash equivalents

| | 2006 £m | 2005 £m |
|---|---|---|
| Cash at bank and in hand | 964 | 800 |
| Short-term deposits | 361 | 346 |
| | 1,325 | 1,146 |

The effective rate of interest on short-term deposits is 3.9% and the average maturity term is 2 weeks.

## Note 18 Trade and other payables

### Current

| | 2006 £m | 2005 £m |
|---|---|---|
| Trade payables | 2,832 | 2,819 |
| Other taxation and social security | 216 | 221 |
| Other payables | 1,257 | 1,236 |
| Amounts payable to Joint ventures and Associates | 79 | 29 |
| Accruals and deferred income | 693 | 663* |
| Dividends | 6 | 6 |
| | 5,083 | 4,974 |

* Includes £163m attributable to realised gains on terminated interest rate swaps. Under IFRS these have been reclassified as part of the IAS 32 and IAS 39 adjustments (note 33).

### Non-current

| | 2006 £m | 2005 £m |
|---|---|---|
| Other payables | 29 | 21 |

## Note 19 Borrowings

### Current

| | Par value | Effective interest rate % | Effective interest rate after hedging transactions % | Maturity year | 2006 £m | 2005 £m |
|---|---|---|---|---|---|---|
| Bank loans and overdrafts (a) | | 4.5 | 4.5 | 2006 | 1,013 | 471 |
| 4% unsecured deep discount loan stock | £125m | 10.2 | 10.8 | 2006 | 122 | – |
| 6% 150m GBP Medium Term Note (MTN) | £150m | 6.0 | 4.9 | 2006 | 158 | – |
| 0.7% 50bn JPY MTN (b) | ¥50bn | 0.7 | 4.8 | 2006 | 247 | – |
| Other MTNs | | 4.8 | 4.8 | 2006 | 86 | – |
| Finance leases (note 31) | | 8.3 | 8.3 | – | 20 | 11 |
| | | | | | 1,646 | 482 |

(a) Includes £9m (2005 – £9m) of loans from Joint ventures and Associates.

(b) The MTNs denominated in currencies other than Pounds Sterling have been swapped into Pounds Sterling liabilities.

**Note 19 Borrowings** continued

Non-current

| | Par value | Effective interest rate % | Effective interest rate after hedging transactions % | Maturity Year | 2006 £m | 2005 £m |
|---|---|---|---|---|---|---|
| Finance leases (note 31) | – | 10.9 | 10.9 | – | 84 | 77 |
| 4% unsecured deep discount loan stock | £125m | 10.2 | 10.2 | 2006 | – | 116 |
| 6% MTN | £150m | 6.0 | 4.9 | 2006 | – | 150 |
| 0.7% MTN (b) | ¥50bn | 0.7 | 4.8 | 2006 | – | 285 |
| 7.5% MTN | £325m | 7.6 | 4.8 | 2007 | 344 | 325 |
| 6% MTN | £250m | 6.0 | 4.9 | 2008 | 268 | 250 |
| 5.25% MTN (b) | €500m | 5.3 | 5.0 | 2008 | 366 | 345 |
| 5.125% MTN | £350m | 5.3 | 4.8 | 2009 | 355 | 350 |
| 6.625% MTN | £150m | 6.7 | 6.7 | 2010 | 153 | 150 |
| 4.75% MTN (b) | €750m | 4.8 | 5.2 | 2010 | 548 | 528 |
| 4% RPI MTN (c) | £229m | 6.5 | 6.5 | 2016 | 236 | 226 |
| 5.5% MTN | £350m | 5.6 | 5.6 | 2019 | 349 | 350 |
| 3.322% LPI MTN (d) | £235m | 5.9 | 5.9 | 2025 | 236 | 228 |
| 6% MTN | £200m | 6.1 | 6.4 | 2029 | 214 | 200 |
| 5.5% MTN | £200m | 5.6 | 5.7 | 2033 | 213 | 200 |
| Other MTNs (e) | – | 2.5 | 2.5 | – | 278 | 334 |
| Other loans (f) | – | 5.3 | 5.3 | – | 98 | 449 |
| | | | | | 3,742 | 4,563 |

(b) The MTNs denominated in currencies other than Pounds Sterling have been swapped into Pounds Sterling liabilities.

(c) The 4% RPI MTN is redeemable at par, indexed for increases in the RPI over the life of the MTN.

(d) The 3.322% LPI MTNs are redeemable at par, indexed for increases in the RPI over the life of the MTN. The maximum indexation of the principal in any one year is 5%, with a minimum of 0%.

(e) The other MTNs are of various maturities and include Pounds Sterling and foreign currency denominated notes, swapped into floating rate Pounds Sterling.

(f) Various bank loans maturing between 2007 and 2008.

**Borrowing facilities**

The Group has the following undrawn committed facilities available at 25 February 2006, in respect of which all conditions precedent had been met as at that date:

| | 2006 £m | 2005 £m |
|---|---|---|
| Expiring within one year | – | – |
| Expiring between one and two years | – | 561 |
| Expiring in more than two years | 1,750 | – |
| | 1,750 | 561 |

All facilities incur commitment fees at market rates and would provide funding at floating rates.

## Note 20 Financial instruments

An explanation of the objectives and policies for holding and issuing financial instruments is set out in the Operating and financial review on page 16.

The following tables provide details of financial instruments in accordance with the relevant IFRSs (including IAS 32 and IAS 39, which the Group adopted as at 27 February 2005). Comparative figures for the year ended 26 February 2005 (before the adoption of IAS 32 and IAS 39) are also provided in the tables that follow those for the current year.

Carrying values of derivative financial instruments and other liabilities in the Balance Sheet:

| | 2006 | |
|---|---|---|
| | Assets £m | Liabilities £m |
| **Current** | | |
| Interest rate swaps and similar instruments | 11 | (69) |
| Forward foreign currency contracts | 59 | (170) |
| | 70 | (239) |
| **Non-current** | | |
| Interest rate swaps and similar instruments | – | (46) |
| Forward foreign currency contracts | – | (2) |
| Put option on Samsung Tesco Co. Limited minority interest | – | (246) |
| | – | (294) |

### Fair values

Fair values of financial assets and financial liabilities are disclosed below:

| | 2006 | |
|---|---|---|
| | Carrying value £m | Fair value £m |
| **Primary financial instruments held or issued to finance the Group's operations:** | | |
| Short-term borrowings | (1,626) | (1,641) |
| Long-term borrowings | (3,658) | (3,848) |
| Finance leases (Group as lessor – note 31) | 17 | 17 |
| Finance leases (Group as lessee – note 31) | (104) | (104) |
| Cash and cash equivalents | 1,325 | 1,325 |
| **Derivative financial instruments held to manage the interest rate and currency profile:** | | |
| Interest rate swaps and similar instruments | (104) | (104) |
| Forward foreign currency contracts | (113) | (113) |
| Put option on Samsung Tesco Co. Limited minority interest | (246) | (246) |
| | (4,509) | (4,714) |

The fair values of financial instruments and derivatives have been determined by reference to prices available from the markets on which the instruments are traded. The fair value of all other items have been calculated by discounting expected future cash flows at prevailing interest rates.

**Note 20** Financial instruments continued

## Financial instruments under IFRS (including IAS 32 and IAS 39)

### Analysis of interest rate exposure of financial assets and liabilities

The interest rate exposure of financial assets and liabilities of the Group as at 25 February 2006, after taking into account the effect of interest rate swaps, was:

| | Within 1 year £m | 1-2 years £m | 2-3 years £m | 3-4 years £m | 4-5 years £m | More than 5 years £m | Total £m |
|---|---|---|---|---|---|---|---|
| Fixed rate | | | | | | | |
| Finance lease receivables | 6 | 6 | 5 | – | – | – | 17 |
| Bank and other loans | (147) | (161) | – | (98) | (153) | (861) | (1,420) |
| Finance lease payables | (20) | (11) | (8) | (3) | (3) | (59) | (104) |
| Floating rate | | | | | | | |
| Cash and cash equivalents | 1,325 | – | – | – | – | – | 1,325 |
| Bank and other loans | (1,479) | (386) | (662) | (355) | (555) | (427) | (3,864) |

### Hedging activities

#### Fair value hedges

The Group uses interest rate swaps and cross-currency swaps to hedge the fair value of fixed rate bonds, this means the fixed rate bonds are hedged against changes to their fair value resulting from changes in interest rates and foreign exchange rates.

The fair value of swaps used for fair value hedging at the Balance Sheet date was a liability of £100m.

#### Cash flow hedges

The Group uses forward foreign exchange contracts and currency options to hedge the cost of future purchases of goods for resale, where those purchases are denominated in a currency other than that of the purchasing company. The hedging instruments are primarily used to hedge purchases in Euros and US Dollars. The cashflows hedged will occur within one year of the Balance Sheet date.

At the Balance Sheet date, the total notional amount of outstanding forward foreign exchange contracts to which the Group has committed was £548m.

The fair value of currency derivatives that are designated as effective cash flow hedges was an asset of £4m. This amount has been deferred as a component of equity.

#### Net investment hedges

The Group uses forward foreign exchange contracts, currency denominated borrowings and currency options to hedge the exposure of a proportion of its non-Sterling denominated assets against changes in value due to changes in foreign exchange rates.

The fair value of these instruments at the Balance Sheet date was a liability of £150m.

The Group has a Korean Won denominated liability relating to the future purchase of the minority shareholding of its subsidiary, Samsung Tesco Co. Limited. This liability has been designated as a net investment hedge on a proportion of the assets of Samsung Tesco Co. Limited. The carrying value of the liability at the Balance Sheet date was £246m.

#### Financial instruments not qualifying for hedge accounting

The Group has a number of financial instruments which do not meet the criteria for hedge accounting.

These instruments include forward foreign exchange contracts, currency options, caps, collars and interest rate swaps.

