TESCO STORES LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017

Registered Number : 00519500

TESCO STORES LIMITED

STRATEGIC REPORT FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017

The Directors present their Strategic Report of Tesco Stores Limited (the "Company") for the 52 weeks ended 25 February 2017 (the prior financial period being the 52 weeks ended 27 February 2016 ("2016")).

Review of the business

The principal activity of the Company is the operation of retail stores and associated activities with 2,654 (2016: 2,646) stores throughout England, Scotland, Wales and Northern Ireland.

This has been a significant financial period for the Tesco PLC group (the "Group"), of which the Company forms part, where, against a challenging external environment, it has continued to make strong progress against the purpose that has been set out for the Group: to serve shoppers a little better every day. The Company has improved competitiveness in the United Kingdom (UK), stabilised the business, is continuing to rebuild trust and has returned to profitability.

The Company's efforts have been guided by the Group's six strategic drivers. These drivers set a clear direction. Our intention is to become even more competitive for customers, simpler for colleagues and an even better partner to our suppliers, while creating long-term value for the Company's stakeholders.

This is discussed in further detail on pages 1 to 25 of the Tesco PLC Annual Report and Financial Statements 2017, which do not form part of this Report.

Details of future developments can be found in the Directors' Report on page 5.

Results and dividends

The results for the 52 weeks ended 25 February 2017 reflect a pre-tax profit of £266m (2016: pre-tax loss of £231m) and an after-tax profit of £263m (2016: after-tax loss of £277m).

Sales amounted to £40,134m (2016: £39,843m). Net assets at the end of the period were £1,265m (2016: £1,589m). The total comprehensive loss for the period of £2,803m (2016: income of £609m) includes an actuarial loss on the defined benefit pension scheme of £3,623m (2016: gain of £1,124m) which is set out in Note 23.

The Company's immediate parent, Tesco Holdings Limited, waived its right to repayment of a loan of £1,255m (2016: £4,750m) and invested a further £1,234m as a capital contribution.

During the period the Company incurred one-off income and charges netting to a charge of £203m. This comprised the following:

Net impairment of tangible fixed assets including onerous lease provisions

Net impairment reversal of non-current assets of £3m includes a reversal of £71m relating to tangible assets and a net property provisions charge of £68m.

Property transactions

The Company generated net profits (pre-tax) of £66m from property transactions.

Net restructuring and redundancy costs

Total costs of £93m relate to ongoing changes to store colleague structures and working practices.

Results and dividends (continued)

Amounts provided in relation to Deferred Prosecution Agreement (DPA) and Financial Conduct Authority (FCA) obligations

The Company has taken a total charge of £235m, in respect of the DPA of £129m, the expected costs of the compensation scheme as agreed with the FCA of £85m, and related costs. Refer to Note 21 for further details.

Interchange settlement

Income of £56m has been recognised in relation to settlement of a legal case in respect of interchange fees.

The Company has not paid either an interim dividend (2016: £nil), or a final dividend (2016: £nil) in respect of the 52 weeks ended 25 February 2017.

The Company has not paid any preference dividends in the period (2016: £nil). Refer to Note 17 for further disclosure.

Key performance indicators (KPIs)

The Group, which includes the Company, employs six simple business performance indicators, namely:

1) Grow sales;
2) Deliver profit;
3) Improve operating cash flow;
4) Customers recommend us and come back time and again;
5) Colleagues recommend us as a great place to work and shop; and
6) We build trusted partnerships.

The Group Chief Financial Officer provides regular updates on progress against the KPI measures to the Group Executive Committee, whose attendees include a number of the Company's Directors. The development, performance and position of the operations of the Group, which includes the Company, is discussed on pages 12 and 13 of the Tesco PLC Annual Report and Financial Statements 2017, which do not form part of this Report. Further KPIs for the Company are therefore not disclosed.

Principal risks and uncertainties

The management of the business and the Company's ability to deliver against its priorities are subject to a number of risks. The most significant risks facing the UK business include: customer proposition risk; risks associated with the failure to achieve the transformation objectives; liquidity risk; competition and markets risk; risks relating to brand, reputation and trust; technology risk; risks associated with data security and data privacy; political, regulatory and compliance risk; safety risk and people risk.

The result of the referendum on the UK's membership of the European Union leading to the departure of the UK from the European Union (Brexit), could cause disruptions to and create uncertainty around our business, including affecting our relationships with our existing and future customers, suppliers and colleagues. These disruptions and uncertainties could have an adverse effect on our business, financial results and operations. As further details of the Brexit terms emerge, management will continue to assess the potential risks and impacts of these on the Company's stakeholders.

Principal risks and uncertainties (continued)

The UK Leadership Team regularly discusses these risks and uncertainties together with the controls and mitigating factors. Further discussion of these risks and uncertainties, together with the controls and mitigating factors, in the context of the Group as a whole, is provided on pages 26 to 30 of the Tesco PLC Annual Report and Financial Statements 2017 which do not form part of this Report. Detail on the principal financial risks faced by the Company can be found in the Directors' Report on page 6.

On behalf of the Board

19 July 2017

A Stewart
Director
Tesco Stores Limited
Registered Number: 00519500
Registered Office: Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, AL7 1GA, United Kingdom

TESCO STORES LIMITED

DIRECTORS' REPORT FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017

The Directors present their Report and the audited financial statements of Tesco Stores Limited (the "Company") for the 52 weeks ended 25 February 2017 (the prior financial period being the 52 weeks ended 27 February 2016 ("2016")).

Results and dividends

This is discussed in the Strategic Report on pages 2 to 3.

Future developments

The Company's future developments form a part of the Tesco PLC group (the "Group") strategic priorities, which are discussed on pages 6 to 10 of the Tesco PLC Annual Report and Financial Statements 2017, which do not form part of this Report. The Company's performance is expected to continue throughout the next financial period and it is anticipated that the current performance levels will be maintained.

Going concern

The Directors consider that the Company has adequate resources to remain in operation for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. The going concern basis has been adopted based on the expectation that it is not the current intention of other Group companies to withdraw funding.

Events after the reporting period

Details of events after the reporting period can be found in Note 29 to the financial statements.

Existence of branches outside the United Kingdom

The Company has a branch in the Isle of Man.

Political donations

There were no political donations for the period (2016: £nil) and the Company did not incur any political expenditure (2016: £nil).

Employees

In this financial period we have made significant progress in updating and revising our people policies to provide our colleagues with direct access to the information they need to help and support them at work. We are making it simpler for colleagues to put our customers first and serve Britain's shoppers a little better every day by giving them easily accessible policies and information on our intranet. We recognise the importance of a fair, honest and transparent culture, and we are working together with our recognised trade union in the United Kingdom, Usdaw, to ensure our policies are right for our business and that they support our people.

Our Equal Opportunities, Diversity and Inclusion policies give both our managers and colleagues up-to-date information about working in, and supporting, a diverse environment, recognising the talents that different colleagues bring to our business and supporting them as individuals. We pride ourselves on having an inclusive environment where colleagues are treated with dignity and respect. By encouraging diversity, and employing people with different experiences, backgrounds and talent, we aim to reflect the customers and communities we serve and strengthen and grow as a business.

Our selection, training, development and promotion policies ensure equal opportunities for all colleagues regardless of factors such as gender, marital status, race, age, sexual preference and orientation, colour, creed, ethnic origin, religion or belief, disability (including colleagues who become disabled during service) or trade union affiliation. All decisions are based on merit.

Employees (continued)

We are working continually to improve the communication channels we use to engage, consult, inform and connect with colleagues, both to enable awareness of the financial and economic factors affecting the Company's performance and to ensure our colleagues' voices are heard. Our colleagues' feedback is important to us and we recognise that to drive our business forward we must respond to their feedback to ensure they are engaged in the decisions we make for the business.

We actively encourage colleagues to become involved in the financial performance of our business through a variety of voluntary Tesco PLC share schemes.

The Company had 278,019 employees on average during the 52 weeks ended 25 February 2017 (2016: 279,140).

Financial risk management

The principal financial risks faced by the Company relate to the availability of funds to meet business needs, fluctuations in interest and foreign exchange rates and credit risks relating to the risk of default by counterparties to financial transactions. An overview of the management of these risks is set out below. Financial risk management for the Group, of which the Company forms a part, is discussed in Note 23 of the Tesco PLC Annual Report and Financial Statements 2017, which do not form part of this Report.

Liquidity risk management

The Company finances its operations by a combination of retained profits, disposals of assets, bank borrowings, leases and intra-Group borrowings.

Interest rate risk management

Our objective is to limit the impact to our Profit and Loss account from rising interest rates. Forward rate agreements, interest rate swaps, caps and floors may be used to achieve the desired mix of fixed and floating rate debt.

Foreign currency risk management

Our principal objective is to reduce the effect of exchange rate volatility on the Profit and Loss account. Currency exposures that could significantly impact the Profit and Loss account, are managed using forward foreign currency contracts or purchased currency options, which are designated as cash flow hedges.

Credit risk management

Our objective is to reduce the risk of loss arising from default by parties to financial transactions. The Company holds positions with an approved list of investment grade rated counterparties and these counterparties and their credit ratings are routinely monitored.

Directors

The following Directors served during the period and up to the date of signing the financial statements:

D Lewis

A Morris

S Rigby

A Stewart

M Davies (appointed 29 July 2016)

Directors' imdemnities

A qualifying third-party indemnity provision as defined in Section 234 of the Companies Act 2006 is in force for the benefit of each of the Tesco PLC Directors listed on page 6 in respect of liabilities incurred as a result of their office, to the extent permitted by law. In respect of those liabilities for which directors and officers may not be indemnified, Tesco PLC maintained a Directors' and Officers' liability insurance policy throughout the financial period and up to the date of signing the financial statements.

Cautionary statement regarding forward-looking information

Where this document contains forward-looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this Report. These statements should be treated with caution due to the inherent risks and uncertainties underlying any such forward-looking information. A number of factors, including those in this document, could cause actual results to differ materially from those contained in any forward-looking statement.

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial period. Under that law the Directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 "Reduced Disclosure Framework".

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable United Kingdom Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' responsibilities statement (continued)

Disclosure of information to the auditor

Each Director who is a Director of the Company at the date of approval of these financial statements confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- he has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

Deloitte LLP, having indicated its willingness to continue in office, will be deemed to be reappointed as auditor under section 487(2) of the Companies Act 2006.

On behalf of the Board 19 July 2017

A Stewart
Director
Tesco Stores Limited
Registered Number: 00519500
Registered Office: Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, AL7 1GA, United Kingdom

TESCO STORES LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF TESCO STORES LIMITED

We have audited the financial statements of Tesco Stores Limited for the 52 week period ended 25 February 2017 which comprise the Profit and Loss account, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity and the related notes 1 to 29. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion, based on the work undertaken in the course of the audit:

- give a true and fair view of the state of the Company's affairs as at 25 February 2017 and of its profit for the 52 week period then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial period for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF TESCO STORES LIMITED (continued)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Simon Letts

Simon Letts FCA (Senior statutory auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
St. Albans, United Kingdom

Date: 19 July 2017

TESCO STORES LIMITED

PROFIT AND LOSS ACCOUNT FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017

	Notes	**52 weeks ended 25 February 2017 £m**	52 weeks ended 27 February 2016 £m
Revenue	3	**40,134**	39,843
Cost of sales		**(38,321)**	(38,376)
Gross profit		**1,813**	1,467
Administrative expenses		**(1,381)**	(1,272)
Profits arising on property-related items		**99**	54
Operating profit		**531**	249
Other losses	14	**-**	(208)
Interest receivable and similar income	7	**42**	48
Interest payable and similar costs	8	**(307)**	(320)
Profit/(loss) on ordinary activities before taxation		**266**	(231)
Taxation	9	**(3)**	(46)
Profit/(loss) for the period		**263**	(277)

There are no material differences between the profit on ordinary activities before taxation and the profit for the period stated above and their historical cost equivalents.

All operations are continuing for the financial period.

The notes on pages 15 to 53 form part of the financial statements.

TESCO STORES LIMITED

STATEMENT OF COMPREHENSIVE INCOME FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017

	Notes	**52 weeks ended 25 February 2017 £m**	52 weeks ended 27 February 2016 £m
Profit/(loss) for the period		**263**	(277)
Other comprehensive income:			
Items that will not be reclassified to profit or loss:			
Actuarial (loss)/gain on defined benefit pension plans	23	**(3,623)**	1,124
Income tax relating to items not reclassified		**585**	(268)
Items that may be reclassified to profit or loss:			
Cash flow hedges:			
Reclassification adjustments for (gains)/losses included in profit or loss		**(199)**	(19)
Net fair value (losses)/gains		**160**	56
Income tax relating to items that may be reclassified		**11**	(7)
Other comprehensive (loss)/income for the period, net of tax		**(3,066)**	886
Total comprehensive (loss)/income for the period		**(2,803)**	609

The notes on pages 15 to 53 form part of the financial statements.

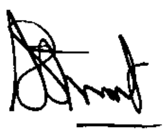
TESCO STORES LIMITED

BALANCE SHEET AS AT 25 FEBRUARY 2017

	Notes	**2017 £m**	2016 £m
Non-current assets			
Intangible assets	11	**516**	512
Tangible fixed assets	12	**9,777**	9,451
Investment properties	13	**44**	63
Investments	14	**-**	5
		10,337	10,031
Current assets			
Stocks	15	**1,317**	1,454
Debtors: amounts falling due within one year	16	**11,621**	9,392
Cash at bank and in hand		**731**	699
Non-current assets classified as held for sale	10	**90**	156
Derivative financial instruments	20	**57**	88
Deferred tax assets	9	**794**	163
		14,610	11,952
Current liabilities			
Creditors: amounts falling due within one year	17	**(16,098)**	(16,421)
Corporation tax payable		**(191)**	(141)
Provisions for liabilities	21	**(372)**	(240)
Derivative financial instruments	20	**(5)**	(53)
		(16,666)	(16,855)
Net current liabilities		**(2,056)**	(4,903)
Total assets less current liabilities		**8,281**	5,128
Non-current liabilities			
Creditors: amounts falling due after more than one year	18	**(35)**	(38)
Provisions for liabilities	21	**(489)**	(491)
Post-employment benefit obligations	23	**(6,492)**	(3,008)
Derivative financial instruments	20	**-**	(2)
Net assets		**1,265**	1,589
Capital and reserves			
Called up share capital	26	**1,325**	1,325
Cash flow hedge reserve		**7**	35
Profit and loss account		**(67)**	229
Total shareholders' funds		**1,265**	1,589

The notes on pages 15 to 53 form part of the financial statements.

The financial statements on pages 11 to 53 were approved by the Board of Directors on 19 July 2017 and were signed on its behalf by:



A Stewart
Director
Tesco Stores Limited
Registered Number: 00519500
Registered Office: Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, AL7 1GA, United Kingdom

TESCO STORES LIMITED

STATEMENT OF CHANGES IN EQUITY

	Notes	Called up share capital [i]	Cash flow hedge reserve	Profit and loss account	Total shareholders' funds
		£m	£m	£m	£m
At 28 February 2015		**1,325**	**5**	**(5,345)**	**(4,015)**
Loss for the period		-	-	(277)	(277)
Other comprehensive income for the period		-	30	856	886
Total comprehensive income for the period		**-**	**30**	**579**	**609**
Transactions with owners					
Contribution from owner[ii]		-	-	4,750	4,750
Share based payment transactions	22	-	-	245	245
At 27 February 2016		**1,325**	**35**	**229**	**1,589**
Profit for the period		-	-	263	263
Other comprehensive loss for the period		-	(28)	(3,038)	(3,066)
Total comprehensive loss for the period		**-**	**(28)**	**(2,775)**	**(2,803)**
Transactions with owners					
Contribution from owner[ii]		-	-	2,489	2,489
Share based payment transactions	22	-	-	(10)	(10)
At 25 February 2017		**1,325**	**7**	**(67)**	**1,265**

[i] See Note 26 for a breakdown of the Called up share capital.

[ii] During the period, the Company's immediate parent, Tesco Holdings Limited, waived its right to repayment of a loan of £1,255m (2016: £4,750m) and invested a further £1,234m as a capital contribution.

NOTES TO THE FINANCIAL STATEMENTS FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017

1 AUTHORISATION OF FINANCIAL STATEMENTS AND STATEMENT OF COMPLIANCE WITH FRS 101

The financial statements of Tesco Stores Limited (the "Company") for the period ended 25 February 2017 were approved by the Board of Directors on 19 July 2017 and the Balance Sheet was signed on the Board's behalf by A Stewart. Tesco Stores Limited is a private company limited by shares and incorporated and domiciled in England and Wales.

These financial statements were prepared in accordance with Financial Reporting Standard 101 "Reduced Disclosure Framework" (FRS 101). The financial statements have been prepared under the historical cost convention and the Companies Act 2006 as modified by the fair value measurement of derivatives. The Company has used a true and fair view override to the Companies Act in respect of the non-amortisation of goodwill (Note 2, "Significant accounting policies", part f)).

The Company has taken advantage of the exemption under s400 of the Companies Act 2006 not to prepare group accounts as it is a wholly owned subsidiary of Tesco PLC. The Company's results are included in the consolidated financial statements of Tesco PLC, which are available from Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, AL7 1GA, United Kingdom.

2 ACCOUNTING POLICIES

General information and basis of accounting

Tesco Stores Limited is a company incorporated in England and Wales under the Companies Act. The address of the registered office is given on page 4. The nature of the Company's operations and its principal activities are set out in the Strategic Report on pages 2 to 3.

The financial statements have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 101 "Reduced Disclosure Framework" (FRS 101) issued by the Financial Reporting Council.

The Company is a qualifying entity for the purposes of FRS 101. Note 25 gives details of the Company's parent and from where its consolidated financial statements prepared in accordance with EU-adopted IFRS may be obtained.

The disclosure exemptions adopted by the Company in accordance with FRS 101 are as follows:

- The requirements of IFRS 7 Financial Instruments: Disclosures.
- The requirements of paragraphs 91-99 of IFRS 13 Fair Value Measurement.
- The requirement in paragraph 38 of IAS 1 'Presentation of Financial Statements' to present comparative information in respect of:
- (i) paragraph 79(a)(iv) of IAS 1;
- (ii) paragraph 73(e) of IAS 16 Property, Plant and Equipment;
- (iii) paragraph 118(e) of IAS 38 Intangible Assets; and
- (iv) paragraphs 76 and 79(d) of IAS 40 Investment Property.
- The requirements of paragraphs 10(d), 10(f), 39(c) and 134-136 of IAS 1 Presentation of Financial Statements;
- The requirements of IAS 7 Statement of Cash Flows;
- The requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- The requirements of paragraph 17 and 18A of IAS 24 Related Party Disclosures;
- The requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and
- The requirements of paragraphs 134(d)-134(f) and 135(c)-135(e) of IAS 36 Impairment of Assets.

2 ACCOUNTING POLICIES (continued)

Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained within the going concern statement included in the Directors' Report on page 5.

The principal accounting policies adopted by the Company are set out below. These policies have been consistently applied to all periods presented unless otherwise stated.

Critical judgements and sources of estimation uncertainty

The preparation of the financial statements requires management to make judgements, estimates and assumptions in applying the Company's accounting policies to determine the reported amounts of assets, 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. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis.

Judgements

Critical judgements, apart from those involving estimations, that are applied in the preparation of the financial statements are discussed below:

Leases

The Company exercises judgement in determining the classification of leases as finance or operating leases at inception of the lease. Management considers the likelihood of exercising break clauses or extension options in determining the lease term. Where the lease term constitutes substantially all of the economic life of the asset, or where the present value of minimum lease payments amount to substantially all of the fair value of the property, the lease is classified as a finance lease. All other leases are classified as operating leases.

Determination of cash-generation units

The Company has determined each store as a separate cash-generating unit for impairment testing. Refer to Note 12.

Classification of investment properties

The Company exercises judgement in determining the appropriate classification of stores as investment properties or tangible fixed assets. Factors considered in making this determination include the level of services provided to tenants, who manages the store and any shared facilities, the proportion of sublet space to own-use space and the variability of earnings from the property.

2 ACCOUNTING POLICIES (continued)

Sources of estimation uncertainty

The key assumptions about the future, and other key sources of estimation uncertainty at the reporting period end that may have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial period are discussed below:

Impairment of assets

The Company has determined each store as a separate cash-generating unit for impairment testing. Where there are indicators of impairment, the Company performs an impairment test. Recoverable amounts for cash-generating units are based on the higher of value in use and fair value less costs of disposal. Value in use is calculated from cash flow projections based on the Company's three year internal forecasts. The forecasts are extrapolated to five years based on the Company's expectations, and beyond five years based on estimated long-term growth rates. Key estimates and sensitivies for impairment of assets are disclosed in Note 12.

Commercial income

The Company is required to make estimates in determining the amount and timing of recognition of commercial income (as defined on page 25) for some transactions with suppliers. In determining the amount of volume-related allowances recognised in any period, the Company estimate the probability that it will meet contractual target volumes, based on historical and forecast performance. There is limited estimation involved in recognising income for promotional and other allowances.

The Company assesses its performance against the obligations conditional on earning the income, with the income recognised either over time as the obligations are met, or recognised at the point when all obligations are met, dependent on the contractual requirements. Commercial income is recognised as a credit within cost of sales. Where the income earned relates to stocks which are held by the Company at period ends, the income is included within the cost of those stocks, and recognised in cost of sales upon sale of those stocks. The Company views that the cost of stocks sold (which is inclusive of commercial income) provides a consistent and complete measure of the Profit and Loss account impact of the overall supplier relationships.

Property provisions

Property provisions comprise onerous lease provisions, including leases on unprofitable stores and vacant properties, and other onerous contracts related to property. These provisions are based on the least net cost of fulfilling or exiting the contract.

Stocks

A stock provision is booked for cases where the realisable value from sale of the stock is estimated to be lower than the inventory carrying value. Management has estimated the inventory provisioning percentage for different product categories based on various factors, including the expected sales profiles of the items, the prevailing sales prices, the items' seasonality pattern and expected losses associated with slow-moving stock items.

2 ACCOUNTING POLICIES (continued)

Sources of estimation uncertainty (continued)

Post-employment benefit obligations

The present value of the post-employment benefit obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of post-employment benefit obligations. Key assumptions for post-employment benefit obligations are disclosed in Note 23.

Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the Company's control, or present obligations that are not recognised because it is not probable that a settlement will be required or the value of such a payment cannot be reliably estimated. The Company does not recognise contingent liabilities but discloses them. Refer to Note 28 for the disclosures.

Significant accounting policies

a) Foreign currency translation

The Company's financial statements are presented in Pounds Sterling, which is also the Company's functional currency.

Transactions and balances

Transactions in foreign currencies are translated to the functional currency 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 to the functional currency at the rates prevailing on the Balance Sheet date. All differences are taken to the Profit and Loss account.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

When the Company acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

b) Intangible assets

Goodwill

Goodwill is initially measured at cost, being the excess of the aggregate of the acquisition-date fair value of the consideration transferred and the amount recognised for the non-controlling interest over the net identifiable amounts of the assets acquired and the liabilities assumed in exchange for the business combination.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

b) Intangible assets (continued)

Goodwill (continued)

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Software and other intangible assets

Intangible assets, such as software and pharmacy licences, are measured initially at acquisition cost or costs incurred to develop the asset. Development expenditure incurred on an individual project is capitalised only if specific criteria are met including that the asset created will probably generate future economic benefits. Intangible assets acquired in a business combination are recognised at fair value at the acquisition date.

Following initial recognition, intangible assets with finite useful lives are carried at cost less accumulated amortisation and accumulated impairment losses. They are amortised on a straight-line basis over their estimated useful lives, at 10% to 25% of cost per annum.

c) Investment property

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 tangible fixed assets in part e).

d) Investments

Investments in subsidiaries, associates and joint ventures are held at historical cost less any applicable provision for impairment.

e) Tangible fixed assets

Tangible fixed assets are carried at cost less accumulated depreciation and any recognised impairment in value. Tangible fixed assets are depreciated on a straight-line basis to their residual value over its anticipated useful economic life.

The following depreciation rates were applied for the Company and are consistent with the prior period:

- Freehold and leasehold buildings with greater than 40 years unexpired – at 2.5% of cost per annum;
- 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 predominantly varying from 10% to 33% of cost per annum; and
- Freehold land is not depreciated.

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.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

f) Impairment of non-financial assets

Goodwill is reviewed for impairment at least annually by assessing the recoverable amount of each cash-generating unit to which the goodwill relates. The recoverable amount is the higher of fair value less costs to sell and value in use. 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 Profit and Loss account and is not subsequently reversed.

For all other non-financial assets (including intangible assets and tangible fixed assets) the Company performs impairment testing where there are indicators of impairment.

If such an indicator 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 Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of value in use and fair value less costs of disposal. 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 immediately in the Profit and Loss account.

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 periods. A reversal of an impairment loss is recognised immediately as a credit to the Profit and Loss account.

g) Non-current assets classified as held for sale

Non-current assets are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell.

h) Provisions for liabilities

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

Provisions for onerous leases are recognised when the Company believes that the unavoidable costs of meeting or exiting the lease obligations exceed the economic benefits expected to be received under the lease.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

i) Leases

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.

Company as a lessee

Assets held under finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease, with a corresponding liability being recognised for the lower of the fair value of the leased asset and the present value of the minimum lease payments. Lease payments are apportioned between the reduction of the lease liability and finance charges in the Profit and Loss account so as to achieve a constant rate of interest on the remaining balance of the liability. Assets held under finance leases are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases and rentals payable are charged in the Profit and Loss account on a straight-line basis over the lease term.

Company as a lessor

Assets leased out under operating leases are included in tangible fixed assets and depreciated over their estimated useful lives. Rental income, including the effect of lease incentives, is recognised on a straight-line basis over the lease term.

Where the Company transfers substantially all the risks and benefits of ownership of the asset, the arrangement is classified as a finance lease and a receivable is recognised for the initial direct costs of the lease and the present value of the minimum lease payments. As payments fall due, finance income is recognised in the Profit and Loss account so as to achieve a constant rate of return on the remaining net investment in the lease.

j) Financial instruments

Financial assets and financial liabilities are recognised on the Balance Sheet when the Company becomes a party to the contractual provisions of the instrument. The expected maturity of the financial assets and liabilities is not considered to be materially different to their current and non-current classification.

Debtors

Debtors including intercompany balances are non-interest-bearing and are recognised initially at fair value, and subsequently at amortised cost using the effective interest rate method, less provision for impairment.

Interest-bearing borrowings including intercompany balances

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 proceeds and redemption value being recognised in the Profit and Loss account over the period of the borrowings on an effective interest basis.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

j) Financial instruments (continued)

Creditors

Creditors including intercompany balances are non-interest-bearing and are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

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 Company uses derivative financial instruments to hedge its exposure to foreign exchange and commodity risks arising from operating activities. The Company 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. Where derivatives do not qualify for hedge accounting, any gains or losses on remeasurement are immediately recognised in Profit and Loss account. 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 Company is required to document from inception the relationship between the item being hedged and the hedging instrument.

The Company 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 financial reporting date to ensure that the hedge remains highly effective.

Derivative financial instruments with maturity dates of more than one year from the Balance Sheet date are disclosed as non-current.

Cash flow hedging

Derivative financial instruments are classified as cash flow hedges when they hedge the Company'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 other comprehensive income.

The associated cumulative gain or loss is reclassified from other comprehensive income and recognised in the Profit and Loss account in the same period or periods during which the hedged transaction affects the Profit and Loss account. The classification of the effective portion when recognised in Profit and Loss account 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 Profit and Loss account within finance income or costs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or if a voluntary de-designation takes place or no longer qualifies for hedge accounting.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

j) Financial instruments (continued)

Cash flow hedging (continued)

At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in the Statement of Changes in Equity until the forecast transaction occurs or the original hedged item affects the Profit and Loss account.