The fair value of these instruments at the Balance Sheet date was a liability of £5m.

**Financial instruments under UK GAAP FRS 13 'Derivatives and other financial instruments: disclosures' (relating to the comparative period ended 26 February 2005)**

An explanation of the objectives and policies for holding and issuing financial instruments is set out in the Operating and financial review on page 16. Other than where these items have been included in the currency risk disclosures, short-term receivables and payables have been excluded from the following analysis.

**Analysis of interest rate exposure and currency of financial liabilities**

The interest rate exposure and currency profile of the financial liabilities of the Group as at 26 February 2005, after taking into account the effect of interest rate and currency swaps, were:

| | | | 2005 |
|---|---|---|---|
| | Floating rate liabilities £m | Fixed rate liabilities £m | Total £m |
| Currency | | | |
| Sterling | – | 2,203 | 2,203 |
| Euro | 577 | 24 | 601 |
| Thai Baht | 550 | – | 550 |
| Czech Krona | 335 | 139 | 474 |
| Slovak Krona | 13 | 31 | 44 |
| Japanese Yen | 23 | 141 | 164 |
| Korean Won | 654 | – | 654 |
| Chinese Yuan | 127 | – | 127 |
| Other | 149 | 22 | 171 |
| Gross liabilities | 2,428 | 2,560 | 4,988 |

| | Fixed rate financial liabilities 2005 | |
|---|---|---|
| | Weighted average interest rate 26 Feb 2005 % | Weighted average time for which rate is fixed Years |
| Currency | | |
| Sterling | 5.7 | 7 |
| Euro | 5.4 | 1 |
| Japanese Yen | 1.3 | 5 |
| Czech Krona | 3.9 | 3 |
| Slovak Krona | 4.3 | 3 |
| Malaysian Ringgit | 7.9 | 12 |
| Taiwanese Dollar | 4.5 | – |
| Weighted average | 5.5 | 6 |

Floating rate liabilities as at 26 February 2005 bore interest at rates based on relevant national LIBOR equivalents. The interest rate profile of the Group was further managed by the purchase of Euro interest rate collars with an aggregate notional principal of £145m. The average strike rate of the interest rate caps purchased was 6.76%, while the average strike rate of the interest rate floors sold was 2.98%. The average maturity of the collars as at 26 February 2005 was two and a half years. The value of these contracts as at 26 February 2005, if realised, would have resulted in a loss of £1.7m.

Sterling interest rate caps with an aggregate notional principal of £600m were purchased during the year ended 26 February 2005. The strike rate on these caps was 6% and the average maturity was five years. The value as at 26 February 2005 of these contracts, if realised, would have been £3.5m.

Retail Price Index funding of £226m, maturing in 2016, was outstanding as at 26 February 2005 and was classified as fixed rate debt. The interest rate payable on this debt was 4% and the principal was linked to the Retail Price Index. Limited Price Index funding, of £228m, maturing in 2025, was outstanding as at 26 February 2005 and was classified as fixed rate debt. The interest rate payable on this debt was 3.322% and the principal was linked to the Retail Price Index. The maximum indexation of the principal in any one year is 5.0% and the minimum is 0.0%.

**Note 20** **Financial instruments** continued

**Financial instruments under UK GAAP FRS 13 (relating to the comparative period ended 26 February 2005)** continued

**Analysis of interest rate exposure and currency profile of financial assets**

The interest rate exposure and currency profile of the financial assets of the Group as at 26 February 2005 were:

| | | | | 2005 |
|---|---|---|---|---|
| | Cash at bank and in hand £m | Short-term deposits £m | Other £m | Total £m |
| Sterling | 411 | 231 | 104 | 746 |
| Other currencies | 389 | 115 | 4 | 508 |
| Total financial assets | 800 | 346 | 108 | 1,254 |

An investment in collateralised Deutsche Bank preference shares of £150m was held at 26 February 2005, paying fixed interest of 4.3%.

Other financial assets, in respect of amounts owed by undertakings in which the Company has a participating interest, attracted a rate of interest of 5.7% (being LIBOR plus a margin). Surplus funds as at 26 February 2005 were invested in accordance with approved limits on security and liquidity and bore rates of interest based on relevant LIBOR equivalents. Cash at bank and in hand included non-interest bearing cash and cash in transit.

**Currency exposures**

Within the Group, the principal differences on exchange arising, which are taken to the Income Statement, relate to purchases made by Group companies in currencies other than their reporting currencies. After taking account of forward currency purchases used to hedge these transactions, there were no significant balances on these exposures as at 26 February 2005. Also, rolling hedges of up to 18 months duration were maintained against the value of investments in, and long-term intercompany loans to, overseas subsidiaries and, to the extent permitted in IAS 21, differences on exchange were taken to the Statement of Recognised Income and Expense.

**Fair values of financial assets and financial liabilities**

| | | 2005 |
|---|---|---|
| | Book value £m | Fair value £m |
| Primary financial instruments held or issued to finance the Group's operations: | | |
| Short-term borrowings | (471) | (469) |
| Long-term borrowings | (4,486) | (4,696) |
| Finance leases (Group as lessee) | (88) | (88) |
| Short-term deposits | 346 | 346 |
| Cash at bank and in hand | 800 | 800 |
| Derivative financial instruments held to manage the interest rate and currency profile: | | |
| Interest rate swaps and similar instruments | – | (181) |
| Interest rate options | 4 | 2 |
| Forward foreign currency contracts | – | (15) |
| Currency options | 2 | (6) |
| | (3,893) | (4,307) |

**Note 20** Financial instruments continued

**Financial instruments under UK GAAP FRS 13 (relating to the comparative period ended 26 February 2005)** continued

Other significant financial instruments outstanding as at 26 February 2005 were £479m nominal value forward foreign exchange contracts hedging the cost of foreign currency denominated purchases. On a marking-to-market basis, these contracts showed a loss of £15m. The fair values of interest rate swaps, forward foreign exchange contracts and long-term fixed rate debt were determined by reference to prices available from the markets on which the instruments were traded. The fair values of all other items were calculated by discounting expected future cash flows at prevailing interest rates.

**Hedges**

Gains and losses on instruments used for hedging interest rates and currency risks, unrealised as at 26 February 2005, and those recognised in the year ended 26 February 2005 were as follows:

| | Unrecognised | | | Deferred | | |
|---|---|---|---|---|---|---|
| | Gains £m | Losses £m | Total £m | Gains £m | Losses £m | Total £m |
| At 28 February 2004 | 6 | (214) | (208) | 211 | – | 211 |
| Arising in previous years and recognised in the year ended 26 February 2005 | (1) | 44 | 43 | (48) | – | (48) |
| Arising in the period to be recognised in future years | 9 | (44) | (35) | – | – | – |
| At 26 February 2005 | 14 | (214) | (200) | 163 | – | 163 |

**Note 21** Provisions

| | Property provisions £m |
|---|---|
| At 26 February 2005 | 9 |
| Additions | 1 |
| Amount credited in the year | (3) |
| At 25 February 2006 | 7 |

Property provisions comprise future rents payable net of rents receivable on onerous and vacant property leases, provisions for terminal dilapidations and provisions for future rents above market value on unprofitable stores. The majority of the provision is expected to be utilised over the period to 2017.

The balances are analysed as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Current | 2 | 3 |
| Non-current | 5 | 6 |
| | 7 | 9 |

**Note 22** Share-based payments

The Group has not taken advantage of the transitional provisions of IFRS 2 'Share-based payment' in respect of equity-settled awards but instead applied IFRS 2 retrospectively to all awards granted, but not vested, as at 28 February 2004.

The total Income Statement charge for the year recognised in respect of share-based payments is £190m (2005 – £173m) which is made up of share option schemes and share bonus payments.

**a) Share option schemes**

The Company had eight share option schemes, all of which are equity-settled 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 or five years with contributions from employees of an amount between £5 and £250 per four-weekly period. Options are capable of being exercised at the end of the three or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceeding the offer date.

ii) The Irish savings-related share option scheme (2000) permits the grant to Irish employees of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three or five years with contributions from employees of an amount between €12 and €320 per four-weekly period. Options are capable of being exercised at the end of the three or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceeding the offer date.

iii) The approved executive share option scheme (1994) was adopted on 17 October 1994. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the discretionary share option plan (2004). There were no discounted options granted under this scheme.

iv) The unapproved 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. The exercise of options granted under this scheme will normally be conditional upon the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the discretionary share option plan (2004). There were no discounted options granted under this scheme.

v) The international executive share option scheme (1994) was adopted on 20 May 1994. This scheme permits the grant to selected non-UK executives of options to acquire ordinary shares on substantially the same basis as their UK counterparts. The exercise of options granted under this scheme will normally be conditional on the achievement of a specified performance target related to the growth in earnings per share over a three-year period. No further options will be granted under this scheme and it has been replaced by the discretionary share option plan (2004). There were no discounted options granted under this scheme.

vi) The executive incentive plan (2004) was adopted on 4 July 2004. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from the date of grant for nil consideration.

vii) The performance share plan (2004) was adopted on 4 July 2004. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between four and ten years from the date of grant for nil consideration. The exercise of options will normally be conditional on the achievement of specified performance targets related to the return on capital employed over a three-year period.

viii) The discretionary share option plan (2004) was adopted on 4 July 2004. This scheme permits the grant of approved, unapproved and international options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from the date of grant at a price not less than the middle market quotation or average middle market quotations of an ordinary share for the dealing day or three dealing days preceeding the date of grant. The exercise of options will normally be conditional on the achievement of a specified performance target related to the annual percentage growth in earnings per share over a three-year period. There will be no discounted options granted under this scheme.