If a forecast hedged transaction is no longer expected to occur. the net cumulative gain or loss recognised in the Statement of Changes in Equity is reclassified to the Profit and Loss account.

k) Stocks

Stocks comprise goods and development properties held for resale. Stocks are valued at the lower of cost and fair value less costs to sell using the weighted average cost basis. Directly attributable costs and incomes (including applicable commercial income) are included in the cost of stocks.

l) Cash at bank and in hand

Cash and at bank and in hand in the Balance Sheet comprise cash at banks and in hand and short term deposits with an original maturity of three months or less.

m) Taxation

Current tax, including United Kingdom (UK) corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the Balance Sheet date. The tax currently payable is based on taxable profit for the period. Taxable profit differs from net profit as reported in the Profit and Loss account because it excludes items of income or expense that are taxable or deductible in other periods and it further excludes items that are never taxable or deductible. Tax provisions are recognised for uncertain tax positions where a risk of an additional tax liability has been identified and it is probable that that the Company will be required to settle that tax. Measurement is dependent on subjective judgements as to the outcome of decisions by tax authorities in the various tax jurisdictions in which the Company operates. This is assessed on a case by case basis using in-house tax experts, professional firms and previous experience.

Group relief on taxation

The Company may receive or surrender group relief from Group companies without payment and consequently there may be no tax charge in the Profit and Loss account.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences 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. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

m) Taxation (continued)

Deferred tax (continued)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future. 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 is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited to the Profit and Loss account, except when it relates to items charged or credited directly in equity or other comprehensive income, in which case deferred tax is also recognised in equity or other comprehensive income, respectively.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set-off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Current tax and deferred tax for the period

Current and deferred tax are recognised in the Profit and Loss account, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

n) Pensions and other post-employment benefits

The Company participates in defined benefit pension schemes and cannot identify its share of the underlying assets and liabilities of the schemes. Therefore, in accordance with IAS 19, the entire net defined benefit deficit relating to the schemes are recognised by the Company, as per Group policy. There is no contractual agreement or agreed policy for recharges.

The Company also participates in a defined contribution scheme open to all UK employees. Payments to this scheme are recognised as an expense as they fall due.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

o) Revenue

Revenue comprises the fair value of consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities.

Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have transferred to the buyer and the amount of revenue can be measured reliably. Revenue is recorded net of returns, discounts/offers and value added taxes.

Clubcard, loyalty and other initiatives

The cost of Clubcard and loyalty initiatives is part of the fair value of the consideration received and is deferred and subsequently recognised over the period that the awards are redeemed. The deferral is treated as a deduction from revenue.

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

p) Rental income

Rental income is recognised in the period in which it is earned, in accordance with the terms of the lease.

q) Commercial income

Consistent with standard industry practice, the Company has agreements with suppliers whereby volume-related allowances, promotional and marketing allowances and various other fees and discounts are received in connection with the purchase of goods for resale from those suppliers. Most of the income received from suppliers relates to adjustments to a core cost price of a product, and as such is considered part of the purchase price for that product. Sometimes receipt of the income is conditional on the Company performing specified actions or satisfying certain performance conditions associated with the purchase of the product. These include achieving agreed purchases or sales volume targets and providing promotional or marketing materials and activities or promotional product positioning. Whilst there is no standard definition, these amounts receivable from suppliers in connection with the purchase of goods for resale are generally termed commercial income.

Commercial income is recognised when earned by the Company, which occurs when all obligations conditional for earning income have been discharged, and the income can be measured reliably based on the terms of the contract. The income is recognised as a credit within cost of sales. Where the income earned relates to stocks which are held by the Company at period end, the income is included within the cost of those stocks, and recognised in cost of sales upon sale of those stocks. Amounts due relating to commercial income are recognised within other debtors, except in cases where the Company currently has a legally enforceable right of set-off and intends to offset amounts due from suppliers against amounts owed to those suppliers, in which case only the net amount receivable or payable is recognised. Accrued commercial income is recognised within accrued income when commercial income earned has not been invoiced at the Balance Sheet date.

r) Interest receivable and similar income

Interest income is recognised in the period to which it relates using the effective interest rate method.

2 ACCOUNTING POLICIES (continued)

Significant accounting policies (continued)

s) Interest payable and similar costs

Finance 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 and from which future economic benefits are expected to arise. All other borrowing costs are recognised in the Profit and Loss account in finance costs in the period in which they occur.

t) Share-based payments

Some employees of the Company 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 either the Monte Carlo or Black-Scholes models. The resulting cost is charged to the Profit and Loss account over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

Options awarded to employees are for share capital of Tesco PLC. This is treated as a capital contribution to the reserves of the Company.

3 REVENUE

The Company operates within one business segment being that of the operation of retail stores and associated activities with business principally transacted in the United Kingdom (UK).

4 OPERATING PROFIT

This is stated after charging/(crediting):

	2017 £m	2016 £m
Investment property rental income	**(31)**	(32)
Other rental income	**(54)**	(57)
Direct expenses for investment properties generating rental income	**11**	16
Depreciation of tangible assets (Note 12)	**519**	561
Amortisation of intangible assets (Note 11)	**89**	129
Net impairment of tangible fixed assets (Note 12)	**(205)**	103
Net impairment of intangible fixed assets (Note 11)	**7**	200
Cost of stocks recognised as an expense (included in cost of sales)	**29,770**	29,095
Stock losses and provisions	**888**	901
Operating lease charges:		
- plant and machinery	**28**	39
- rent payable	**655**	758
Provision in relation to Deferred Prosecution Agreement (DPA) and Financial Conduct Authority (FCA) obligations (Note 21)	**235**	-
Restructuring and redundancy costs (Note 21)	**93**	-
Interchange settlement	**(56)**	-
Pension scheme curtailment gain	**-**	(538)

5 AUDITOR'S REMUNERATION

The Company paid the following amounts to its auditor in respect of the audit of the financial statements. The audit fees were borne on the Company's behalf by another Group company.

	2017	2016
	£'000	£'000
Audit of the financial statements	**96**	96

The Company has taken advantage of the exemption not to disclose amounts paid for non-audit services as these are disclosed in the Group financial statements of its ultimate parent, Tesco PLC.

6 STAFF COSTS AND DIRECTORS' REMUNERATION

(a) Staff costs

	2017	2016
	£m	£m
Wages and salaries	**3,929**	3,902
Social security costs	**241**	208
Post-employment defined benefits (Note 23)	**22**	3
Post-employment defined contributions (Note 23)	**275**	136
Share based payments expense (Note 22)	**240**	255
Termination benefits charge	**137**	38
Termination benefits release	**-**	(58)
	4,844	4,484

The average monthly number of employees during the period was 278,019 (2016: 279,140) and the average number of full time equivalents was 178,709 (2016: 182,027).

(b) Directors' remuneration

	2017	2016
	£m	£m
Directors' remuneration	**6**	8
Number of Directors who received shares in respect of qualifying services	**5**	4

There were no payments for loss of office or retirement in the period.

	2017	2016
	£m	£m
In respect of the highest paid Director:		
Aggregate remuneration	**3**	3

In the current and prior financial periods the highest paid Director was not a member of the Company's defined benefit pension scheme.

In the current and prior financial periods no share options were exercised. In the current financial period, shares were received under a long term incentive scheme by the highest paid Director.

7 INTEREST RECEIVABLE AND SIMILAR INCOME

	2017	2016
	£m	£m
Interest receivable on loans to Group undertakings	**33**	45
Other interest receivable	**9**	3
	42	48

8 INTEREST PAYABLE AND SIMILAR COSTS

	2017	2016
	£m	£m
Interest payable on loans from Group undertakings	**102**	124
Unwinding of discount on provisions	**41**	43
Finance charges payable under finance leases and hire purchase contracts	**2**	3
Other interest payable	**14**	2
Capitalised interest	**(4)**	(4)
Net pension finance costs	**109**	151
Financial instruments - fair value remeasurements	**43**	1
	307	320

9 TAXATION

Factors that have affected the tax charge

The Finance Act 2015 included legislation to reduce the main rate of UK corporation tax to 20% from 1 April 2015 to 31 March 2017, and to 19% from 1 April 2017 to 31 March 2020. The blended tax rate for the period is therefore 20% (2016: 20.1%). From 1 April 2020, the rate will be reduced to 17%, in accordance with Finance Act 2016.

(a) Tax charged in the Profit and Loss account

	2017	2016
	£m	£m
Current income tax:		
UK corporation tax	**(18)**	-
Foreign tax	**(7)**	(15)
Adjustments in respect of previous periods	**(14)**	132
Total current income tax (charge)/credit	**(39)**	117
Deferred tax:		
Origination and reversal of temporary differences	**(53)**	(63)
Adjustments in respect of previous periods	**62**	(123)
Impact of change in tax laws and rates	**27**	23
Total deferred tax credit/(charge)	**36**	(163)
Total income tax charge	**(3)**	(46)

9 TAXATION (continued)

(b) Reconciliation of the effective tax charge

	2017 £m	2016 £m
Profit/(loss) on ordinary activities before taxation	**266**	(231)
Profit/(loss) on ordinary activities multiplied by blended rate in the UK 20% (2016: 20.1%)	**(53)**	46
Effect of:		
Non-qualifying depreciation	**(15)**	(10)
Non-qualifying impairment	**44**	(22)
Other non-deductible items	**(48)**	(64)
Overseas tax paid	**-**	(15)
Movement in provision for uncertain tax positions	**(18)**	77
Profit/(loss) on property disposals not taxable or available for tax relief	**14**	(2)
Share-based payments	**(10)**	-
Prior period items	**47**	(69)
Rate change adjustment	**26**	23
Group relief claimed without payment	**10**	-
Deferred tax only movements	**-**	(11)
Other items	**-**	1
Total income tax charge for the period	**(3)**	(46)

Tax on items credited/(charged) directly to the Statement of Changes in Equity

	2017 £m	2016 £m
Deferred tax credit/(charge) on:		
Share based payments	**2**	(1)
Total tax credit/(charge) on items charged directly to Statement of Changes in Equity	**2**	(1)

Tax relating to components of the Statement of Comprehensive Income

	2017 £m	2016 £m
Deferred tax credit/(charge) on:		
Defined benefit pension plan	**585**	(268)
Cash flow hedges	**11**	(7)
Total tax credit/(charge) on items charged to Statement of Comprehensive Income	**596**	(275)

The Finance Act 2016 included legislation to reduce the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and to 17% from 1 April 2020. These rate reductions were substantively enacted by the Balance Sheet date and therefore included in these financial statements. Temporary differences have been remeasured using the enacted tax rates that are expected to apply when the liability is settled or the asset realised.

TESCO STORES LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017 (continued)

9 TAXATION (continued)

(c) Deferred tax

The following are the major deferred tax (liabilities)/assets recognised by the Company and movements thereon during the current and prior financial periods measured using the tax rates that are expected to apply when the liability is settled or the asset realised based on the tax rates that have been enacted or substantially enacted by the Balance Sheet date:

	Short-term timing differences	Accelerated capital allowances	Share-based payments	Property-related items	Pension	Financial instruments	Transitional adjustment	Transitional adjustment - Financial Instruments (10 year spread)	Trading loss	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 27 February 2016	9	(73)	(6)	(315)	541	(12)	-	5	14	163
Origination and reversal of temporary differences:										
- In respect of the current period Profit and Loss account	(3)	(6)	8	16	(23)	-	-	-	(20)	(28)
- In respect of prior periods Profit and Loss account	6	8	15	25	1	-	-	(1)	7	61
Charged to Other Comprehensive Income	-	-	-	-	585	11	-	-	-	596
Charged to equity	-	-	2	-	-	-	-	-	-	2
At 25 February 2017	**12**	**(71)**	**19**	**(274)**	**1,104**	**(1)**	**-**	**4**	**1**	**794**

10 NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE

The following non-current assets are classified as held for sale and included within Net Assets:

	2017	2016
	£m	£m
Non-current assets classified as held for sale	**90**	156

The non-current assets classified as held for sale consist mainly of properties in the UK.

11 INTANGIBLE ASSETS

	Software	Other intangible assets	Goodwill	Total
	£m	£m	£m	£m
Cost				
At 27 February 2016	1,725	49	131	1,905
Additions	105	-	-	105
Disposals	(14)	(1)	-	(15)
At 25 February 2017	**1,816**	**48**	**131**	**1,995**
Accumulated amortisation and impairment losses				
At 27 February 2016	(1,366)	(27)	-	(1.393)
Charge for the period	(89)	-	-	(89)
Disposals	10	-	-	10
Impairment losses	(6)	(1)	-	(7)
At 25 February 2017	**(1,451)**	**(28)**	**-**	**(1,479)**
Net book value				
At 25 February 2017	**365**	**20**	**131**	**516**
At 27 February 2016	359	22	131	512

Assessment of the carrying value of goodwill

Goodwill has been allocated to the grouping of all stores within the Company in the UK. This represents the lowest level within the Company at which goodwill is monitored for internal management purposes. Goodwill is not amortised but is reviewed for impairment on an annual basis, or more frequently if there are indications that goodwill may be impaired.

An impairment review was performed by comparing the carrying value of goodwill with the recoverable amount of the cash-generating unit to which goodwill has been allocated. The recoverable amount for the group of cash-generating units is the higher of value in use and fair value less costs of disposal.

The key estimates for the value in use calculations are those regarding discount rate, growth rate and expected changes in margins. Management estimates the discount rate using the pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the cash-generating unit.

Cash flow projections are based on the Company's three year internal forecasts, the results of which are reviewed by the Board. Estimates of selling prices and direct costs are based on past experience and expectations of future changes in the market. The pre-tax discount rate of 9.3% (2016: 9.1%) used to calculate the value in use range is derived from the Group's post-tax weighted average cost of capital, as adjusted for the specific risks relating to each cash-generating unit. On a post-tax basis, the discount rate is 7.5% (2016: 7.2%). The forecast is extrapolated to five years based on management's expectations and extrapolated beyond five years based on an estimated long-term average growth rate of 2.0% (2016: 2.0%).

12 TANGIBLE FIXED ASSETS

	Land and buildings	Plant, equipment, fixtures and fittings and motor vehicles	Total
	£m	**£m**	**£m**
Cost			
At 27 February 2016	12,968	5,828	18,796
Additions (a)	516	228	744
Disposals	(251)	(340)	(591)
Reclassification	(21)	26	5
Classified as held for sale	(115)	5	(110)
At 25 February 2017	**13,097**	**5,747**	**18,844**
Accumulated depreciation and impairment			
At 27 February 2016	(4,953)	(4,392)	(9,345)
Charge for the period	(224)	(295)	(519)
Reversal of impairment losses (b)	219	(14)	205
Disposals	209	318	527
Reclassification	(7)	-	(7)
Classified as held for sale	76	(4)	72
At 25 February 2017	**(4,680)**	**(4,387)**	**(9,067)**
Net book value			
At 25 February 2017	**8,417**	**1,360**	**9,777**
At 27 February 2016	8,015	1,436	9,451

Assets under construction included above (c):

	Land and buildings	Plant and equipment	Total
	£m	**£m**	**£m**
At 25 February 2017	**23**	**16**	**39**
At 27 February 2016	69	25	94

The net book value of land and buildings comprises:

	2017	2016
	£m	£m
Freehold	**7,294**	6,827
Long leasehold – 50 years or more	**231**	304
Short leasehold – less than 50 years	**892**	884
	8,417	8,015

12 TANGIBLE FIXED ASSETS (continued)

Notes:

a) Additions at cost includes £4m (2016: £4m) 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 52 weeks to 25 February 2017 was 4.7% (2016: 4.2%).

b) Of the net impairment release for the period of £205m (2016: charge £103m), £184m (2016: charge £62m) has been recognised within cost of sales and £21m (2016: charge £41m) has been recognised within profits arising on property-related items.

c) Assets under construction does not include land.

Net carrying value includes land and buildings held under finance leases which are analysed below:

	2017	2016
	£m	£m
Net book value	**24**	28

Impairment of tangible fixed assets

The Company 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 the higher of value in use or fair value less costs of disposal.

Fair values are determined in regard to the market rent for the stores or for alternative uses with investment yields appropriate to reflect the physical characteristics of the property and the location. In some cases, fair values include residual valuations where stores may be viable for redevelopment.

The key estimates for the value in use calculations are those regarding discount rate, growth rate and expected changes in margins. Management estimates the discount rate using the pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the cash-generating unit.

Cash flow projections are based on the Company's three year internal forecasts, the results of which are reviewed by the Board. Estimates of selling prices and direct costs are based on past experience and expectations of future changes in the market. The pre-tax discount rate of 9.3% (2016: 9.1%) used to calculate the value in use range is derived from the Group's post-tax weighted average cost of capital, as adjusted for the specific risks relating to each cash-generating unit. On a post-tax basis, the discount rate is 7.5% (2016: 7.2%). The forecast is extrapolated to five years based on management's expectations and extrapolated beyond five years based on an estimated long-term average growth rate of 2.0% (2016: 2.0%).

The impairment credit included in the operating profit has been shown in Note 4.

The Company has carried out a sensitivity analysis on the impairment tests for its trading stores portfolio. A reasonably possible increase of one percentage point in the post-tax discount rates would increase impairment by £153m. A decrease by one percentage point would decrease impairment by £141m.

13 INVESTMENT PROPERTIES

	Investment properties £m
Cost	
At 27 February 2016	91
Additions	-
Transfer to tangible fixed assets	(6)
Disposals	(12)
Classified as held for sale	(13)
At 25 February 2017	**60**
Accumulated depreciation and impairment losses	
At 27 February 2016	(28)
Charge for the period	-
Transfer to tangible fixed assets	6
Impairment loss	(2)
Reversal of impairment losses	3
Disposals	4
Classified as held for sale	1
At 25 February 2017	**(16)**
Net book value	
At 25 February 2017	**44**
At 27 February 2016	63

The estimated fair value of the Company's investment property is £212m (2016: £178m). This fair 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.

In the period there has been a £1m net impairment reversal for investment properties which has been recognised within cost of sales.

14 INVESTMENTS

	2017 £m	2016 £m
Investments in subsidiaries	-	5

Sanders Supermarkets Limited was placed into liquidation on 24 February 2017. The Company has recognised an impairment charge of £5m at the Balance Sheet date which has been classified within administrative expenses in the Profit and Loss account.

On 22 October 2015, the Company completed the sale of its 48.15% share in Homeplus Tesco Co. Limited. The Company recognised a loss on disposal (including fees) of £208m which had been classified in other losses in the Profit and Loss account in 2016.

Related undertakings of the Company

In accordance with Schedule 4 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, a full list of related undertakings, the registered office address, the place of incorporation and the percentage of share class owned as at 25 February 2017 are disclosed on page 35 and 36. All undertakings are directly owned by the Company unless otherwise stated. Footnotes are included on page 36.

NOTES TO THE FINANCIAL STATEMENTS FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017 (continued)

14 INVESTMENTS (continued)

Name of company- Subsidiary undertaking	*Registered office address*	*Place of incorporation*	*Proportion of voting rights and shares held*	*Share class*
Sanders Supermarkets Limited (in liquidation from 24 February 2017)	(1)	England and Wales	100%	Ordinary share
Brian Ford's Discount Store Limited (in liquidation)	(2)	England and Wales	100%	Ordinary share
Bedminster Estates Limited (in liquidation)[i]	(2)	England and Wales	100%	Ordinary share
Premier Garage (Worthing) Limited (in liquidation)[i]	(2)	England and Wales	100%	Ordinary share
Pulford Foods Limited (in liquidation)[i]	(2)	England and Wales	100%	Ordinary share
Value House Properties Limited (in liquidation)[i]	(2)	England and Wales	100%	Ordinary share
Broughton Retail Park Nominee 1 Limited	(1)	England and Wales	100%	Ordinary share
Broughton Retail Park Nominee 2 Limited	(1)	England and Wales	100%	Ordinary share
Broughton Retail Park Nominee 3 Limited	(1)	England and Wales	100%	Ordinary share
Broughton Retail Park Nominee 4 Limited	(1)	England and Wales	100%	Ordinary share
Flitwick Pharmacies Limited (in liquidation from 3 February 2017)	(1)	England and Wales	100%	Ordinary share
Halesworth SPV Limited	(1)	England and Wales	100%	Ordinary share
Honiton Wholesale Supplies Ltd (in liquidation)	(2)	England and Wales	100%	Ordinary share
J.E.Cohen & Company Limited	(1)	England and Wales	100%	Ordinary share
Motorcause Limited	(1)	England and Wales	100%	Ordinary share
NPL (Hardgate) Limited (in liquidation)	(3)	England and Wales	100%	Ordinary share
NutriCentre Limited	(1)	England and Wales	100%	Ordinary share
Sarcon (No. 239) Limited (in liquidation)	(4)	England and Wales	100%	Ordinary share
Seacroft Green Nominee 1 Limited	(1)	England and Wales	100%	Ordinary share
Seacroft Green Nominee 2 Limited	(1)	England and Wales	100%	Ordinary share
Spen Hill Residential No 1 Limited	(1)	England and Wales	100%	Ordinary share
Bath Upper Bristol Road Management Company Limited[ii]	(1)	England and Wales	100%	Guarantee Membership
Cardiff Cathays Terrace Management Company Limited[ii]	(1)	England and Wales	100%	Guarantee Membership
Oxford Fox and Hounds Management Company Limited[ii]	(1)	England and Wales	100%	Guarantee Membership
Ventnor High Street Management Company Limited[ii]	(1)	England and Wales	100%	Guarantee Membership
Spen Hill Residential No 2 Limited	(1)	England and Wales	100%	Ordinary share

TESCO STORES LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017 (continued)

14 INVESTMENTS (continued)

Name of company- Subsidiary undertaking (continued)	*Registered office address*	*Place of incorporation*	*Proportion of voting rights and shares held*	*Share class*
Telegraph Properties (Kirkby) Limited (in liquidation)	(2)	England and Wales	100%	Ordinary share
Tesco Kirkby (General Partner) Limited	(1)	England and Wales	100%	Ordinary share
Tesco Kirkby (Nominee Holdco) Limited[iii] (in liquidation from 24 February 2017)	(1)	England and Wales	100%	Ordinary share
Tesco Kirkby (Nominee 1) Limited[iv] (in liquidation from 24 February 2017)	(1)	England and Wales	100%	Ordinary share
Tesco Kirkby (Nominee 2) Limited[iv] (in liquidation from 24 February 2017)	(1)	England and Wales	100%	Ordinary share
Tesco Property Nominees (No.5) Limited	(1)	England and Wales	100%	Ordinary share
Tesco Property Nominees (No.6) Limited	(1)	England and Wales	100%	Ordinary share
Tesco Seacroft Limited	(1)	England and Wales	100%	Ordinary share
Weymouth Avenue (Dorchester) Limited	(1)	England and Wales	100%	Ordinary share
Whitecastle Properties Limited (in liquidation)	(3)	England and Wales	100%	Ordinary share
Tesco FFC Limited (formerly Fred's Food Construction Limited)	(1)	England and Wales	100%	Ordinary share
Tesco Employees' Share Scheme Trustees Limited	(1)	England and Wales	50%	Ordinary share

Name of company - associates	*Registered office address*	*Place of incorporation*	*Proportion of voting rights and shares held*	*Share class*
Broadfields Management Limited	(5)	England and Wales	35.33%	Ordinary share
Clarepharm Limited	(6)	England and Wales	22.70%	Ordinary share
Shire Park Limited	(7)	England and Wales	54.52%	Ordinary share

[ii] Directly held by Brian Ford's Discount Store Limited
[ii] Directly held by Spen Hill Residential No 1 Limited
[iii] Directly held by Tesco Kirkby (General Partner) Limited
[iv] Directly held by Tesco Kirkby (Nominee Holdco) Limited

Registered office addresses

(1) Tesco House, Shire Park, Kestrel Way, Welwyn Garden City AL7 1GA, United Kingdom
(2) KPMG LLP, 15 Canada Square, London E14 5GL, United Kingdom
(3) KPMG LLP, Saltire Court, 20 Castle Terrace, Edinburgh, Midlothian EH1 2EG, United Kingdom
(4) KPMG LLP, Stokes House, 17-25 College Square East, Belfast BT1 6DH, Northern Ireland
(5) 2 Paris Parklands, Railton Road, Guildford, Surrey, GU2 9JX, United Kingdom
(6) Thompson Jenner, 28 Alexandra Terrace, Exmouth, Devon, EX8 1BD, United Kingdom
(7) c/o Lamburn & Turner, Riverside House, 1 Place Farm, Wheathampstead, St Albans, AL4 8SB, United Kingdom

15 STOCKS

	2017 £m	2016 £m
Goods held for resale	**1,297**	1,420
Development properties	**20**	34
	1,317	1,454

16 DEBTORS - AMOUNTS FALLING DUE WITHIN ONE YEAR

	2017 £m	2016 £m
Amounts owed by Group undertakings	**10,970**	8,840
Other debtors	**251**	358
Prepayments and accrued income	**400**	194
	11,621	9,392

Included within amounts owed to Group undertakings are amounts that are unsecured, have no fixed date of repayment and are repayable on demand.

17 CREDITORS - AMOUNTS FALLING DUE WITHIN ONE YEAR

	2017 £m	2016 £m
Bank loans and overdrafts	**549**	220
Trade creditors	**3,613**	3,351
Amounts owed to Group undertakings	**9,427**	10,550
Other taxation and social security	**179**	253
Other creditors	**985**	858
Accruals and deferred income	**1,078**	924
External interest payable	**6**	4
Finance lease liability (Note 19)	**2**	2
"A" Preference shares of £1 each - 259,000,000 (2016: 259,000,000)	**259**	259
	16,098	16,421

Preference shares

The Preference shares confer on the holder the right to receive a fixed dividend. Dividends accrue on the "A" Preference shares at a fixed rate of 6.08 per cent per annum of the nominal value of each "A" Preference share. As regards capital, on winding up the Company, the Preference shares shall be redeemed in priority to ordinary shares, together with any arrears of dividend.

The "A" Preference shares are redeemable at par value at any date after 22 May 2007 by service of a notice of redemption by the Company or the "A" Preference shareholders.

The right to receive dividends on the "A" Preference shares in the capital of the Company was waived in respect of the period.

18 CREDITORS – AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2017	2016
	£m	£m
Finance lease liability (Note 19)	**35**	38

19 OBLIGATIONS UNDER LEASES AND HIRE PURCHASE CONTRACTS

Obligations under finance leases

There are a small number of buildings which are held under finance leases. The fair value of the Company'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:

	2017	2016
	£m	£m
Future minimum lease payments due:		
Not later than one year	**4**	4
After one year but not more than five years	**18**	18
After five years	**37**	42
	59	64
Less finance charges allocated to future periods	**(22)**	(24)
Present value of minimum lease payments	**37**	40
The present value of minimum lease payments is analysed as follows:		
Not later than one year	**2**	2
After one year but not more than five years	**9**	9
After five years	**26**	29
	37	40

Operating lease agreements where the Company is lessee

Future minimum rentals payable under non-cancellable operating leases are as follows:

	Land and Buildings		**Other**	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Not later than one year	**802**	838	**35**	42
After one year but not more than five years	**2,974**	2,983	**83**	105
After five years	**6,232**	6,508	**10**	23
	10,008	10,329	**128**	170

The future minimum sublease payments expected to be received under non-cancellable sublease agreements as at 25 February 2017 is £110m (2016: £87m).

Operating lease payments represent rentals payable by the Company for certain of its retail, distribution and office properties and other assets, such as motor vehicles. The leases have an average duration of between 4 and 10 years and include purchase options, escalation clauses and renewal rights. Purchase options and renewal rights, where they occur, are at market value. Escalation clauses are in line with market practices and include inflation linked, fixed rates, resets to market rents and hybrids of these.