**Note 22** Share-based payments *continued*

The following tables reconcile the number of share options outstanding and the weighted average exercise price (WAEP):

### For the year ended 25 February 2006

| | Savings-related share option scheme | | Irish savings-related share option scheme | | Approved share option scheme | | Unapproved share option scheme | | International executive share option scheme | | Nil cost share options | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP |
| Outstanding at 26 February 2005 | 186,022,500 | 194.78 | 4,895,103 | 190.80 | 21,290,693 | 222.10 | 97,695,342 | 227.08 | 23,025,502 | 227.10 | 1,126,257 | 0.00 |
| Granted | 44,347,668 | 248.00 | 1,673,357 | 248.00 | 4,401,080 | 312.75 | 17,483,188 | 312.75 | 8,989,071 | 309.54 | 2,333,201 | 0.00 |
| Forfeited | (11,451,171) | 200.07 | (416,444) | 192.11 | (1,316,210) | 233.62 | (4,543,756) | 239.06 | (1,086,847) | 240.94 | – | – |
| Exercised | (37,752,217) | 175.82 | (1,446,993) | 168.25 | (6,428,026) | 209.19 | (15,115,453) | 226.56 | (2,830,270) | 239.54 | – | – |
| Outstanding at 25 February 2006 | 181,166,780 | 211.42 | 4,705,023 | 217.96 | 17,947,537 | 248.11 | 95,519,321 | 242.28 | 28,097,456 | 251.69 | 3,459,458 | 0.00 |
| Exercisable as at 25 February 2006 | 5,904,791 | 196.90 | 227,107 | 169.95 | 7,721,660 | 231.7 | 28,646,347 | 232.85 | 7,958,413 | 224.75 | – | – |
| Exercise price range (pence) | | 159.00 to 198.00 | | 159.00 to 198.00 | | 205.00 to 259.00 | | 164.00 to 259.00 | | 176.70 to 259.00 | | Nil |
| Weighted average remaining contractual life (years) | | 0.19 | | 0.19 | | 5.02 | | 4.97 | | 4.73 | | – |

### For the year ended 26 February 2005

| | Savings-related share option scheme | | Irish savings-related share option scheme | | Approved share option scheme | | Unapproved share option scheme | | International executive share option scheme | | Nil cost share options | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP | Options | WAEP |
| Outstanding at 28 February 2004 | 187,050,572 | 179.99 | 4,444,839 | 174.03 | 25,854,991 | 217.07 | 107,563,724 | 208.13 | 21,501,380 | 215.87 | – | – |
| Granted | 48,551,270 | 232.00 | 1,196,397 | 232.00 | 3,299,752 | 253.30 | 25,624,301 | 253.30 | 5,942,435 | 253.30 | 1,126,257 | 0.00 |
| Forfeited | (15,350,601) | 184.54 | (480,687) | 192.26 | (1,837,930) | 242.30 | (3,351,952) | 234.55 | (367,038) | 241.31 | – | – |
| Exercised | (34,228,741) | 171.36 | (265,446) | 192.26 | (6,026,120) | 211.44 | (32,140,731) | 183.77 | (4,051,275) | 204.67 | – | – |
| Outstanding at 26 February 2005 | 186,022,500 | 194.78 | 4,895,103 | 185.42 | 21,290,693 | 222.10 | 97,695,342 | 227.08 | 23,025,502 | 227.10 | 1,126,257 | 0.00 |
| Exercisable as at 26 February 2005 | 4,138,485 | 176.28 | 89,057 | 198.00 | 11,320,445 | 211.41 | 24,885,840 | 211.43 | 7,072,253 | 213.25 | – | – |
| Exercise price range (pence) | | 151.00 to 198.00 | | 198.00 | | 90.30 to 247.00 | | 164.00 to 247.00 | | 176.70 to 247.00 | | Nil |
| Weighted average remaining contractual life (years) | | 0.19 | | 0.20 | | 5.17 | | 5.02 | | 5.22 | | – |

**Note 22 Share-based payments** continued

Share options were exercised on a regular basis throughout the year. The average share price during the year to 25 February 2006 was 317.79 pence (2005 – 277.87 pence).

The fair value of share options is estimated at the date of grant using the Black-Scholes option pricing model. The following table gives the assumptions applied to the options granted in the respective periods shown. No assumption has been made to incorporate the effects of expected early exercise.

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | Savings-related share option schemes | Executive share option schemes | Nil cost option schemes | Savings-related share option schemes | Executive share option schemes | Nil cost option schemes |
| Expected dividend yield (%) | 3% | 3% | 3% | 3% | 3% | 3% |
| Expected volatility (%) | 28% | 28% | 28% | 28% | 28% | 28% |
| Risk-free interest rate (%) | 4.4% | 4.2% | 4.2% | 4.6% | 4.9% | 4.9% |
| Expected life of option (years) | 3 or 5 | 6 | 6 | 3 or 5 | 6 | 6 |
| Weighted average fair value of options granted (pence) | 93.55 | 77.24 | 256.75 | 73.97 | 65.93 | 210.91 |
| Probability of forfeiture (%) | 20-25% | 10% | 0% | 20-25% | 10% | 0% |
| Weighted average exercise price (pence) | 248.00 | 312.75 | 0.0 | 232.00 | 288.25 | 0.0 |

Volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in Tesco PLC option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. In estimating the future volatility of the Company's share price, the Board consider the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option, taking into account the remaining contractual life of the option.

**b) Share bonus schemes**

Eligible UK employees are able to participate in Shares in Success, an all-employee profit sharing scheme. Each year, shares are awarded as a percentage of earnings up to a statutory maximum of £3,000.

Senior management also participate in performance-related bonus schemes. The amount paid to employees is based on a percentage of salary and is paid partly in cash and partly in shares. Bonuses are awarded to eligible employees that have completed a required service period and depend on the achievement of corporate targets.

The Executive Directors participate in short-term and long-term bonus schemes designed to align their interests with those of shareholders. Full details of these schemes can be found in the Directors' Remuneration Report.

The fair value of shares awarded under these schemes is their market value on the date of award. Expected dividends are not incorporated into the fair value.

The number and weighted average fair value (WAFV) of share bonuses issued during the period was:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Shares Number | WAFV Pence | Shares Number | WAFV Pence |
| Shares in Success – May 2005 | 22,337,747 | 309.75 | 25,331,808 | 247.25 |
| Executive incentive scheme | 16,328,179 | 309.88 | 12,287,315 | 249.88 |

**Note 22** Share-based payments continued

### c) Historical fair value information

The fair value of all awards relating to pre-February 2004 but impacting the Income Statement in these financial statements are included below:

| Award date | Plan type | Fair value of individual award at grant date (pence) |
|---|---|---|
| October 1999 | Save As You Earn – 5 year scheme | 69 |
| May 2000 | Executive incentive scheme | 209 |
| June 2000 | Save As You Earn – 5 year scheme | 74 |
| October 2000 | Save As You Earn – 5 year scheme | 90 |
| April 2001 | Executive incentive scheme | 258 |
| April 2001 | Executive options | 73 |
| May 2001 | Executive incentive scheme | 246 |
| November 2001 | Save As you Earn – 5 year scheme | 86 |
| November 2001 | Save As you Earn – 3 year scheme | 76 |
| April 2002 | Executive incentive scheme | 255 |
| April 2002 | Executive options | 77 |
| May 2002 | Executive incentive scheme | 262 |
| November 2002 | Save As You Earn – 5 year scheme | 62 |
| November 2002 | Save As You Earn – 3 year scheme | 56 |
| April 2003 | Executive options | 49 |
| May 2003 | Executive incentive scheme | 203 |
| May 2003 | Shares in Success | 197 |
| November 2003 | Save As You Earn – 5 year scheme | 80 |
| November 2003 | Save As You Earn – 3 year scheme | 72 |

**Note 23** Post-employment benefits

### Pensions

The Group operates a variety of post-employment benefit arrangements, which cover the majority of employees worldwide. These include funded defined contribution and funded and unfunded defined benefit plans. The most significant of these are the funded defined benefit schemes for the Group's employees in the UK, the Republic of Ireland and South Korea.

### Defined contribution plans

The contributions payable for defined contribution schemes of £7m (2005 – £2m) have been fully expensed against profits in the current year.

### Defined benefit plans

United Kingdom

The principal plan within the Group is the Tesco PLC Pension Scheme, which is a funded defined benefit pension scheme in the UK, the assets of which are held as a segregated fund and administered by trustees. An independent actuary, using the projected unit method, carried out the latest triennial actuarial assessment of the scheme as at 31 March 2005.

At the date of the last actuarial valuation the actuarial deficit was £153m. The market value of the schemes' assets represented 95% of the benefits that had accrued to members, after allowing for expected increases in earnings and pensions in payment.

The T&S Stores PLC Senior Executive Pension Scheme is a funded defined benefit scheme open to senior executives and certain other employees at the invitation of the company. An independent actuary, using the projected unit method, carried out the latest actuarial assessment of the scheme as at 1 April 2004.

Overseas

The most significant overseas scheme is the funded defined benefit scheme which operates in the Republic of Ireland. An independent actuary, using the projected unit method, carried out the latest actuarial assessment of the scheme as at 1 April 2004.

The valuations used for IAS 19 have been based on the most recent actuarial valuations and updated by Watson Wyatt Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 25 February 2006. The schemes' assets are stated at their market values as at 25 February 2006. Buck Consultants (Ireland) Limited have updated the most recent Republic of Ireland valuation. The liabilities relating to post-retirement healthcare benefits have also been determined in accordance with IAS 19, and are incorporated in the following tables.

**Note 23 Post-employment benefits** continued

**Principal assumptions**

The valuations used have been based on the most recent actuarial valuations and updated by Watson Wyatt Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 25 February 2006. The major assumptions, on a weighted average basis, used by the actuaries were as follows:

| | 2006 % | 2005 % | 2004 % |
|---|---|---|---|
| Rate of increase in salaries | 4.0 | 3.9 | 3.8 |
| Rate of increase in pensions in payment | 2.7 | 2.6 | 2.5 |
| Rate of increase in deferred pensions | 2.7 | 2.6 | 2.5 |
| Rate of increase in career average benefits | 2.7 | 2.6 | 2.5 |
| Discount rate | 4.8 | 5.4 | 5.7 |
| Price inflation | 2.7 | 2.6 | 2.5 |

The main financial assumption is the real discount rate, i.e. the excess of the discount rate over the rate of price inflation. If this assumption increased/decreased by 0.1%, the UK defined benefit obligation would decrease/increase by approximately £110m and the annual UK current service cost would decrease/increase by between £13m and £15m.

**UK mortality assumptions**

Following analysis of the mortality trends under the Tesco PLC Pension Scheme in the UK, which was carried out as part of the formal valuation of the Scheme as at 31 March 2005, it was decided to alter the mortality assumptions used in the formal valuation. The updated mortality tables as at 31 March 2005 were PMA92COO for male members and PFA92COO for female members. This change has been carried through into the calculation of the pension liabilities in the Balance Sheet as at 25 February 2006 for the main UK fund.

The following table illustrates the expectation of life of an average member retiring at age 65 at the Balance Sheet date and a member reaching age 65 at the same date +25 years.

| | | At 25 Feb 2006 in years | At 26 Feb 2005 in years |
|---|---|---|---|
| Retiring at Reporting date at age 65: | Male | 17.5 | 16.4 |
| | Female | 21.8 | 20.3 |
| Retiring at Reporting date +25 years at age 65: | Male | 18.4 | 18.2 |
| | Female | 23.0 | 21.1 |

The assets in the defined pension schemes and the expected rates of return were:

| | 2006 | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | Long term rate of return % | Market value £m | Long term rate of return % | Market value £m | Long term rate of return % | Market value £m |
| Equities | 8.1 | 2,416 | 8.2 | 1,908 | 8.1 | 1,399 |
| Bonds | 4.8 | 656 | 5.4 | 560 | 5.7 | 445 |
| Property | 6.4 | 253 | 6.8 | 183 | 6.9 | 92 |
| Other | 3.7 | 123 | 3.5 | 67 | 3.8 | 43 |
| Total market value of assets | | 3,448 | | 2,718 | | 1,979 |
| Present value of liabilities relating to unfunded schemes | | (17) | | (12) | | (5) |
| Present value of liabilities relating to partially funded schemes | | (4,642) | | (3,441) | | (2,648) |
| Pension deficit | | (1,211) | | (735) | | (674) |

Changes in the fair value of defined benefit pension plan assets are as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Opening fair value of plan assets | 2,718 | 1,979 |
| Expected return | 209 | 156 |
| Actuarial gains | 309 | 66 |
| Contributions by employer | 270 | 437* |
| Actual member contributions | 6 | 6 |
| Foreign currency translation differences | – | 2 |
| Benefits paid | (64) | 72 |
| Closing fair value of plan assets | 3,448 | 2,718 |

* Includes additional contribution of £200m paid in February 2005.

Changes in the present value of defined benefit obligations are as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Opening defined benefit obligation | (3,453) | (2,653) |
| Service cost | (328) | (272) |
| Interest cost | (184) | (152) |
| Losses on change of assumptions | (727) | (282) |
| Experience losses | (24) | (14) |
| Foreign currency translation differences | (1) | (2) |
| Benefits paid | 64 | (72) |
| Actual member contributions | (6) | (6) |
| Closing defined benefit obligation | (4,659) | (3,453) |

The amounts that have been charged to the Income Statement and Statement of Recognised Income and Expense for the year ended 25 February 2006 are set out below:

| | 2006 £m | 2005 £m |
|---|---|---|
| **Analysis of the amount charged to Operating profit:** | | |
| Current service cost | 328 | 272 |
| Total charge to Operating profit | 328 | 272 |
| **Analysis of the amount credited/(charged) to Finance income:** | | |
| Expected return on pension schemes' assets | 209 | 156 |
| Interest on pension schemes' liabilities | (184) | (152) |
| Net pension finance income (note 5) | 25 | 4 |
| Total charge to the Income Statement | 303 | 268 |

| | 2006 £m | 2005 £m |
|---|---|---|
| **Analysis of the amount recognised in the Statement of Recognised Income and Expense:** | | |
| Actual return less expected return on pension schemes' assets | 309 | 66 |
| Experience gains and losses arising on the schemes' liabilities | (24) | (14) |
| Changes in assumptions underlying the present value of the schemes' liabilities | (727) | (282) |
| Total actuarial loss recognised in the Statement of Recognised Income and Expense | (442) | (230) |

**Note 23** Post-employment benefits continued

### Movement in deficit during the year

| | 2006 £m | 2005 £m | 2004 £m |
|---|---|---|---|
| Deficit in schemes at beginning of the year | (735) | (674) | (769) |
| Current service cost | (328) | (272) | (201) |
| Other finance (charge)/income | 25 | 4 | (6) |
| Contributions | 270 | 437* | 162 |
| Foreign currency translation differences | (1) | – | – |
| Actuarial (loss)/gain | (442) | (230) | 140 |
| Deficit in schemes at end of the year | (1,211) | (735) | (674) |

* Includes additional contribution of £200m paid in February 2005.

### Post-employment benefits other than pensions

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

The liability as at 25 February 2006 of £10m (2005 – £8.5m), was determined in accordance with the advice of qualified actuaries. In 2005/06, £0.5m has been charged to the Income Statement and £0.7m of benefits were paid.

A change of 1.0% in assumed healthcare cost trend rates would have the following effect:

| | 2006 £m |
|---|---|
| Effect on the annual service and interest cost | 0.1 |
| Effect on defined benefit obligations | 1.0 |

### Expected contributions

The Group expects to make contributions of approximately £320m to defined benefit pension schemes in the UK and overseas in the year ending 24 February 2007.

**Note 24** Called up share capital

| | Ordinary shares of 5p each | |
|---|---|---|
| | Number | £m |
| Authorised: | | |
| At 26 February 2005 | 10,600,000,000 | 530 |
| Authorised during the year | 100,000,000 | 5 |
| **At 25 February 2006** | 10,700,000,000 | 535 |
| Allotted, called up and fully paid: | | |
| At 26 February 2005 | 7,783,169,542 | 389 |
| Scrip dividend election | 53,639,219 | 3 |
| Share options | 57,668,156 | 3 |
| **At 25 February 2006** | 7,894,476,917 | 395 |

During the financial year, 111 million shares of 5p each were issued for an aggregate consideration of £290m, which comprised £167m for scrip dividend and £123m for share options.

Between 25 February 2006 and 24 April 2006, options on 3,425,477 ordinary shares have been exercised under the terms of the savings-related share option scheme (1981) and the Irish savings-related share option scheme (2000). Between 25 February 2006 and 24 April 2006, options over 5,945,937 options have been exercised under the terms of the executive share option schemes (1994 and 1996) and the discretionary share option plan (2004).

As at 25 February 2006, the Directors were authorised to purchase up to a maximum in aggregate of 778.7 million ordinary shares.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at the meetings of the Company.

## Note 25 Statement of changes in equity

| | Issued share capital | Share premium | Other reserves: Merger reserve | Retained earnings: Hedging reserve | Retained earnings: Translation reserves | Retained earnings: Treasury shares | Retained earnings: Retained earnings | Minority interests | Total |
|---|---|---|---|---|---|---|---|---|---|
| At 26 February 2005 | 389 | 3,704 | 40 | – | 11 | (87) | 4,546 | 51 | 8,654 |
| Changes in accounting policy relating to the adoption of IAS 32 and IAS 39 | – | – | – | – | – | – | (314) | – | (314) |
| **27 February 2005 – restated** | 389 | 3,704 | 40 | – | 11 | (87) | 4,232 | 51 | 8,340 |
| Foreign currency translation differences | – | – | – | – | 25 | – | – | 7 | 32 |
| Actuarial losses on defined benefit plans | – | – | – | – | – | – | (442) | – | (442) |
| Tax on items taken directly to or transferred from equity | – | – | – | – | 2 | – | 131 | – | 133 |
| Increase in fair value of available-for-sale financial assets | – | – | – | – | – | – | 2 | – | 2 |
| Gains on cash flow hedges | – | – | – | 39 | – | – | – | – | 39 |
| Cost of share-based payments | – | – | – | – | – | 38 | 45 | – | 83 |
| Issue of shares | 6 | 284 | – | – | – | – | – | – | 290 |
| Profit for the year | – | – | – | – | – | – | 1,570 | 6 | 1,576 |
| Equity dividends authorised in the year | – | – | – | – | – | – | (609) | – | (609) |
| **At 25 February 2006** | 395 | 3,988 | 40 | 39 | 38 | (49) | 4,929 | 64 | 9,444 |

| | Issued share capital | Share premium | Other reserves: Merger reserve | Retained earnings: Translation reserves | Retained earnings: Treasury shares | Retained earnings: Retained earnings | Minority interests | Total |
|---|---|---|---|---|---|---|---|---|
| At 29 February 2004 | 384 | 3,470 | 40 | – | (42) | 3,841 | 45 | 7,738 |
| Foreign currency translation differences | – | – | – | 11 | – | – | 3 | 14 |
| Actuarial losses on defined benefit plans | – | – | – | – | – | (230) | – | (230) |
| Tax on items taken directly to or transferred from equity | – | – | – | – | – | 92 | – | 92 |
| Cost of share-based payments | – | – | – | – | (45) | 41 | – | (4) |
| Issue of shares | 5 | 234 | – | – | – | – | – | 239 |
| Profit for the year | – | – | – | – | – | 1,344 | 3 | 1,347 |
| Equity dividends authorised in the year | – | – | – | – | – | (542) | – | (542) |
| **At 26 February 2005** | 389 | 3,704 | 40 | 11 | (87) | 4,546 | 51 | 8,654 |

**Note 25** **Statement of Changes in Equity** continued

### Share premium account

The share premium account is used to record amounts received in excess of the nominal value of shares on issue of new shares.