19 OBLIGATIONS UNDER LEASES AND HIRE PURCHASE CONTRACTS (continued)

Operating lease agreements where the Company is lessee (continued)

The Company has lease-break options on certain sale and leaseback transactions. These options are exercisable if either the Company or a subsidiary of its ultimate parent undertaking exercises an existing option to buy back, at market value and at a specified date, either the leased asset or the equity of the other joint venture partner. No commitment has been included in respect of the buy-back option as the option is discretionary. The Company is not obliged to pay lease rentals after that date, therefore minimum lease payments exclude those falling after the buy-back date. The current market value of these properties is £2,948m (2016: £3,160m) and the total lease rentals, if they were to be incurred following the option exercise date, would be £2,547m (2016: £2,636m) using current rent values. The lease break options are exercisable between 2016 and 2023.

Operating lease agreements where the Company is lessor

The Company both rents out its properties and also sublets various leased buildings under operating leases. At the Balance Sheet date, the following future minimum lease payments are contractually receivable from tenants:

	2017	2016
	£m	£m
Not later than one year	**27**	24
After one year but not more than five years	**73**	63
After five years	**96**	87
	196	174

20 DERIVATIVE FINANCIAL INSTRUMENTS

The fair values of derivative financial instruments have been disclosed in the Balance Sheet as follows:

	2017		2016	
	Asset	**Liability**	Asset	Liability
	£m	**£m**	£m	£m
Current	**57**	**(5)**	88	(53)
Non-current	**-**	**-**	-	(2)
	57	**(5)**	88	(55)

The fair value and notional amounts of derivatives analysed by hedge type are as follows:

	2017				2016			
	Asset		**Liability**		Asset		Liability	
	Fair Value	**Notional Value**	**Fair Value**	**Notional Value**	Fair Value	Notional Value	Fair Value	Notional Value
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Cash flow hedges								
Forward contracts	**51**	**425**	**(1)**	**12**	83	1,395	(18)	781
Derivatives not in a formal hedging arrangement								
Forward contracts	**6**	**243**	**(4)**	**142**	5	102	(37)	451
	57	**668**	**(5)**	**154**	88	1,497	(55)	1,232

20 DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Financial risk factors

The fair values of derivative financial instruments are measured using a discounted cash flow technique based on market data applied consistently for similar types of instruments.

Derivatives are used to hedge exposure to market risks. Derivatives may qualify as hedges for accounting purposes and the Company's hedging policies are further described below:

Cash flow hedges

The Company uses forward contracts to mainly hedge the foreign currency 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. Where these contracts qualify for hedge accounting, fair value gains and losses are deferred in equity. These hedging instruments are primarily used to hedge purchases in Euros and US Dollars. The cash flows hedges will occur and will affect the Profit and Loss account within one year of the Balance Sheet date.

Financial instruments not qualifying for hedge accounting

The Company's policy does not permit use of derivatives for trading purposes. However, some derivatives do not qualify for hedge accounting, or are specifically not designated as a hedge where gains and losses on the hedging instrument and the hedged item naturally offset in the Profit and Loss account.

Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the Profit and loss account within finance income or costs. The Company also uses forward contracts to hedge the future purchase of diesel. These are designated as cash flow hedges at Group level but for the Company they are not in a formal hedge relationship.

21 PROVISIONS FOR LIABILITIES

	Property provisions £m	Restructuring provisions £m	Other provisions £m	Total £m
At 27 February 2016				
Current	231	9	-	240
Non-current	491	-	-	491
	722	9	-	731
Amount provided in the period	224	106	92	422
Amount utilised in the period	(124)	(76)	-	(200)
Amount released in the period	(127)	(5)	-	(132)
Unwinding of discount	40	-	-	40
At 25 February 2017	**735**	**34**	**92**	**861**
Analysed as:				
Current	246	34	92	372
Non-current	489	-	-	489
	735	**34**	**92**	**861**

21 PROVISIONS FOR LIABILITIES (continued)

Property provisions

Property provisions comprise onerous lease provisions, including leases on unprofitable stores and vacant properties, and other onerous contacts related to property. These provisions are based on the least net cost of fulfilling or exiting the contract.

The calculation of the value in use of the leased property to the Company is based on the same assumptions for discount rates, growth rates and expected change in margins as those for owned properties, as discussed in detail in Note 12. The provision calculations also assume that the Company can sublet properties at market rents. For some leases, termination of the lease at the break clause requires the Company to either purchase the property or buy out the equity ownership of the property at fair value. No value is attributed to the purchase conditions since they are at fair value. It is also assumed that the Company is indifferent to purchasing the properties.

Based on the factors set out above, the Company has recognised a net property provision charge in the period of £97m (2016: £172m). Of this charge, £94m (2016: £156m) has been included within cost of sales and £3m (2016: £16m) has been included within profits arising on property-related items in the Profit and Loss account. Onerous lease provisions will be utilised over the lease terms, predominantly within the next 25 years.

Restructuring provisions

The net charge of £101m (£106m charge and £5m released) relates to ongoing changes to store colleague structures and working practices and has been recognised within cost of sales. This charge is expected to be utilised in the next financial period.

Other provisions

On 10 April 2017, the Tesco PLC Group (the "Group") announced that the Company had obtained Court approval and entered into a Deferred Prosecution Agreement (DPA) with the UK Serious Fraud Office regarding historic accounting practices. On 28 March 2017, the Group also announced that it had agreed with the UK Financial Conduct Authority (FCA) to a finding of market abuse in relation to the Tesco PLC trading statement announced on 29 August 2014. The DPA is a voluntary agreement under which neither the Company nor the Group will be prosecuted provided the business fulfils certain requirements including the payment of a financial penalty of £129m.

The Company has taken a total charge of £235m, in respect of the DPA, the expected costs of the compensation scheme as agreed with the FCA of £85m, and related costs. This has been recorded in the financial statements in the period to 25 February 2017 as an adjusting post Balance Sheet event. Of the £235m, £91m is included within other current provisions to cover the cost of the compensation scheme and related costs. The remaining £144m has been recorded within accruals.

22 SHARE BASED PAYMENTS

The Profit and Loss account charge for the period recognised in respect of share based payment is £240m (2016: £255m) which is made up of share option schemes and share bonus payments. Of this amount, £10m (2016: £245m) will be settled in equity and £230m (2016: £10m) in cash. The movement between cash and equity settled charge with reference to the prior period is predominantly due to a one-off award which was previously disclosed as equity-settled. During the period, colleagues were offered a choice of cash settlement, which resulted in a reclassification from equity to cash.

Share option schemes

The Company had seven share option schemes in operation during the financial period, all of which are equity-settled schemes:

a) The Savings-related Share Option Scheme (1981) permits the grant to colleagues 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 colleagues of an amount between £5 and £500 per four-weekly period. Options are capable of being exercised at the end of the three or five-year period at a subscription price of 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.

b) The Executive Incentive Plan (2004) was adopted on 5 July 2004. This scheme permitted the grant of options in respect of ordinary shares to selected senior executives. Options are normally exercisable between three and ten years from the date of grant for nil consideration. No further options will be granted under this scheme.

c) The Executive Incentive Plan (2014) was adopted on 10 February 2014. This scheme permits the grant of options in respect of ordinary shares to selected senior executives as a proportion of annual bonus following the completion of a required service period and is dependent on the achievement of corporate performance and individual targets. Options are normally exercisable between three and ten years from the date of grant for nil consideration.

d) The Performance Share Plan (2011) was adopted on 1 July 2011 and amended on 4 July 2011. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between the vesting date(s) set at grant and ten years from the date of grant for nil consideration. The vesting of options will normally be conditional upon the achievement of specified performance targets over a three-year period and/or continuous employment.

e) The Discretionary Share Option Plan (2004) was adopted on 5 July 2004. This scheme permitted 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 vesting of options will normally be conditional upon the achievement of a specified performance target related to the annual percentage growth in earnings per share over a three-year period. There were no discounted options granted under this scheme.

f) The Group Bonus Plan was adopted on 3 July 2009. This scheme was amended on 20 April 2015 to permit the grant of options in respect of ordinary shares to selected senior executives as a proportion of annual bonus following the completion of a required service period and is dependent on the achievement of corporate performance and individual targets. Options are normally exercisable between three and ten years from the date of grant for nil consideration.

g) The Long-Term Incentive Plan (2015) was adopted on 14 May 2015. This scheme permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between the vesting date(s) set at grant and ten years from the date of grant for nil consideration. The vesting of options will normally be conditional upon the achievement of specified performance targets over a three-year period and/or continuous employment.

22 SHARE BASED PAYMENTS (continued)

The following tables reconcile the number of share options outstanding and the weighted average exercise price ('WAEP'):

For the 52 weeks ended 25 February 2017

	Savings-related share option scheme		Approved share option scheme		Unapproved share option scheme		Nil cost option scheme	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 27 February 2016	254,124,204	173.32	5,661,537	407.19	29,429,531	387.09	15,723,718	-
Granted	30,985,176	190.00	-	-	-	-	8,938,230	-
Forfeited	(50,726,330)	205.10	(1,463,454)	361.29	(7,963,877)	360.37	(6,880,744)	-
Exercised	(774,524)	150.11			-	-	(689,442)	-
Outstanding at 25 February 2017	233,608,526	168.91	4,198,083	420.87	21,465,654	395.84	17,091,762	-
Exercisable as at 25 February 2017	10,077,474	339.47	4,198,083	420.87	21,465,654	395.84	1,267,719	-
Exercise price range (pence)		282.00 to 364.00		338.40 to 473.75		338.40 to 473.75		
Weighted average remaining contractual life (years)		0.43		1.10		1.45		7.71

For the 52 weeks ended 27 February 2016

	Savings-related share option scheme		Approved share option scheme		Unapproved share option scheme		Nil cost option scheme	
	Options	WAEP	Options	WAEP	Options	WAEP	Options	WAEP
Outstanding at 28 February 2015	260,091,775	191.11	6,620,644	400.03	36,045,381	380.72	8,903,538	-
Granted	67,156,272	151.00	-	-	-	-	11,081,431	-
Forfeited	(72,573,782)	218.82	(959,107)	354.25	(6,615,850)	364.62	(3,625,191)	-
Exercised	(550,061)	150.00	-	-	-	-	(636,060)	-
Outstanding at 27 February 2016	254,124,204	173.32	5,661,537	407.19	29,429,531	387.09	15,723,718	-
Exercisable as at 27 February 2016	12,590,796	329.78	5,661,537	407.19	29,429,531	387.09	947,338	-
Exercise price range (pence)		282.00 to 386.00		318.60 to 473.75		318.60 to 473.75		-
Weighted average remaining contractual life (years)		0.42		1.84		2.18		7.80

Share options were exercised on a regular basis throughout the financial period. The average share price during the financial period ended 25 February 2017 was 184.26p (2016: 196.55p).

The fair value of share options is estimated at the date of grant using the Black-Scholes or Monte Carlo 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.

22 SHARE BASED PAYMENTS (continued)

	2017	2017	2016	2016
	SAYE	Nil cost	SAYE	Nil cost
Expected dividend yield (%)	1.40%	-	1.3%	-
Expected volatility (%)	29-32%	29-36%	25-26%	23-25%
Risk-free interest rate (%)	0.4%-0.7%	0.2-0.5%	0.9-1.3%	0.6-1.6%
Expected life of option (years)	3 or 5	3-6	3 or 5	3 or 6
Weighted average fair value of options granted (pence)	53.14	61.00 to 159.64	52.58	129.90 to 221.20
Probability of forfeiture (%)	10-11%	-	9-11%	-
Share price (pence)	211.00	159.04 to 196.84	188.50	207.40 to 228.01
Weighted average exercise price (pence)	190.00	-	151.00	-

Volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in the 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 Tesco PLC's share price, the Tesco PLC Board considers 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.

Share bonus schemes

Selected executives participate in the Group Bonus Plan, a performance-related bonus scheme. The amount paid to colleagues is based on a percentage of salary and is paid partly in cash and partly in shares. Bonuses are awarded to selected executives who have completed a required service period and depend on the achievement of corporate and individual performance targets.

Selected executives participate in the Performance Share Plan (2011) and the Long-Term Incentive Plan (2015). Awards made under these plans will normally vest on the vesting date(s) set on the date of the award for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets over a three-year performance period and/or continuous employment.

Eligible UK colleagues are able to participate in Shares In Success, an all-employee profit-sharing scheme. Until May 2015, shares were awarded as a percentage of earnings, up to a statutory maximum permitted under the Share Incentive Plan at the time of the award. Shares awarded through Shares In Success are held in trust on behalf of employees for a period of at least three years.

The Executive Directors participate in short-term and long-term bonus schemes designed to align their interests with those of shareholders.

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 financial period were:

	2017		2016	
	Shares number	WAFV (pence)	Shares number	WAFV (pence)
Shares in Success	-	-	14,296,968	221.79
Group Bonus Plan	21,334,123	159.04	3,453,981	215.65
Performance Share Plan	49,656,728	162.06	18,368,111	213.43
Long Term Incentive Plan	-	-	529,292	216.35

23 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS

Pensions

The Company operates a funded defined benefit scheme (now closed to future accrual) and a funded defined contribution scheme. Both schemes are in place for employees in the United Kingdom.

Defined contribution plans

A defined contribution scheme, Tesco Retirement Savings Plan, was opened on 22 November 2015 and is open to all Tesco employees in the UK.

A defined contribution pension scheme is one under which members pay contributions to an independently administered fund, into which the Company also pays contributions based upon a fixed percentage of the members' contributions. The Company has no legal or constructive obligation to pay further contributions to this fund once its initial contributions have been paid. Members' benefits upon retirement are then determined by the amount of contributions paid into the fund, together with the performance of the investments into which those contributions have been invested. Members are able to choose the investments into which their contributions are invested, as well as how they wish to receive benefits upon retirement. As a result, any risks associated with either the future value of benefits or the performance of the assets invested lie with the member.

The contributions payable to defined contribution schemes of £275m (2016: £136m) have been recognised in the Profit and Loss account. This includes £114m (2016: £38m) of salaries paid as pension contributions.