### Translation reserve

The translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. It is also used to record the movements in net investment hedges.

### Treasury shares

During the year, the qualifying employee share ownership trust (QUEST) subscribed for 10 million from the Company, 0.1% of called-up share capital as at 25 February 2006 (2005 – 10 million, 0.1%). An amount of £12m (2005 – £16m) represents contributions to the QUEST from subsidiary undertakings.

The employee benefit trusts hold shares in Tesco PLC for the purpose of the various executive share incentive and profit share schemes. At 25 February 2006, the trusts held 48.4 million shares (2005 – 70.9 million), which cost £140m (2005 – £185m) and had a market value of £163m (2005 – £219m).

### Merger reserve

The merger reserve arose on the acquisition of Hillards plc in 1987.

### Other

The cumulative goodwill written-off against the reserves of the Group as at 25 February 2006 amounted to £718m (2005 – £718m).

**Note 26** **Business combinations**

On 1 March 2005 the Group acquired the trade and assets of Aram-Mart, which operates a chain of 12 hypermarkets in Korea. The consideration paid for this business was £49m cash.

The net assets and results of the acquired business are included in the consolidated accounts of the Group from the date of acquisition. Acquisition accounting has been applied and the goodwill arising has been capitalised and is subject to annual impairment testing.

The goodwill acquired in the business combination listed below has been allocated to the single group of cash-generating units represented by the acquired business, as this is the lowest level within the entity at which the goodwill is monitored internally.

The fair value of the identifiable assets and liabilities of Aram-Mart are:

| | Carrying value £m | Fair value adjustments £m | Recognised on acquisition £m |
|---|---|---|---|
| Property, plant and equipment | 16 | 7 | 23 |
| Inventories | 2 | – | 2 |
| Trade and other receivables | 5 | – | 5 |
| Trade and other payables | (1) | – | (1) |
| Net assets acquired | 22 | 7 | 29 |
| Cash consideration | | | 49 |
| Goodwill arising on acquisition | | | 20 |

**Note 26** **Business combinations** continued

The net cash outflow arising from the acquisition is as follows:

| | £m |
|---|---|
| Net cash acquired with the subsidiary | – |
| Cash paid as consideration | (49) |
| Net cash outflow | (49) |

From the date of acquisition, the acquired business contributed revenue of £111m and made a £1.3m loss which is included in the profit of the Group.

The Group made a number of other immaterial acquisitions during the year, mostly of small store operations, recognising £7m of goodwill.

**Note 27** **Related party transactions**

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint ventures and associates are disclosed below:

### i) Trading transactions

| | Sales to related parties* | | Purchases from related parties | | Amounts owed by related parties | | Amounts owed to related parties | |
|---|---|---|---|---|---|---|---|---|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Joint ventures | 624 | 761 | 195 | 132 | 19 | 6 | – | 7 |
| Associates | – | – | 502 | 324 | – | – | 79 | 22 |

* Consists of sales of services, loan interest and assets transferred

### ii) Non-trading transactions

| | Loans to related parties | | Loans from related parties | | Injection of equity funding | |
|---|---|---|---|---|---|---|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Joint ventures | 122 | 130 | 9 | 9 | 35 | 3 |
| Associates | – | – | – | – | 1 | 4 |

Transactions between the Group and the Group's pension plans are disclosed in note 23.

Tesco Stores Limited is a member of one or more partnerships to whom the provisions of the Partnerships and Unlimited Companies (Accounts) Regulations 1993 apply ('Regulations'). The accounts for those partnerships have been consolidated into these accounts pursuant to regulation 7 of the Regulations.

### iii) Transactions with key management personnel

Only members of the Board of Directors of Tesco PLC are deemed to be key management personnel. It is the Board who have responsibility for planning, directing and controlling the activities of the Group. Key management personnel compensation is disclosed in the audited part of the Directors' remuneration report.

During the year, there were no other material transactions or balances between the Group and its key management personnel or members of their close family.

## Note 28 Reconciliation of profit before tax to net cash generated from operations

| | 2006 £m | 2005 £m |
|---|---|---|
| Profit before tax | 2,235 | 1,894 |
| Net finance costs | 127 | 132 |
| Share of post-tax profits of Joint ventures and Associates | (82) | (74) |
| Operating profit | 2,280 | 1,952 |
| Operating loss of discontinuing operation | (9) | (6) |
| Depreciation and amortisation | 838 | 743 |
| Profit arising on property-related items | (77) | (49) |
| Loss on disposal of non-property assets | 4 | – |
| Release of impairment provisions | (5) | – |
| Share-based payments | 142 | 131 |
| Additional pension contribution | – | (200) |
| Increase in inventories | (146) | (67) |
| Increase in trade and other receivables | (38) | (48) |
| Increase in trade payables | 89 | 337 |
| Increase in other payables | 334 | 216 |
| Decrease in working capital (a) | 239 | 438 |
| Cash generated from operations (b) | 3,412 | 3,009 |

(a) The decrease in working capital includes the impact of translating foreign currency working capital movements at average exchange rates rather than year end exchange rates.
(b) The subsidiaries acquired during the year have not had a significant impact on Group operating cashflows.

## Note 29 Analysis of changes in net debt

| | At 26 Feb 2005 £m | Opening adjustment for IAS 32 & IAS 39 £m | Cashflow £m | Net debt of disposal group £m | Other non-cash changes £m | At 25 Feb 2006 £m |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | 1,146 | – | 165 | (2) | 16 | 1,325 |
| Finance lease receivables | – | – | – | – | 17 | 17 |
| Derivative financial instruments | – | 40 | (22) | – | 52 | 70 |
| Cash and receivables | 1,146 | 40 | 143 | (2) | 85 | 1,412 |
| Bank and other borrowings | (471) | (63) | (1,074) | 57 | (75) | (1,626) |
| Finance lease payables | (11) | – | 6 | – | (15) | (20) |
| Derivative financial instruments | – | (258) | 300 | – | (281) | (239) |
| Debt due within one year | (482) | (321) | (768) | 57 | (371) | (1,885) |
| Bank and other borrowings | (4,486) | (53) | 939 | – | (58) | (3,658) |
| Finance lease payables | (77) | – | – | – | (7) | (84) |
| Derivative financial instruments | – | (402) | (34) | – | 142 | (294) |
| Debt due after one year | (4,563) | (455) | 905 | – | 77 | (4,036) |
| | (3,899) | (736) | 280 | 55 | (209) | (4,509) |

**Note 30** Commitments and contingencies

**Capital commitments**

On 25 February 2006 there were commitments for capital expenditure contracted for, but not provided, of £1,578m (2005 – £416m), principally relating to the store development programme.

**Contingent liabilities**

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.

Tesco Personal Finance, in which the Group owns a 50% joint venture share, has commitments, described in its own financial statements as at 31 December 2005, of formal standby facilities, credit lines and other commitments to lend, totalling £6.0bn (2005 – £5.2bn). The amount is intended to provide an indication of the volume of business transacted and not of the underlying credit or other risks.

For details of assets held under finance leases, which are pledged as security for the finance lease liabilities, see note 11.

There are a number of contingent liabilities that arise in the normal course of business which if realised are not expected to result in a material liability to the Group. In connection with the railway tunnel collapse at Gerrards Cross, the Group is currently assessing a number of potential claims. Due to the nature of those claims it is not currently possible to assess their potential impact, therefore no provision has been made. The final outcome is not expected to be material to the Group.

**Note 31** Leasing commitments

**Finance lease commitments – Group as lessee**

Future minimum lease payments under finance leases and hire purchase contracts, together with the present value of the net minimum lease payments are as follows:

| | Minimum lease payments | | Present value of minimum lease payments | |
|---|---|---|---|---|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Within one year | 23 | 12 | 20 | 11 |
| Between two and five years | 37 | 32 | 27 | 23 |
| After five years | 132 | 126 | 57 | 54 |
| Total minimum lease payments | 192 | 170 | 104 | 88 |
| Less future finance charges | (88) | (82) | | |
| Present value of minimum lease payments | 104 | 88 | | |
| Analysed as: | | | | |
| Current finance lease payables | 20 | 11 | | |
| Non-current finance lease payables | 84 | 77 | | |
| | 104 | 88 | | |

The Group has finance leases for various items of plant, equipment, fixtures and fittings. There are also a small number of buildings which are held under finance leases. The fair value of the Group's lease obligations approximate to their carrying value.

## Note 31 Leasing commitments continued

### Finance lease receivables – Group as lessor

Future minimum lease receivables under finance leases together with the present value of the net minimum lease receivables are as follows:

| | Minimum lease receivables | | Present value of minimum lease receivables | |
|---|---|---|---|---|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Within one year | 7 | – | 6 | – |
| Between two and five years | 12 | – | 11 | – |
| Total minimum lease receivables | 19 | – | 17 | – |
| Less unearned finance income | (2) | – | | |
| Net lease receivables | 17 | – | | |
| Analysed as: | | | | |
| Current finance lease receivables | 6 | – | | |
| Non-current finance lease receivables | 11 | – | | |
| | 17 | – | | |

The Group entered into finance leasing arrangements with UK staff for certain of its electronic equipment as part of the Computers for Staff scheme. The average term of finance leases entered into is 3 years. The interest rate inherent in the leases is fixed at the contract date for all of the lease term. The average effective interest rate contracted approximates 4.6% (2005 – nil) per annum. The fair value of the Group's finance lease receivables at 25 February 2006 is estimated at £16m (2005 – nil).

### Operating lease commitments – Group as lessee

Future minimum rentals payable under non-cancellable operating leases are as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Within one year | 315 | 220 |
| Between two and five years | 1,105 | 771 |
| After five years | 3,795 | 2,808 |
| Total minimum lease payments | 5,215 | 3,799 |

Operating lease payments represent rentals payable by the Group for certain of its retail, distribution and office properties. The leases have varying terms, purchase options, escalation clauses and renewal rights.

### Operating lease receivables – Group as lessor

The Group both rents out its Investment properties and also sub-lets various leased buildings under operating leases. At the Balance Sheet date, the following future minimum lease payments are contractually receivable from tenants:

| | 2006 £m | 2005 £m |
|---|---|---|
| Within one year | 84 | 79 |
| Between two and five years | 234 | 204 |
| After five years | 283 | 247 |
| Total minimum lease payments | 601 | 530 |

**Note 32** **Explanation of transition to IFRSs**

This is the first year that the Group has presented its financial statements under IFRSs.

The accounting policies set out in note 1 have been applied in preparing the financial statements for the year ended 25 February 2006, the comparative information presented in these financial statements for the year ended 26 February 2005 and in the preparation of an opening IFRS Balance Sheet as at 28 February 2004 (the Group's date of transition to IFRSs).

An explanation of how the transition from UK GAAP to IFRSs has affected the Group's financial position, financial performance and cash flows is set out in the following tables and the accompanying notes.

### Reconciliation of profit

For the year ended 26 February 2005

| | Reported under UK GAAP £m | Share-based payments IFRS 2 £m | Business combinations IFRS 3 £m | Leasing IAS 17 £m | Employee benefits IAS 19 £m | Presentation of JVs and Associates IAS 28/31 £m | Deferred tax IAS 12 £m | Total IFRS adjustments £m | Restated under IFRSs £m |
|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | 33,974 | – | – | – | – | – | – | – | 33,974 |
| Cost of sales | (31,271) | – | – | (11) | (40) | – | – | (51) | (31,322) |
| **Gross profit** | 2,703 | – | – | (11) | (40) | – | – | (51) | 2,652 |
| Administrative expenses | (754) | (52) | 56 | – | (5) | – | – | (1) | (755) |
| Profit/(loss) on property-related items | 53 | – | – | (4) | – | – | – | (4) | 49 |
| **Operating profit** | 2,002 | (52) | 56 | (15) | (45) | – | – | (56) | 1,946 |
| Share of post-tax profits from Joint ventures and Associates | 130 | – | 5 | 4 | – | (64) | – | (55) | 75 |
| Finance income | 99 | – | – | – | 4 | – | – | 4 | 103 |
| Finance costs | (269) | – | – | (1) | – | 34 | – | 33 | (236) |
| **Profit before tax** | 1,962 | (52) | 61 | (12) | (41) | (30) | – | (74) | 1,888 |
| Taxation | (593) | 16 | – | 5 | 12 | 32 | (13) | 52 | (541) |
| **Profit for the year** | 1,369 | (36) | 61 | (7) | (29) | 2 | (13) | (22) | 1,347 |

Note: The above table represents the Income Statement prior to the reclassification of the Taiwanese business as a disposal group (note 7).

## Note 32 Explanation of transition to IFRSs continued

### Reconciliation of equity

As at 29 February 2004 (date of transition to IFRSs)

| | Reported under UK GAAP £m | Business combinations IFRS 3 £m | Pensions IAS 19 £m | Dividends IAS 10 £m |
|---|---|---|---|---|
| **Non-current assets** | | | | |
| Goodwill and intangible assets | 965 | – | – | – |
| Property, plant and equipment | 14,094 | – | – | – |
| Investment property | – | – | – | – |
| Investments in Joint ventures and Associates | 330 | – | – | – |
| Other investments | 6 | – | – | – |
| Deferred tax assets | – | – | – | – |
| | 15,395 | – | – | – |
| **Current assets** | | | | |
| Inventories | 1,199 | – | – | – |
| Trade and other receivables | 826 | – | (12) | – |
| Investments | 430 | – | – | – |
| Cash and cash equivalents | 670 | – | – | – |
| | 3,125 | – | (12) | – |
| **Current liabilities** | | | | |
| Trade and other payables | (4,364) | – | 10 | 365 |
| Short-term borrowings | (844) | – | – | – |
| Current tax liabilities | (308) | – | – | – |
| Provisions | – | – | – | – |
| | (5,516) | – | 10 | 365 |
| **Net current liabilities** | (2,391) | – | (2) | 365 |
| **Non-current liabilities** | | | | |
| Long-term borrowings | (4,346) | – | – | – |
| Post-employment benefit obligations | – | – | (674) | – |
| Other non-current liabilities | (22) | – | – | – |
| Deferred tax liabilities | (579) | – | 199 | – |
| Provisions | (14) | – | – | – |
| | (4,961) | – | (475) | – |
| **Net assets** | 8,043 | – | (477) | 365 |
| **Equity** | | | | |
| Share capital | 384 | – | – | – |
| Share premium account | 3,470 | – | – | – |
| Other reserves | 40 | – | – | – |
| Retained earnings | 4,104 | – | (477) | 365 |
| **Equity attributable to equity holders of the parent** | 7,998 | – | (477) | 365 |
| Minority interests | 45 | – | – | – |
| **Total equity** | 8,043 | – | (477) | 365 |

| | Investment property IAS 40 £m | Intangible assets IAS 38 £m | Leasing IAS 17 £m | Share-based payments IFRS 2 £m | Impairment of fixed assets IAS 36 £m | Deferred tax IAS 12 £m | Other £m | Restated under IFRSs £m |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |
| | – | 255 | – | – | – | – | – | 1,220 |
| | (473) | (255) | 29 | – | (142) | – | – | 13,253 |
| | 473 | – | – | – | – | – | – | 473 |
| | – | – | – | – | – | – | 1 | 331 |
| | – | – | – | – | – | – | – | 6 |
| | – | – | – | – | – | – | 12 | 12 |
| | – | – | 29 | – | (142) | – | 13 | 15,295 |
| | | | | | | | | |
| | – | – | – | – | – | – | – | 1,199 |
| | – | – | (3) | – | – | – | – | 811 |
| | – | – | – | – | – | – | (430) | – |
| | – | – | – | – | – | – | 430 | 1,100 |
| | – | – | (3) | – | – | – | – | 3,110 |
| | | | | | | | | |
| | – | – | (1) | – | – | – | 3 | (3,987) |
| | – | – | (3) | – | – | – | – | (847) |
| | – | – | – | – | – | – | – | (308) |
| | – | – | – | – | – | – | (4) | (4) |
| | – | – | (4) | – | – | – | (1) | (5,146) |
| | – | – | (7) | – | – | – | (1) | (2,036) |
| | | | | | | | | |
| | – | – | (30) | – | – | – | – | (4,376) |
| | – | – | – | – | – | – | – | (674) |
| | – | – | – | – | – | – | (3) | (25) |
| | – | – | 1 | 17 | 15 | (79) | (12) | (438) |
| | – | – | 2 | – | – | – | 4 | (8) |
| | – | – | (27) | 17 | 15 | (79) | (11) | (5,521) |
| | – | – | (5) | 17 | (127) | (79) | 1 | 7,738 |
| | | | | | | | | |
| | – | – | – | – | – | – | – | 384 |
| | – | – | – | – | – | – | – | 3,470 |
| | – | – | – | – | – | – | – | 40 |
| | – | – | (5) | 17 | (127) | (79) | 1 | 3,799 |
| | – | – | (5) | 17 | (127) | (79) | 1 | 7,693 |
| | – | – | – | – | – | – | – | 45 |
| | – | – | (5) | 17 | (127) | (79) | 1 | 7,738 |

**Note 32** **Explanation of transition to IFRSs** continued

## Reconciliation of Equity

As at 26 February 2005 (date of last UK GAAP financial statements)

| | Reported under UK GAAP £m | Business combinations IFRS 3 £m | Pensions IAS 19 £m | Dividends IAS 10 £m |
|---|---|---|---|---|
| **Non-current assets** | | | | |
| Goodwill and intangible assets | 1,044 | 58 | – | – |
| Property, plant and equipment | 15,495 | – | – | – |
| Investment property | – | – | – | – |
| Investments in Joint ventures and Associates | 407 | 5 | – | – |
| Other investments | 7 | – | – | – |
| Deferred tax assets | – | – | – | – |
| | 16,953 | 63 | – | – |
| **Current assets** | | | | |
| Inventories | 1,309 | – | – | – |
| Trade and other receivables | 1,002 | – | (230) | – |
| Investments | 346 | – | – | – |
| Cash and cash equivalents | 800 | – | – | – |
| | 3,457 | – | (230) | – |
| **Current liabilities** | | | | |
| Trade and other payables | (5,374) | – | 14 | 410 |
| Short-term borrowings | (477) | – | – | – |
| Current tax liabilities | (221) | – | – | – |
| Provisions | – | – | – | – |
| | (6,072) | – | 14 | 410 |
| **Net current liabilities** | (2,615) | – | (216) | 410 |
| **Non-current liabilities** | | | | |
| Long-term borrowings | (4,511) | – | – | – |
| Post-employment benefit obligations | – | – | (735) | – |
| Other non-current liabilities | (20) | – | – | – |
| Deferred tax liabilities | (731) | – | 279 | – |
| Provisions | (19) | – | – | – |
| | (5,281) | – | (456) | – |
| **Net assets** | 9,057 | 63 | (672) | 410 |
| **Equity** | | | | |
| Share capital | 389 | – | – | – |
| Share premium account | 3,704 | – | – | – |
| Other reserves | 40 | – | – | – |
| Retained earnings | 4,873 | 63 | (672) | 410 |
| **Equity attributable to equity holders of the parent** | 9,006 | 63 | (672) | 410 |
| Minority interests | 51 | – | – | – |
| **Total equity** | 9,057 | 63 | (672) | 410 |