Defined benefit plans

The principal plan operated by the Company is the Tesco PLC Pension Scheme (the "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 the Trustee.

The Scheme is established under trust law and has a corporate trustee that is required to run the Scheme in accordance with the Scheme's Trust Deed and Rules and to comply with the Pension Scheme Act 1993, Pensions Act 1995, Pensions Act 2004, Pensions Act 2014 and all the relevant legislation. Responsibility for governance of the Scheme lies with the Trustee. The Trustee is a company whose directors comprise of:

i) Representatives of the Tesco Group; and
ii) Representatives of the Scheme participants, in accordance with its articles of association and UK pension law.

Willis Towers Watson Limited (formerly Towers Watson Limited), an independent actuary, carried out the latest triennial actuarial assessment of the Scheme as at 31 March 2014, using the projected unit credit method. At 31 March 2014, the actuarial deficit was £2,751m. The market value of the Scheme's assets was £8,020m and these assets represented 75% of the benefits that had accrued to members, after allowing for expected increases in earnings and pensions in payment.

The next triennial actuarial valuation is effective as at 31 March 2017 and work is already underway. The Trustee is aiming to conclude the valuation as soon as is reasonably possible.

The Scheme has a duration of 27 years.

23 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (continued)

Closure to future accrual and new members

The Career Average section of the Scheme ('Pension Builder') was closed to new members and future accrual on 21 November 2015. The Final Salary section of the Scheme, which was closed to new entrants in 2001, was also closed to future accrual on 21 November 2015. As a result of this closure, a one off past service credit of £538m and other associated costs of £54m were recognised as one-off items in the prior period.

Scheme Liabilities as at 31 March 2014

The table below shows a breakdown of the liabilities held by the Scheme as at 31 March 2014, the date of the last triennial valuation. As at 25 February 2017, none of the liabilities relate to active members, as the Scheme had closed to future accrual on 21 November 2015.

	%
Active	55
Deferred	21
Pensioner	24

The table below shows a breakdown of the liabilities for active members held by the Scheme as at 31 March 2014:

	%
Pension	57
Final Salary	43

Principal Assumptions

The major assumptions, on a weighted average basis, used by the actuaries to value the defined benefit obligation as at 25 February 2017 were as follows:

	2017	2016
	%	%
Discount rate	**2.5**	3.8
Price inflation	**3.2**	2.9
Rate of increase in deferred pensions*	**2.2**	1.9
Rate of increase in pensions in payment*		
Benefits accrued before 1 June 2012	**3.0**	2.7
Benefits accrued after 1 June 2012	**2.2**	1.9

*In excess of any Guaranteed Minimum Pension ('GMP') element.

23 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (continued)

Mortality assumptions

The Company conducts analysis of mortality trends under the Tesco PLC Pension Scheme in the UK as part of the triennial actuarial valuation of the Scheme. At the latest triennial actuarial valuation as at 31 March 2014 the following assumptions were adopted for funding purposes:

Base tables:

95% of the SAPS S2 normal male pensioners for male staff and 80% of SAPS S2 normal light male pensioners for male senior managers.
100% of the SAPS S2 all female pensioners for female staff and 80% of SAPS S2 all female pensioners for female senior managers.

These assumptions were used for the calculation of the pension liability as at 25 February 2017 for the Scheme.

The mortality assumptions used are based on tables that have been projected to 2014 with CMI 2013 improvements. In addition, the allowance for future mortality improvements from 2014 is in line with CMI 2013 improvements with a long term improvement rate of 1.25% per annum.

The following table illustrates the expectation of life of an average member retiring at age 65 at the reporting date and a member reaching age 65 at the reporting date +25 years:

		2017 Years	2016 Years
Retiring at reporting date at age 65:	Male	**23.2**	23.1
	Female	**24.5**	24.5
Retiring at reporting date +25 years at age 65:	Male	**25.5**	25.4
	Female	**26.9**	26.8

Risks

The Company bears a numbers of risks in relation to the Scheme, which are described below:

Investment risk - The Scheme's accounting liabilities are calculated using a discount rate set with reference to corporate bond yields. If the return on the Scheme's assets underperform this rate, the accounting deficit will increase. The Trustee and the Company regularly monitor the funding position and operate a diversified investment strategy.

Inflation risk - The Scheme's benefit obligations are linked to inflation therefore higher inflation will lead to higher liabilities. This will be partially offset by an increase in any Scheme assets that are linked to, or correlate with, inflation. Changes to future benefits were introduced in June 2012 to reduce the Scheme's exposure to inflation risk by changing the basis for calculating the rate of increase in pensions to CPI (previously RPI).

Changes in bond yields - A decrease in corporate bond yields will increase the Scheme's liabilities. However, this may be partially offset by an increase in the capital value of the Scheme's assets that have similar characteristics.

23 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (continued)

Risks (continued)

Life expectancy risk - The Scheme's obligations are to provide benefits for the life of the member and so increases in life expectancy will lead to higher liabilities. To reduce this risk, changes to future benefits were introduced in June 2012 to increase the age at which members can take their full pension by two years.

The Operations & Audit Pensions Committee (formerly the Audit & Risk Pensions Committee) was established to further strengthen the Company's Trustee Governance and provide greater oversight and stronger internal control over the Company's risks. Further mitigation of the risks is provided by external advisors and the Trustee who consider the funding position, fund performance, and impacts of any regulatory changes.

A different approach is used to calculate the triennial actuarial liabilities and the accounting liabilities. The key difference is that the accounting valuation requires the discount rate to be set using corporate bonds whilst the actuarial liabilities discount rate is based on expected returns of Scheme assets.

Sensitivity analysis of significant actuarial assumptions

	2017 £m	2016 £m
Change in defined benefit obligation from a 0.1% increase in discount rate	**526**	312
Decrease in UK defined benefit obligation from a 1.0% increase in discount rate	**4,536**	2,691
Increase in UK defined benefit obligation from a 0.1% decrease in discount rate	**545**	315
Increase in UK defined benefit obligation from a 1.0% decrease in discount rate	**6,541**	3,754
Increase in defined benefit obligation from a 1.0% increase in pensions in payment	**3,173**	1,797
Increase in defined benefit obligation from each additional year of longevity assumed	**818**	439

The method and assumptions used to determine sensitivity and their limitation is the effect of varying the assumption whilst holding all other assumptions constant.

TESCO STORES LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE 52 WEEKS ENDED 25 FEBRUARY 2017 (continued)

23 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (continued)

Plan Assets

The table below shows a breakdown of the combined investments held by the Scheme:

	2017 £m	2016 £m
Equities		
UK	**365**	386
Europe	**604**	892
Rest of the World	**3,800**	3,861
	4,769	5,139
Bonds		
Government	**4,689**	1,868
Corporates - Investment grade	**501**	338
Corporates - Non-investment grade	**-**	6
	5,190	2,212
Property		
UK	**787**	701
Rest of the World	**366**	317
	1,153	1,018
Alternative Assets		
Hedge Funds	**489**	650
Private Equity	**707**	640
Other	**540**	192
	1,736	1,482
Cash	**142**	278
Total Market Value of Assets	**12,990**	10,129

The Scheme uses financial instruments to balance the asset allocation and to manage inflation risk, interest rate risk, liquidity risk and foreign currency risk. The analysis of investments on the previous page are shown net of such instruments.

The Government Bonds category consists of assets of the value of £6,526m (2016: £2,836m) and associated repurchase agreements and swaps of £(1,837)m (2016: £(968)m). The repurchase agreements and swaps serve to help the Scheme reduce exposure to fluctuations in interest rate risk and inflation risk.

At the period end, 75% (2016: 75%) of investments were quoted on a recognised stock exchange or held in cash or assets readily convertible to cash and are therefore considered to be liquid.

The plan assets include £176m (2016: £171m) relating to property used by the Tesco Group. In addition, Group property with net carrying value of £411m (2016: £412m) has been held as security in favour of the Scheme.

Movement in pension deficit during the financial period

Changes in the fair value of defined benefit pension assets are as follows:

	2017 £m	2016 £m
Opening fair value of defined benefit pension assets	**10,129**	9,394
Interest income	**381**	356
Return on plan assets greater than discount rate	**2,675**	66
Contributions by Tesco Stores Limited*	**22**	369
Contributions by other participating employers*	**-**	37
Additional contribution by employer	**248**	222
Actual member contributions	**-**	9
Benefits paid	**(465)**	(324)
Closing fair value of defined benefit pension assets	**12,990**	10,129

* Contributions by employer include £nil (2016: £125m) of salaries paid as pension contributions.

23 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (continued)

Movement in pension deficit during the financial period (continued)
Changes in the present value of defined benefit pension obligations are as follows:

	2017 £m	2016 £m
Opening defined benefit pension obligation	**(13,137)**	(14,000)
Current service cost	**(22)**	(541)
Past service credit	-	538
Interest cost	**(490)**	(507)
(Losses)/gains on change of financial assumptions	**(6,513)**	969
Experience gains	**215**	89
Benefits paid	**465**	324
Actual member contributions	-	(9)
Closing defined benefit pension obligation	**(19,482)**	(13,137)

The amounts that have been charged to the Profit and Loss account and the Statement of Comprehensive Income for the period ended 25 February 2017 are set out below:

	2017 £m	2016 £m
Analysis of the amount charged to operating profit:		
Current service cost	**(22)**	(541)
Past service credit	-	538
Contributions by other participating employers	-	37
Total (charge)/credit to operating profit	**(22)**	34
Analysis of the amount credited/(charged) to finance income/(cost):		
Interest on defined benefit pension assets	**381**	356
Interest on defined benefit pension obligation	**(490)**	(507)
Net pension finance cost (Note 8)	**(109)**	(151)
Total charge to the Profit and Loss account	**(131)**	(117)
Analysis of the amount recognised in the Statement of Comprehensive Income:		
Return on plan assets greater than discount rate	**2,675**	66
Experience gains on defined benefit pension obligation	**215**	89
Demographic assumption losses on defined benefit pension obligation	**(6,513)**	-
Financial assumption gains on defined benefit pension obligation	-	969
Total (losses)/gains recognised in the Statement of Comprehensive Income	**(3,623)**	1,124

Summary of movements in deficit during the financial period
Changes in the deficit are as follows:

	2017 £m	2016 £m
Deficit in the Scheme at beginning of the period	**(3,008)**	(4,606)
Current service cost	**(22)**	(541)
Past service credit	-	538
Net pension finance cost	**(109)**	(151)
Contributions by employers*	**22**	406
Additional contribution by employer	**248**	222
Remeasurements	**(3,623)**	1,124
Deficit in the Scheme at the end of the period	**(6,492)**	(3,008)
Deferred tax asset (Note 9)	**1,104**	541
Deficit in the Scheme at the end of the period, net of deferred tax	**(5,388)**	(2,467)

* Contributions by employer include £nil (2016: £125m) of salaries paid as pension contributions.

23 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (continued)

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 2017 of £13m (2016: £11m) was determined in accordance with the advice of independent actuaries. During the period, £nil (2016: £nil) has been charged to the Profit and Loss account and £1m (2016: £1m) of benefits were paid.

Additional contributions

A plan to pay £270m a year was agreed with the Trustee to fund the UK pension deficit and to meet the expenses of the Scheme. The expenses of the Scheme were £22m (2016: £27m).

24 RELATED PARTY TRANSACTIONS

During the period the Company entered into transactions, in the ordinary course of business, with other related parties. The Company has taken advantage of the exemption under paragraph 8(k) of FRS 101 not to disclose transactions with fellow wholly owned subsidiaries within the Group. Transactions entered into with other related parties in the Group which are not wholly owned subsidiaries, are as follows:

	2017	2016
	£m	£m
Sales to related parties	**386**	340
Purchases from related parties	**398**	484

Transactions between the Company and the Company's pension plans are disclosed in Note 23.

25 ULTIMATE GROUP UNDERTAKING

The Company's immediate parent undertaking is Tesco Holdings Limited. The Company's ultimate parent undertaking and controlling party is Tesco PLC, which is registered in England and Wales, and which is the parent undertaking of the smallest and largest group to consolidate these financial statements.

Copies of the Tesco PLC financial statements can be obtained from the Company Secretary, Tesco PLC, Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, AL7 1GA, United Kingdom.

26 CALLED UP SHARE CAPITAL

Allotted, called up and fully paid:	**2017**	2016
	£m	£m
1,320,006,000 Ordinary shares of £1 each (2016: 1,320,006,000)	**1,320**	1,320
5,000,000 "B" Irredeemable preference shares of £1 each (2016: 5,000,000)	**5**	5
	1,325	1,325

26 CALLED UP SHARE CAPITAL (continued)

The Preference shares confer on the holder the right to receive a fixed dividend. Dividends for the "B" Preference shares are calculated based on the pre-determined formula of the Reference Gilt Rate plus 1.279% multiplied by the RPI ratio applicable to the month in which the dividend payment falls. As regards capital, on winding up the Company, the Preference shares shall be redeemed in priority to ordinary shares, together with any arrears of dividend.

The "B" Preference shares are irredeemable.

The right to receive dividends on the "B" Preference Shares in the capital of the Company was waived in respect of the period.

27 CAPITAL COMMITMENTS

At 25 February 2017 there were commitments for capital expenditure contracted for but not provided of approximately £77m (2016: £151m), principally related to store development.

28 CONTINGENT LIABILITIES

A number of contingent liabilities can arise in the normal course of business. The Company recognises provisions for liabilities when it is more likely than not a settlement will be required and the value of such a payment can be reliably estimated.

The Company has provided a fixed charge over a portfolio of several properties with a net carrying value of up to £411m in favour of the Tesco PLC Pension Scheme in the event of the Company defaulting on its obligations to the Scheme.

The Company is a guarantor to £4,427m of committed facilities consisting of a revolving credit facility and bilateral lines. The Company is a guarantor to these facilities alongside Tesco PLC. As at 25 February 2017, these facilities remain undrawn.

The Company has guaranteed the rental payments of certain Group undertakings relating to a portfolio of retail stores, distribution centres and mixed use retail developments.