| | Investment property IAS 40 £m | Intangible assets IAS 38 £m | Leasing IAS 17 £m | Share-based payments IFRS 2 £m | Impairment of fixed assets IAS 36 £m | Deferred tax IAS 12 £m | Other £m | Restated under IFRSs £m |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |
| | – | 306 | – | – | – | – | – | 1,408 |
| | (565) | (306) | 49 | – | (152) | – | – | 14,521 |
| | 565 | – | – | – | – | – | – | 565 |
| | – | – | 4 | – | – | – | – | 416 |
| | – | – | – | – | – | – | – | 7 |
| | – | – | – | – | – | – | 14 | 14 |
| | – | – | 53 | – | (152) | – | 14 | 16,931 |
| | | | | | | | | |
| | – | – | – | – | – | – | – | 1,309 |
| | – | – | (3) | – | – | – | – | 769 |
| | – | – | – | – | – | – | (346) | – |
| | – | – | – | – | – | – | 346 | 1,146 |
| | – | – | (3) | – | – | – | – | 3,224 |
| | | | | | | | | |
| | – | – | (17) | (8) | – | – | 1 | (4,974) |
| | – | – | (5) | – | – | – | – | (482) |
| | – | – | – | – | – | – | – | (221) |
| | – | – | – | – | – | – | (3) | (3) |
| | – | – | (22) | (8) | – | – | (2) | (5,680) |
| | – | – | (25) | (8) | – | – | (2) | (2,456) |
| | | | | | | | | |
| | – | – | (52) | – | – | – | – | (4,563) |
| | – | – | – | – | – | – | – | (735) |
| | – | – | – | – | – | – | (1) | (21) |
| | – | – | 6 | 41 | 17 | (94) | (14) | (496) |
| | – | – | 7 | – | – | – | 6 | (6) |
| | – | – | (39) | 41 | 17 | (94) | (9) | (5,821) |
| | – | – | (11) | 33 | (135) | (94) | 3 | 8,654 |
| | | | | | | | | |
| | – | – | – | – | – | – | – | 389 |
| | – | – | – | – | – | – | – | 3,704 |
| | – | – | – | – | – | – | – | 40 |
| | – | – | (11) | 33 | (135) | (94) | 3 | 4,470 |
| | – | – | (11) | 33 | (135) | (94) | 3 | 8,603 |
| | – | – | – | – | – | – | – | 51 |
| | – | – | (11) | 33 | (135) | (94) | 3 | 8,654 |

**Note 32** **Explanation of transition to IFRSs** continued

**Notes to the reconciliations of equity and profit**

The following describes the most significant adjustments arising from transition to IFRSs.

**Share-based payment (IFRS 2)**

a) Share Option Schemes

The main impact of IFRS 2 for the Group is the expensing of employees' and Directors' share options.

The expense is calculated with reference to the fair value of the award on the date of grant and is recognised over the vesting period of the scheme, adjusted to reflect actual and expected levels of vesting. We have used the Black-Scholes model to calculate the fair value of options on their grant date.

To ensure better comparability, the Group has applied IFRS 2 retrospectively to all options granted but not fully vested as at 29 February 2004, rather than just to those granted after 7 November 2002.

In 2004/05, application of IFRS 2 results in a pre-tax charge to the Income Statement of £48m; the pre-tax effect is partially offset by a deferred tax credit of £16m. Deferred tax is calculated based on the difference between market price at the Balance Sheet date and the option exercise price. As a result the tax effect will not correlate to the charge. The excess of the deferred tax over the cumulative Income Statement charge at the tax rate is recognised in equity (in 2004/05 this amounted to a credit of £9m to retained earnings). The deferred tax assets recognised in February 2004 and February 2005 relating to the share option schemes are £25m and £49m, respectively.

b) Share Bonus Schemes

Under UK GAAP the Group expensed share bonus schemes by applying the rules of UITF 17. Whereas the UK GAAP Profit and loss account charge was based on the intrinsic value of the award, the IFRS 2 charge is based on the fair value. This results in an additional charge of £4m to the Income Statement in 2004/05.

As a result of IFRSs, deferred tax assets recognised under UK GAAP relating to share bonus schemes have reduced by approximately £8m at both the 2004 and 2005 Balance Sheet dates.

**Goodwill arising on Business Combinations (IFRS 3)**

Under IFRS 3, goodwill is not amortised on a straight-line basis but instead is subject to annual impairment testing. Consequently, the goodwill balances were reviewed for impairment at February 2004 and February 2005 and no impairment adjustments were identified.

In terms of adjustments to the Income Statement in 2004/05, the non-amortisation of goodwill results in an increase of pre-tax profit of £61m. There are no associated tax impacts.

In the February 2005 Balance Sheet, a foreign exchange gain of £2m has been recognised through reserves relating to the non-amortisation of goodwill; therefore, the total adjustment to net assets relating to goodwill amounts to £63m.

**Recognition of dividends (IAS 10)**

Under IFRSs dividends declared after the Balance Sheet date are not recognised as a liability as at that Balance Sheet date.

The final dividend of £365m declared in April 2004 relating to the 2003/04 financial year has been reversed in the opening Balance Sheet and charged to equity in the Balance Sheet as at 26 February 2005. Similarly, the final dividend accrued for the 2004/05 financial year of £410m has been reversed in the IFRS Balance Sheet as at 26 February 2005 and has been charged to equity in the Balance Sheet as at 25 February 2006.

**Leasing (IAS 17)**

There are two impacts that have arisen from the adoption of IAS 17 – firstly, the reclassification of some leases between operating and finance leases, and secondly, the treatment of fixed rental uplifts.

Reclassification between operating leases and finance leases

The finance lease tests under UK GAAP and IFRSs are broadly similar except that IAS 17 requires the Group to consider property leases in their component parts (i.e. land and building elements separately).

**Note 32** **Explanation of transition to IFRSs** continued

Following a detailed review of our property lease portfolio, a small number of 'building' leases have been reclassified as finance leases and brought onto the Balance Sheet as at 29 February 2004, based on the criteria of IAS 17. This led to a relatively small increase in Property, plant and equipment, and a similar increase in the finance lease creditor.

The following adjustments have been made at the opening Balance Sheet and as at 26 February 2005:

| | 29 February 2004 £m | 26 February 2005 £m |
|---|---|---|
| Property, plant & equipment | 29 | 49 |
| Adjustment to net assets | (4) | (5) |

The associated impact on the Income Statement of the above is that some UK GAAP operating lease expenses are replaced with depreciation and financing charges for the building elements of the reclassified leases. Over the life of the lease, the total Income Statement charge remains the same, but the timing of expenses will change, with more of the total expense recognised earlier in the lease term. The net pre-tax impact on the Income Statement is immaterial for the year ended 26 February 2005.

In 2004/05 there was a one-off Income Statement adjustment of £4m, relating to the deferral of some profit from the sale and leaseback transaction completed in April 2004, which instead will be recognised over the 25-year lease term.

### Fixed rental uplifts

The Group has a number of leases that contain minimum rental uplifts at predetermined rent review dates. Some of these leases are with external landlords and some with the Group's property joint ventures. The International Financial Reporting Interpretations Committee (IFRIC) has recently clarified that it is necessary to account for these increases on a straight-line basis over the life of the lease. Previously, the Group charged such increases to the Income Statement in the year they arose.

The total amount payable over the life of the lease remains unchanged but the timing of the Income Statement charge changes. The excess of the rent charged to the Income Statement over the cash payment in any given period will be held on the Balance Sheet in Trade and other payables. This change in accounting treatment has the following effect on the Balance Sheets as at 29 February 2004 and 26 February 2005, and the Income Statement for 2004/05.

| | 29 February 2004 Balance Sheet £m | 2004/05 Income Statement £m | 26 February 2005 Balance Sheet £m |
|---|---|---|---|
| Operating profit impact | (1) | (12) | (13) |
| Joint ventures and Associates | – | 4 | 4 |
| Deferred tax | – | 3 | 3 |
| Impact on net assets/profit after tax | (1) | (5) | (6) |

## Employee benefits (IAS 19)

### Post-employment benefits

For UK GAAP reporting, we applied the measurement and recognition policies of SSAP 24 'Accounting for pension costs' for pensions and other post-employment benefits, whilst providing detailed disclosures for the alternative measurement principles of FRS 17 'Retirement Benefits'.

IAS 19 takes a similar approach to accounting for defined benefit schemes as FRS 17, thus on transition, the deficit disclosed under FRS 17 has been recognised in the Balance Sheet. At the opening Balance Sheet, this resulted in a pre-tax reduction in net assets of £676m representing the sum of the deficit plus the reversal of a SSAP 24 debtor in the UK GAAP Balance Sheet as at 29 February 2004. An associated deferred tax asset of £199m has been recognised in respect of the pension deficit. Therefore the total adjustment to net assets as at 29 February 2004 was £477m.

**Note 32 Explanation of transition to IFRSs** continued

Thereafter, the Group has chosen to apply the amendment to IAS 19 which allows actuarial gains and losses to be recognised immediately in the Statement of Recognised Income and Expense i.e. the actuarial gains and losses will be taken directly to equity.

The incremental pre-tax Income Statement charge for 2004/05 from the adoption of IAS 19 is £41m. This is split between the current service cost (increases operating costs by £45m) and the return on plan assets (increases finance income by £4m). The related tax effect of this is a £12m credit to the Income Statement. The actuarial loss on the scheme for 2004/05, recognised through reserves, is £230m, with an offsetting tax adjustment of £67m.

The February 2005 IAS 19 pension deficit is £735m, with an associated deferred tax asset of £279m.

**Joint ventures (IAS 31) and Associates (IAS 28)**

The Group applies the equity method of accounting for joint ventures (JVs) and associates, which is largely consistent with how they were accounted for under UK GAAP.

The adoption of IFRSs leads to a change in the presentation of the Group's share of the results of our JVs and associates. Under UK GAAP, we included our share of JV and associate operating profit before interest and tax and showed our share of their interest and tax in the respective Group lines within the Profit and Loss Account. Under IFRSs, JV and associate profit is shown as a net figure i.e. post interest and tax. This has the effect of reducing profit before tax, but reduces the tax charge. Overall, there is no impact on the Group profit after tax as this is purely a presentational change.

Another impact of using the equity method of accounting for JVs and associates under IFRSs is that when the Balance Sheet investment relating to a loss-making JV or associate reduces to nil then no further losses should be recognised in the Income Statement. Under UK GAAP, losses would continue to be recognised. This change has led to a small adjustment in the opening Balance Sheet of £1m and an increase in JV and associate profit of £2m in 2004/05.

**Impairment of assets (IAS 36)**

Under IAS 36, individual assets are reviewed for impairment when there are any indicators of impairment. Where individual assets do not generate cash flows independently from one another, the impairment reviews are carried out at the 'Cash-Generating Unit' level, which represents the lowest level at which cash flows are independently generated. The illustrative examples in IAS 36 suggest that for retailers this is at the individual store level.

Following impairment reviews at the opening Balance Sheet date, we identified a small number of stores which required provisions for impairment of £142m. This had the effect of reducing the total fixed asset balance by approximately 1% as at 29 February 2004.

A similar review was performed for 2004/05 but no further stores required an impairment provision. However, due to movements in foreign exchange rates, the overall provision set against fixed assets increased by £10m – this consolidation adjustment has been taken through equity, with no impact on the 2004/05 Income Statement.

The methodology and assumptions applied in the impairment reviews conducted on transition to IFRSs can be found in note 11.

IAS 36 has the additional effect of reducing the deferred tax liability by £15m as at February 2004 and £17m as at February 2005 (the movement year-on-year relates to foreign exchange differences which have been taken to equity). The deferred tax adjustments arise because the impairment reviews have reduced the carrying values of certain assets qualifying for capital allowances, with no corresponding change in the tax base.

**Intangible assets (IAS 38)**

Under UK GAAP, we included licences and capitalised development costs within tangible fixed assets on the Balance Sheet. Under IAS 38, 'Intangible Assets', such items are disclosed separately on the face of the Balance Sheet.

As a result, there is a reclassification of £255m in the opening Balance Sheet, and £306m in the Balance Sheet as at 26 February 2005, between Property, plant and equipment and Intangible assets. There is no impact on the Income Statement from this reclassification.

### Investment properties (IAS 40)

Under UK GAAP, we included all owned property assets within Tangible fixed assets on the Balance Sheet. Under IAS 40, 'Investment Properties', we are required to split out any property which earns rental income or is held for capital appreciation.

As a result, there is a reclassification of £473m in the opening Balance Sheet and £565m in the Balance Sheet as at 26 February 2005 between Property, plant and equipment and Investment property. There is no impact on the Income Statement from this reclassification.

### Deferred and current taxes (IAS 12)

Under UK GAAP deferred tax was recognised in respect of all timing differences that had originated but not reversed by the Balance Sheet date and which could give rise to an obligation to pay more or less taxation in the future.

Deferred tax under IAS 12 'Income Taxes' is recognised in respect of all temporary differences at the Balance Sheet date between the tax bases of assets and liabilities and their carrying value for financial reporting purposes.

The change to a Balance Sheet liability method of providing for deferred tax leads to a number of adjustments, as follows:

| | 29 February 2004 Net assets £m | 2004/05 Income Statement £m | 2004/05 Reserves £m | 26 February 2005 Net assets £m |
|---|---|---|---|---|
| Impact of IAS 12 | (79) | (13) | (2)* | (94) |
| Tax effect of accounting changes | 232 | 33 | 78* | 343 |
| Net impact on tax balance/profit after tax | 153 | 20 | 76 | 249 |
| JV and Associate presentation change | | 32 | | |
| Total impact on tax | | 52 | | |

* Includes foreign currency translation differences in respect of foreign operations

The significant components of the Balance Sheet adjustments are the recognition of deferred tax assets on the pension deficit and share-based payments, less deferred tax provisions for potential future gains arising from rolled-over gains and for the potential future tax liabilities arising from fair value adjustments recorded for business combinations. Neither of these provisions were previously recognised under FRS 19.

### Other adjustments

Other adjustments arise from the reclassification of money-market deposits from current asset investments to cash and cash equivalents (as a result of the definition within IAS 7 'Cash Flow Statements'), and other minor presentation differences.

### Significant changes to the Cash flow statement for 2004/05

None of the adjustments arising from IFRSs relate to cash, and therefore there is no impact on reported cash flows.

However, IAS 7 'Cash flow statements' extends the definition of cash to 'cash and cash equivalents' which includes movements on short-term deposits. This results in a change in presentation of the cash flow information to include these cash equivalents.

| | £m |
|---|---|
| Increase in cash as reported under UK GAAP | 121 |
| Movement on short-term deposits (cash equivalents under IFRSs) | (97) |
| Increase in cash and cash equivalents (per IFRS definition) | 24 |
| Cash and cash equivalents as at 29 February 2004 | 1,100 |
| Effect of exchange rate fluctuations on cash and cash equivalents | 22 |
| Cash and cash equivalents as at 26 February 2005 | 1,146 |

**Note 33** **Effect of adoption of IAS 32 and IAS 39 on Financial instruments**

The Group adopted IAS 32 and IAS 39 from 27 February 2005 and has taken the exemption available under IFRS 1 not to restate comparatives for IAS 32 and IAS 39. The analysis below details the transitional adjustments arising from the adoption of IAS 32 and IAS 39 as at 27 February 2005.

| | Under IFRSs (excluding IAS 32 and IAS 39) £m | Financial Instruments: Presentation and Disclosure IAS 32 £m | Financial Instruments: Recognition and Measurement IAS 39 £m | Under IFRSs (including IAS 32 and IAS 39) £m |
|---|---|---|---|---|
| Non-current assets | | | | |
| Goodwill and intangible assets | 1,408 | – | – | 1,408 |
| Property, plant and equipment | 14,521 | – | – | 14,521 |
| Investment property | 565 | – | – | 565 |
| Investments in Joint ventures and Associates | 416 | – | (10) | 406 |
| Other investments | 7 | – | (7) | – |
| Deferred tax assets | 14 | – | – | 14 |
| | 16,931 | – | (17) | 16,914 |
| Current assets | | | | |
| Inventories | 1,309 | – | – | 1,309 |
| Trade and other receivables | 769 | – | (64) | 705 |
| Derivative financial instruments | – | – | 40 | 40 |
| Cash and cash equivalents | 1,146 | – | – | 1,146 |
| | 3,224 | – | (24) | 3,200 |
| Current liabilities | | | | |
| Trade and other payables | (4,974) | – | 475 | (4,499) |
| Financial liabilities | | | | |
| – Borrowings | (482) | – | (63) | (545) |
| – Derivative financial instruments | – | – | (258) | (258) |
| Current tax liabilities | (221) | – | – | (221) |
| Provisions | (3) | – | – | (3) |
| | (5,680) | – | 154 | (5,526) |
| Net current liabilities | (2,456) | – | 130 | (2,326) |

| | Under IFRSs (excluding IAS 32 and IAS 39) £m | Financial Instruments: Presentation and Disclosure IAS 32 £m | Financial Instruments: Recognition and Measurement IAS 39 £m | Under IFRSs (including IAS 32 and IAS 39) £m |
|---|---|---|---|---|
| **Non-current liabilities** | | | | |
| Financial liabilities | | | | |
| – Borrowings | (4,563) | – | (53) | (4,616) |
| – Derivative financial instruments and other liabilities (a) | – | (228) | (174) | (402) |
| Post-employment benefit obligations | (735) | – | – | (735) |
| Other non-current liabilities | (21) | – | – | (21) |
| Deferred tax liabilities (b) | (496) | – | 28 | (468) |
| Provisions | (6) | – | – | (6) |
| | (5,821) | (228) | (199) | (6,248) |
| **Net assets** | 8,654 | (228) | (86) | 8,340 |
| **Equity** | | | | |
| Share capital | 389 | – | – | 389 |
| Share premium account | 3,704 | – | – | 3,704 |
| Other reserves | 40 | – | – | 40 |
| Retained earnings | 4,470 | (228) | (86) | 4,156 |
| **Equity attributable to equity holders of the parent** | 8,603 | (228) | (86) | 8,289 |
| Minority interests | 51 | – | – | 51 |
| **Total equity** | 8,654 | (228) | (86) | 8,340 |

Notes

(a) The Group has entered into an agreement with the Samsung Corporation to purchase the remaining shares of Samsung Tesco Co. Limited. These shares are expected to be purchased in three tranches in 2007, 2011 and 2012. The purchase price will reflect the market value of these shares at the date of acquisition.

Under IAS 32, the net present value of the future payments are shown as a financial liability, the value of which was £228m at 27 February 2005.

(b) The deferred tax impacts of the introduction of IAS 32 and IAS 39 as at 27 February 2005 is £28m.

(c) In 2003, the Group monetised profitable interest rate swaps. The amount realised was held in deferred income and amortised through the interest line in the Income Statement.

On transition to IAS 32 and IAS 39, the remaining credit balance held in deferred income of £163m was transferred to retained earnings.

Under IFRS 1, there is a corresponding credit of £163m to the value of financial liabilities, which is subsequently amortised through the interest line in the Income Statement.

The net effect is a transfer of £163m from deferred income to financial liabilities, with no impact on the Income Statement and net assets.

(d) Other adjustments are due to the marking-to-market of financial instruments and the reclassification of other creditors and debtors which are defined as net borrowings under IFRSs.

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$2,000,000,000

# Tesco plc

## $850,000,000 5.50% Senior Notes due 2017
## $1,150,000,000 6.15% Senior Notes due 2037

TESCO

**PROSPECTUS**

**October 29, 2007**

*Joint Book-Running Managers*

**Citi**

**JPMorgan**

*Joint Lead Manager*

**BNP PARIBAS**