Law firms in the UK have announced the intention of forming claimant groups to commence litigation against the Group for matters arising out of or in connection with the overstatement of expected profits in the Tesco PLC trading statement announced in August 2014, and purport to have secured third party funding for such litigation. In this regard, the Group has received two High Court claims against Tesco PLC. The first was received on 31 October 2016 from a group of 112 investors and the second was received on 5 December 2016 from an investment company and a trust company. The merit, likely outcome and potential impact on the Group and the Company of any such litigation that either has been or might potentially be brought against the Group is subject to a number of significant uncertainties and therefore, the Group and the Company cannot make any assessment of the likely outcome or quantum of any such litigation as at the date of this disclosure.

29 EVENTS AFTER THE REPORTING PERIOD

On 10 April 2017, the Company had obtained Court approval and entered into a Deferred Prosecution Agreement (DPA) with the UK Serious Fraud Office regarding historic accounting practices. The Company has taken a total charge of £235m in respect of the DPA, expected costs of the compensation scheme as agreed with the FCA of £85m, and related costs. Of this, the Company settled the financial penalty of £129m due under the DPA shown as a provision for liability in the Balance Sheet on page 13 on 9 May 2017. Further details are set out in Note 21 of these financial statements.

On 21 June 2017 the Group announced its intention to simplify customer service operations by consolidating the Customer Engagement Centre in Cardiff into a single operation in Dundee. This is proposed to take place in February 2018. Additionally on 28 June 2017 the Group announced planned changes which form part of a new Service Model as a significant next step to continue the turnaround of the business. Both of these events are non-adjusting post Balance Sheet events. A reasonable estimate of their financial effect cannot be made as at the date of this disclosure.

519500

THE TESCO RED LIMITED PARTNERSHIP

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

Registered Number: LP011522

THE TESCO RED LIMITED PARTNERSHIP

STRATEGIC REPORT FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

The Partners present their Strategic Report of The Tesco Red Limited Partnership ("the Partnership") for the 52 weeks ended 31 December 2016 (prior period ended 31 December 2015).

Business review and principal activities

The principal activity of the Partnership is to carry out property investment in 16 retail stores to Tesco Stores Limited for which a rental income is received. There has been no significant change in the nature or level of this activity during the period and the General Partner does not expect this to change significantly throughout the next financial period.

The financial statements of the Partnership have been prepared in accordance with FRS 102.

The results for the period show a pre-tax loss of £27,024,808 (2015: pre-tax profit of £10,105,594) and rental income of £31,085,295 (2015: £30,728,368). During the period the Partnership distributed £2,861,084 (2015: £9,625,886).

On 17th June 2016, the Directors of Tesco Red (1LP) Limited placed the Company into Voluntary Liquidation. The Partners' investment in The Tesco Red Limited Partnership was transferred over to Tesco Red (3LP) Limited, a newly incorporated Company, registered in the United Kingdom.

Principal risks and uncertainties

From the perspective of the partnership, the principal risks and uncertainties are integrated with the principal risks of the Tesco PLC Group (the "Group") and are not managed separately. Accordingly, the principal risks and uncertainties of the Group, which include the Partnership, are discussed on page 26 to 30 of the Tesco PLC Annual Report 2017 which does not form part of this Report.

Business Risk

On 29 March 2017, the United Kingdom government invoked Article 50, initiating the process of the United Kingdom leaving the European Union within two years. This could cause disruptions and uncertainties which could have an adverse effect on our property business, financial results and operations.

Key performance indicators

Given the straightforward nature of the business, the General Partner is of the opinion that analysis using key performance indicators is not necessary for an understanding of the development, performance or position of the business.

On behalf of the General Partner 15 August 2017.

R Welch, Director
For and on behalf of the General Partner
Tesco Red (GP) Limited
Registered Number: 05721630
Registered Office: Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, AL7 1GA

THE TESCO RED LIMITED PARTNERSHIP

GENERAL PARTNER'S REPORT FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

Tesco Red (GP) Limited (the "General Partner") presents its report and the audited financial statements of The Tesco Red Limited Partnership (the "Partnership") for the period ended 31 December 2016 (prior period ended 31 December 2015). During the period, Tesco Red (GP) Limited acted as the General Partner and Tesco Red Unit Trust and Tesco Red (3LP) Limited acted as limited partners of the Partnership.

Tesco Red (GP) Limited is owned by Tesco Property Holdings (No.2) Limited, Tesco Red (3LP) Limited is owned by Tesco Property Holdings Limited and Tesco Red Unit Trust was owned by Tesco Property Holdings Limited and Tesco Property Holdings (No.2) Limited.

The Partnership was originally constituted under an Initial Partnership Agreement, which was then superseded by the fifth amended and restated Limited Partnership Deed (the "Limited Partnership Deed") on 20 August 2009.

Political donations

There were no political donations for the period (2015: £nil).

Future developments

The Partnership's performance is expected to continue throughout the next financial period and it is anticipated that the current performance levels will be maintained.

Going concern

In order to form a view as to the most appropriate basis of preparation of these financial statements, the General Partner has assessed the likelihood of whether the Limited Partnership will be able to continue trading over the foreseeable future versus the likelihood of either intending to or being forced to either cease trading or putting the Limited Partnership into liquidation. The ability of the Company to meet its obligations on the loans and to meet its operating and administrative expenses is dependent on the extent that it receives the amounts due from its sole customer, Tesco PLC and its ability to discharge its obligations under the Property Portfolio leases.

The Partnership had an external loan with Deutsche Bank with the total value of the loan being £382,400,000 which was repaid in January 2017. In January 2017, the £382,400,000 loan from Deutsche Bank was repaid utilising funds provided by Tesco Corporate Treasury Services PLC, a 100% owned-subsidiary of Tesco PLC. The loan of £382,400,000 from Tesco Corporate Treasury Services PLC to the Partnership is repayable in January 2019.

Tesco PLC and the Tesco Red Unit Trust have also confirmed that they will not recall their loans that are due in January 2017 of £35,737,846 and £32,905,000 respectively within a period of 12 months from the date of signing these financial statements.

Having assessed the Partnership's future expected cash flows, the General Partner believes that the Limited Partnership can continue to support itself. The General Partner has therefore prepared the financial statements on a going concern basis. The going concern basis has been adopted based on the expectation that it is not the current intention of the Tesco PLC and its subsidiaries to withdraw funding.

Research and development

The Partnership does not undertake any research and development activities (2015: none).

Employees

The Partnership had no employees during the period (2015: none).

Partners

The partners, including the General Partner, Tesco Red (GP) Limited, are set out in Note 11 of the financial statements.

Auditor

Deloitte LLP have been deemed re-appointed under section 487 of the Companies Act 2006.

Statement of General Partner's responsibilities in respect of the financial statements

The General Partner is responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

The Companies Act 2006 as applied to qualifying Partnerships by the Partnerships (Accounts) Regulations 2008 (the "Regulations") requires the Partnership to prepare financial statements for each financial period. Under that law the General Partner has prepared the Partnership financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'. The financial statements are required by law to give a true and fair view of the state of affairs of the Partnership and of the profit or loss of the Partnership for that period. In preparing these financial statements, the General Partner is required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Partnership will continue in business.

The General Partner is responsible for keeping adequate accounting records that disclose with reasonable accuracy at any time the financial position of the Partnership and enable them to ensure that the financial statements comply with the Companies Act 2006, as applicable to limited liability partnerships. They are also responsible for safeguarding the assets of the Partnership and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of information to auditor

At the date of approval of this report, the General Partner confirms that:

- so far as the General Partner is aware, there is no relevant information of which the Partnership's auditor is unaware; and
- the General Partner has taken all the steps that ought to have been taken as a general partner to be aware of any relevant audit information and to establish that the Partnership's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006. The financial statements have been prepared in accordance with part 14 of the Limited Partnership Deed and part 15 of the Companies Act 2006 as required under the Regulations.

On behalf of the General Partner 15 August 2017.

R Welch, Director
For and on behalf of the General Partner
Tesco Red (GP) Limited
Registered Number: 05721630
Registered Office: Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, United Kingdom, AL7 1GA

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE TESCO RED LIMITED PARTNERSHIP

We have audited the financial statements of the Tesco Red Limited Partnership for the period ended 31 December 2016 which comprise the Profit and Loss Account, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Partners' Interests, the Cash Flow Statement, Reconciliation of Net Cash Flow to Movement in Net Debt and the related notes 1 to 17. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".

This report is made solely to the qualifying partnership's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 as applied to qualifying partnerships by The Partnerships (Accounts) Regulations 2008. Our audit work has been undertaken so that we might state to the qualifying partnership's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the qualifying partnership and the qualifying partnership's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the General Partner and auditor
As explained more fully in the General Partner's Responsibilities Statement, the General Partner is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the qualifying partnership's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the General Partner; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view of the state of the qualifying partnership's affairs as at 31 December 2016 and of its loss for the period then ended;
- have been properly prepared in accordance with United Kingdom Generally Accounting Standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006 as applied to qualifying partnerships.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the General Partner's Report for the financial period for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the General Partner's Report have been prepared in accordance with applicable legal requirements..

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the General Partner's Report.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE TESCO RED LIMITED PARTNERSHIP

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 as applied to qualifying partnerships requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of the General Partner's remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Simon Letts

Simon Letts FCA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
St Albans, UK

15 August 2017

THE TESCO RED LIMITED PARTNERSHIP

PROFIT AND LOSS ACCOUNT FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

	Notes	52 weeks to 31 December 2016 £	52 weeks to 31 December 2015 £
Rental income		**31,085,295**	30,728,368
Administrative expenses		**(59,396)**	(159,174)
(Loss)/gain on revaluation of investment properties	7	**(37,130,000)**	400,000
Operating (loss)/profit	3	**(6,104,101)**	30,969,194
Interest receivable and similar income	4	**12,472**	12,432
Interest payable and similar charges	5	**(20,933,179)**	(20,876,032)
(Loss)/profit before taxation		**(27,024,808)**	10,105,594
Tax on (loss)/profit	6	**-**	-
(Loss)/profit for the financial period		**(27,024,808)**	10,105,594

STATEMENT OF COMPREHENSIVE INCOME FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

	52 weeks to 31 December 2016 £	52 weeks to 31 December 2015 £
(Loss)/profit for the period	**(27,024,808)**	10,105,594
Other comprehensive income	**-**	-
Total comprehensive (loss)/income for the period	**(27,024,808)**	10,105,594

There are no material differences between the profit before taxation and the profit for the financial period stated above and their historical cost equivalents.

All operations are continuing for the financial period.

The notes on pages 10 to 16 form part of these financial statements.

THE TESCO RED LIMITED PARTNERSHIP

BALANCE SHEET AS AT 31 DECEMBER 2016

	Notes	31 December 2016 £	31 December 2015 £
Fixed assets			
Investment properties	7	**560,440,000**	597,570,000
Current assets			
Debtors: Amounts falling due within one year	8	**6,001**	-
Cash at bank and in hand		**18,730,980**	11,318,569
		18,736,981	11,318,569
Creditors: Amounts falling due within one year	9	**(464,031,779)**	(81,546,439)
Net current liabilities		**(445,294,798)**	(70,227,870)
Total assets less current liabilities		**115,145,202**	527,342,130
Creditors: Amounts falling due after more than one year	10	**-**	(382,311,036)
Net assets		**115,145,202**	145,031,094
Partners' interest			
Partners' capital accounts	11	**23,996,116**	23,996,116
Profit and loss reserve	11	**91,149,086**	121,034,978
Partners' interest		**115,145,202**	145,031,094

The financial statements on pages 6 to 16 were approved by the General Partner and authorised for issue on 15 August 2017. They were signed on its behalf by:

R Welch, Director
For and on behalf of the General Partner
Tesco Red (GP) Limited
Registered Number: 05721630
Registered Office: Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, United Kingdom, AL7 1GA

THE TESCO RED LIMITED PARTNERSHIP

STATEMENT OF CHANGES IN PARTNERS' INTERESTS FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

	Partners' capital accounts	Profit and loss reserve	Total
	£	£	£
Balance as at 1 January 2015	**23,996,116**	**120,555,270**	**144,551,386**
Total comprehensive income for the period	-	10,105,594	10,105,594
Distributions	-	(9,625,886)	(9,625,886)
Balance as at 31 December 2015	**23,996,116**	**121,034,978**	**145,031,094**
Total comprehensive income for the period	-	(27,024,808)	(27,024,808)
Distributions	-	(2,861,084)	(2,861,084)
Balance as at 31 December 2016	**23,996,116**	**91,149,086**	**115,145,202**

The notes on pages 10 to 16 form part of these financial statements.

CASH FLOW STATEMENT FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

	Note	**52 weeks to 31 December 2016 £**	52 weeks to 31 December 2015 £
Net cash inflow from operating activities	12	**31,105,238**	30,658,845
Returns on investments and servicing of finance			
Interest paid		**(20,844,215)**	(20,787,265)
Interest received		**12,472**	12,432
Cash flow from financing activities			
Partner distribution		**(2,861,084)**	(9,625,886)
Increase in cash and cash equivalents		**7,412,411**	258,126
Cash and cash equivalents at the start of the period		**11,318,569**	11,060,443
Cash and cash equivalents at the end of the period		**18,730,980**	11,318,569

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	Note	**52 weeks to 31 December 2016 £**	52 weeks to 31 December 2015 £
Increase in cash		**7,412,411**	258,126
Reduction in net debt		**7,412,411**	258,126
Opening net debt		**(439,724,277)**	(439,982,403)
Closing net debt	13	**(432,311,866)**	(439,724,277)

NOTES TO THE FINANCIAL STATEMENTS FOR THE 52 WEEKS ENDED 31 DECEMBER 2016

1. ORGANISATION AND CONTROL

The Partnership was established on 14 August 2006 and is registered as a Limited Partnership in England and Wales under the Limited Partnership Act 1907. The Partnership was originally constituted under the Initial Partnership Agreement, which was then superseded by the Limited Partnership Deed on the 20 August 2009. The Partnership is limited by Partners' capital.

The address of the registered office of the Partnership is Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, United Kingdom, AL7 1GA and its principal activities are set out in the Strategic Report on page 1.

The functional currency of the Partnership is considered to be pounds sterling because that is the currency of the primary economic environment in which the Partnership operates.

2. ACCOUNTING POLICIES

Basis of preparation of financial statements

The financial statements of The Red Limited Partnership have been prepared in accordance with FRS 102 (the Financial Reporting Standards applicable in the United Kingdom and the Republic of Ireland) in accordance with the Companies Act 2006 (and as required by the amended and restated Limited Partnership Agreement). They have been prepared under the historical cost convention, as modified by the revaluation of certain investment properties, financial assets and liabilities at fair value through profit and loss.

The Partnership also elected to adopt the fair value model for holding its Investment Property, as permitted under Section 16 of FRS 102. The fair value of the assets as at the date of transition has been adopted as the deemed cost of the assets on transfer, as permitted under Section 35, paragraph 10 of FRS 102.

Investment properties

The Partnership carries its investment property at fair value, with changes in fair value being recognised in profit or loss. The Partnership engaged independent valuation specialists to determine fair value at 31 December 2016.

The valuation is undertaken on a fair value basis. The determined fair value of the investment property is most sensitive to the estimated yield as well as the long-term vacancy rate. The key assumptions used to determine the fair value of investment property are further explained in Note 7.

No amortisation or depreciation is provided in respect of freehold or long leasehold properties. The departure from the requirements of the Companies Act 2006, which requires all properties to be depreciated, is, in the opinion of the General Partner, necessary to show a true and fair view. The financial effect of this departure cannot be reasonably quantified, as amortisation or depreciation is only one of the many factors reflected in the annual valuation and the amount which might otherwise have been shown cannot be separately identified or quantified.

Leases and rental income

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 properties owned by the Partnership are being leased out under operating leases. Rental income is recognised in the Profit and Loss Account when earned, with rent received in advance being deferred on the balance sheet.

The leases are subject to annual uplifts which are linked to the Retail Price Index (RPI), subject to a minimum annual increase of nil and a maximum annual increase of 5% until 2016 and 4% thereafter.

Impairment of fixed assets

At each Balance Sheet date, the Partnership reviews the carrying amounts of the fixed assets to determine whether there is any need for impairment in accordance with Section 27 of FRS 102. Any impairment is recognised in the Profit and Loss account in the period in which it occurs.

2. ACCOUNTING POLICIES (continued)

Critical accounting judgements and key sources of estimation uncertainty

In the application of the Partnership's accounting policies, which are described in this note, the General Partner is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. 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.

For investment properties, determining the value requires an estimation of expected open-market rental income as well as an expected yield to calculate its fair value.

Financial instruments

Financial assets and financial liabilities are recognised when the Partnership becomes a party to the contractual provisions of the instrument.

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

(i) Financial assets and liabilities
All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value (which is normally the transaction price excluding transaction costs), unless the arrangement constitutes a financing transaction. If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Financial assets and liabilities are only offset in the statement of financial position when, and only when there exists a legally enforceable right to set off the recognised amounts and the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Debt instruments which meet the following conditions are subsequently measured at amortised cost using the effective interest method:

(a) The contractual return to the holder is (i) a fixed amount; (ii) a positive fixed rate or a positive variable rate; or (iii) a combination of a positive or a negative fixed rate and a positive variable rate.

(b) The contract may provide for repayments of the principal or the return to the holder (but not both) to be linked to a single relevant observable index of general price inflation of the currency in which the debt instrument is denominated, provided such links are not leveraged.

(c) The contract may provide for a determinable variation of the return to the holder during the life of the instrument, provided that (i) the new rate satisfies condition (a) and the variation is not contingent on future events other than (1) a change of a contractual variable rate; (2) to protect the holder against credit deterioration of the issuer; (3) changes in levies applied by a central bank or arising from changes in relevant taxation or law; or (ii) the new rate is a market rate of interest and satisfies condition (a).

(d) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods.

(e) Contractual provisions that permit the issuer to prepay a debt instrument or permit the holder to put it back to the issuer before maturity are not contingent on future events, other than to protect the holder against the credit deterioration of the issuer or a change in control of the issuer, or to protect the holder or issuer against changes in levies applied by a central bank or arising from changes in relevant taxation or law.

2. ACCOUNTING POLICIES (continued)

Financial instruments (continued)

(f) Contractual provisions may permit the extension of the term of the debt instrument, provided that the return to the holder and any other contractual provisions applicable during the extended term satisfy the conditions of paragraphs (a) to (c).

Debt instruments that have no stated interest rate (and do not constitute a financing transaction) and are classified as payable or receivable within one year are initially measured at an undiscounted amount of the cash or other consideration expected to be paid or received, net of impairment.

With the exception of some hedging instruments, other debt instruments not meeting these conditions are measured at fair value through profit or loss.

Commitments to make and receive loans which meet the conditions mentioned above are measured at cost (which may be nil) less impairment.

Financial assets are derecognised when and only when (a) the contractual rights to the cash flows from the financial asset expire or are settled; (b) the Group transfers to another party substantially all of the risks and rewards of ownership of the financial asset; or (c) the Group, despite having retained some, but not all, significant risks and rewards of ownership, has transferred control of the asset to another party.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

Cash and net debt

Cash is represented by deposits held at call with banks. Any bank overdrafts are shown within borrowings.

Net debt is comprised of loans advanced to the Partnership and cash.

Allocation of profits and drawings

The net profits of the Partnership incurred in each period are divided between the partners in the following proportions:

Tesco Red (1LP) Limited	49.9%
Tesco Red Unit Trust	49.9%
Tesco Red (GP) Limited	0.2%

Any net losses of the Partnership in each period are borne by the partners in the same proportion that they share the balance of the net profits of the Partnership.

Going Concern

The financial statements have been prepared on the going concern basis. The General Partner has assessed the appropriateness of using the going concern basis as set out in the General Partner's Report on page 2.

Borrowing costs

Interest payable is calculated on an accruals basis. The effective interest rate method is a method of calculating the amortised cost of a financial asset or financial liabilities and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount.

Interest payable and receivable is calculated on an accruals basis.

NOTES TO THE FINANCIAL STATEMENTS FOR THE 52 WEEKS ENDED 31 DECEMBER 2016 (continued)

2. ACCOUNTING POLICIES (continued)

Amortisation of loan arrangement fee

The costs associated with the raising of long-term finance for the Partnership are netted off against the loan to which they relate. The costs are being amortised on a straight-line basis, in line with the period over which the loan will be repaid.

3. OPERATING (LOSS)/PROFIT

The General Partner received no emoluments in respect of its services to the Partnership (2015: £nil).

There were no employees of the Partnership during the period (2015: none).

The auditor's remuneration in respect of audit services in the period amounted to £6,890 (2015: £6,890).

4. INTEREST RECEIVABLE AND SIMILAR INCOME

	52 weeks to 31 December 2016 £	52 weeks to 31 December 2015 £
Interest receivable on bank deposits	**12,472**	12,432
	12,472	12,432

5. INTEREST PAYABLE AND SIMILAR CHARGES

	52 weeks to 31 December 2016 £	52 weeks to 31 December 2015 £
Interest payable on other loans	**(20,844,216)**	(20,787,264)
Amortisation of loan issue costs	**(88,963)**	(88,768)
	(20,933,179)	(20,876,032)

The interest payable on other loans is related to the external loan finance received.

6. TAX ON (LOSS)/PROFIT

The financial information does not incorporate any charge or liability for taxation on the results of the Partnership, as the relevant income tax or tax on capital gains is the responsibility of the individual members.

7. INVESTMENT PROPERTIES

	Investment Properties £
Valuation:	
As at 1 January 2016	**597,570,000**
Revaluation	**(37,130,000)**
As at 31 December 2016	**560,440,000**

7. INVESTMENT PROPERTIES (continued)

The investment properties have been valued by Cushman & Wakefield LLP who is deemed to be a suitably qualified independent valuer of the General Partner on the basis of fair value at 31 December 2016. The valuation was carried out in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors (RICS).

The General Partner is of the opinion that there are no factors indicating the fair value of the investment properties has changed significantly up until 31 December 2016. This fair value has been determined by an independent valuer, by applying an appropriate rental yield to the rentals earned by the investment properties.

The property has been valued on the basis of market value which the valuer confirms to be fair value, as the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion. This has been subject to any existing leases of guarantees; otherwise assuming vacant possession.

The average yield across the portfolio is 5.33% with a rental income of £309.56 per square metre.

There were no restrictions on the realisibility of investment property or the remittance of income and proceeds of disposal, nor were there any contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

8. DEBTORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	31 December 2016	31 December 2015
	£	£
The Tesco Kirkby Limited Partnership	**6,001**	-
	6,001	-

Amounts owed by The Tesco Kirby Limited Partnership a subsidiary of the parent undertaking are unsecured, interest free, have no fixed date of repayment and are repayable on demand.

9. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	31 December 2016	31 December 2015
	£	£
Accrued interest payable	**4,157,453**	4,157,453
VAT	**1,559,720**	1,544,125
Tesco Red (GP) Limited	**4,300**	4,300
Accruals	**29,470**	52,524
Deferred income	**7,237,990**	7,145,191
Loan and other debt due to Tesco PLC	**35,737,846**	35,737,846
Loan and other debt due to Tesco Red Unit Trust	**32,905,000**	32,905,000
Loan and other debt due to Deutsche Bank	**382,400,000**	-
	464,031,779	81,546,439

The Tesco PLC and Tesco Red Unit Trust loans are repayable on demand.

The loan from Deutsche Bank is secured by a charge over the investment property. This loan incurred fixed interest at 5.436% and was fully repaid in January 2017. The total value of the loan is £382,400,000 and unamortised issue costs of £nil (2015: £88,964) have been netted off the total value of the loan.

10. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	31 December 2016	31 December 2015
	£	£
Loan and other debt due to Deutsche Bank	-	382,311,036
	-	382,311,036

The loan from Deutsche Bank is secured by a charge over the investment property. This loan incurred fixed interest at 5.436% and was fully repaid in January 2017. The total value of the loan is £382,400,000 and unamortised issue costs of £nil (2015: £88,964) have been netted off the total value of the loan.

11. CUMULATIVE PARTNERS' ACCOUNTS

Partners Accounts as at 31 December 2016	Partners' capital accounts £	Profit and loss reserve £	Distributions £	**Total £**
Tesco Red (3LP) Limited/ Tesco Red (1LP) Limited	11,898,058	46,911,075	(1,427,681)	**57,381,452**
Tesco Red Unit Trust	11,898,058	46,911,075	(1,427,681)	**57,381,452**
Tesco Red (GP) Limited	200,000	188,020	(5,722)	**382,298**
Total	**23,996,116**	**94,010,170**	**(2,861,084)**	**115,145,202**

The Partnership was formed on 14 August 2006. The Partnership was originally constituted under the Initial Partnership Agreement, which was then superseded by the Limited Partnership Deed on 20 August 2009, with capital injections totalling £700,000. Tesco Red (3LP) Limited own 49.9%, Tesco Red Unit Trust own 49.9%, Tesco Red (GP) Limited own 0.2% of the Partnership.

12. NET CASH FLOWS FROM OPERATING ACTIVITIES

Reconciliation of operating profit to net cash inflow from operating activities

	31 December 2016	31 December 2015
	£	£
Operating (loss)/profit	**(6,104,101)**	30,969,194
Adjustment for		
Decrease/(increase) in fair value of investment property	**37,130,000**	(400,000)
Change in debtors	**(6,001)**	1,852
Change in creditors	**85,340**	87,799
Net cash inflow from operating activities	**31,105,238**	30,658,845

13. ANALYSIS OF CHANGES IN NET DEBT

	1 January 2016	Net Cash flow	Non cash movements	31 December 2016
	£	£	£	£
Cash at bank and in hand	11,318,569	7,412,411	-	**18,730,980**
Debt due within one year	(68,642,846)	-	(382,400,000)	**(451,042,846)**
Debt due after more than one year	(382,400,000)	-	382,400,000	-
	(439,724,277)	**7,412,411**	-	**(432,311,866)**

14. RECEIVABLES UNDER OPERATING LEASE

Total future minimum lease receivables under non-cancellable operating leases are as follows:

	31 December 2016 £	31 December 2015 £
Within 1 year	**30,696,687**	23,752,051
2 to 5 years	**122,786,747**	-
After 5 years	**147,175,896**	-
	300,659,330	23,752,051

15. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

The immediate parent undertakings of the Partnership are Tesco Red (3LP) Limited, Tesco Red Unit Trust and Tesco Red (GP) Limited.

The ultimate parent undertaking is Tesco PLC. Tesco PLC is registered in England and Wales and copies of the Tesco PLC financial statements can be obtained from the Company Secretary, Tesco PLC, Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, United Kingdom, AL7 1GA.

16. RELATED PARTY TRANSACTIONS AND BALANCES

During the period ended 31 December 2016 the Partnership received rental income from Tesco Stores Limited of £31,085,295 (2015: £30,728,368) and Spen Hill Management Limited was paid £15,789 (2015: £97,761) in the period for property management services. As at 31 December 2016, the Tesco Red Limited Partnership owed Spen Hill Management Limited an amount of £nil (2015: £32,367).

During the period ended 31 December 2016, the Partnership paid expenses totalling £6,001 (2015: £nil) on behalf of the Kirkby Limited Partnership, a subsidiary of the parent undertaking. An amount of £6,001 (2015: £nil) was receivable from the Kirkby Limited at the period end.

An amount of £4,300 was payable to the Tesco Red (GP) Limited at the period end (2015: £4,300).

There were no further related party transactions.

17. POST BALANCE SHEET EVENTS

The Partnership had an external loan with Deutsche Bank with the total value of the loan being £382,400,000 which was repayable in January 2017. In January 2017, the £382,400,000 loan from Deutsche Bank was repaid utilising the funds provided by Tesco Corporate Treasury Services PLC, a 100% owned-subsidiary of Tesco PLC. The loan of £382,400,000 from Tesco Corporate Treasury Services PLC to the Partnership is repayable in January 2019.