AUSTRALIAN FOOD & GROCERY COUNCIL

Supplemental information for Senate Inquiry into Supermarket Prices

Return on invested capital (slides 1 and 2)

Food and grocery manufacturing is capital intensive and has lower asset turnover than a supermarket business and hence it can be misleading to rely on percentage margin structures. The return on invested capital (ROIC) is a more appropriate metric to assess the financial performance of the food and grocery manufacturing industry.

In the long run, a company's return on capital invested needs to sit above the weighted average cost of capital (WACC) in order to make capital investment worthwhile. Otherwise, the company would earn a return lower than the cost of funding and the business would be better off putting the money into alternate investments that generated higher earnings. Anecdotally a relevant WACC for food and grocery manufacturing is in the order of 8-10 per cent.

Analysis undertaken for AFGC shows that the ROIC for a representative sample of food and grocery manufacturers in Australia (10 per cent) was lower than for Coles, Woolworths and Metcash (13-17 per cent) over the last 12 months. Supermarkets have lower percentage profit margins than manufacturers but a lower capital intensity.

Analysis undertaken by New York University of ROIC in various **industries in the US showed food processing had a ROIC of 17.23% (significantly higher than 10% in Australia) whereas food and grocery retailing had a ROIC of 10.99% (lower than the 13-17% in Australia)**. [1]

This analysis also shows that **domestically owned food and grocery manufacturers (also known as fast moving consumer goods or FMCG companies) have a similar ROIC to the Australian operations of multinational FMCG companies, which is contrary to retailer arguments that multinational suppliers in Australia make excess profits**.

In fact, a major challenge for multinational businesses operating in Australia is the lower ROIC makes it difficult to justify investment here compared to other places in the world.

Margin analysis (slides 3 and 4)

An analysis of EBITDA margin[2] (slide 3) similarly confirms that the EBITDA margin for the Australian operations of multinational suppliers is lower than their global profitability. It also shows that the profitability of the sample of domestically owned suppliers was marginally higher than the Australian operations of multinational suppliers. The EBITDA margin analysis also shows that the operating profit margins for suppliers is higher than retailers. This reflects capital invested and lower asset turnover for suppliers.

A comparison of supermarket margins domestically and globally (slide 4) shows that, with the exception of Loblaws in Canada, **Coles and Woolworths make higher profits than their global peers**. It should be noted that Canada has similar market concentration levels as Australia. The analysis of EBITDAR margins takes into account different rent and property ownership arrangements between retailers which allows for a direct comparison. This measure is a more appropriate comparison than EBIT given that Australian supermarkets predominantly lease their properties whereas their overseas peers predominantly own their property. Another feature of this analysis is that Woolworths and Coles have increased their EBITDAR margins between 2019 and 2023, while all other global retailers, with the exception of Loblaws in Canada, have either maintained or reduced their profitability.

---

[1] https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/mgnroc.html

[2] EBITDA assesses operating profits relative to revenue, while ignoring the effect of non-operating factors such as interest expenses, taxes, or intangible assets.

AUSTRALIAN FOOD & GROCERY COUNCIL

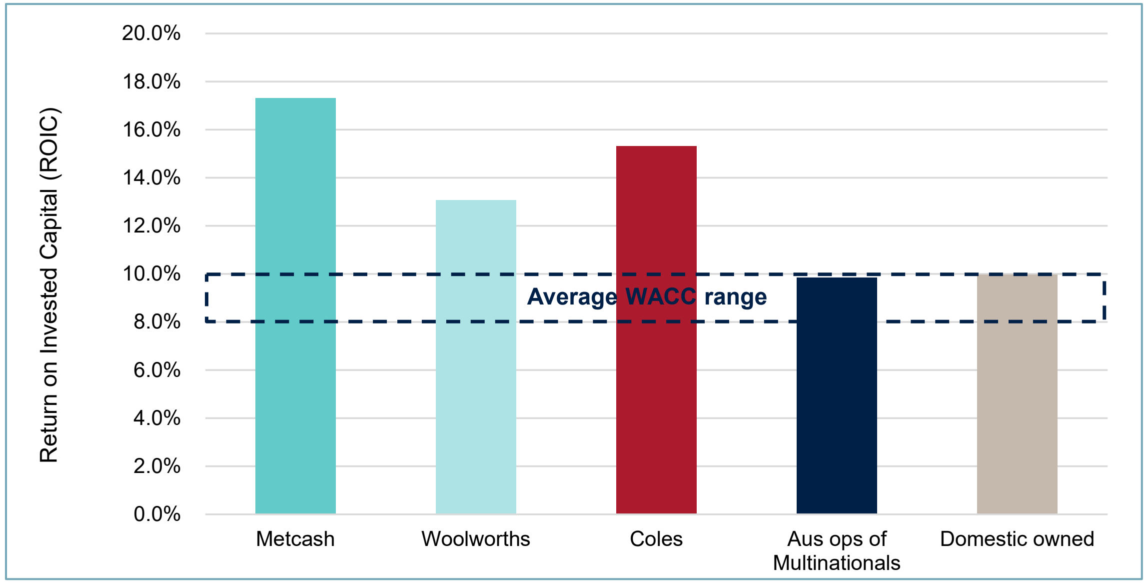
Grocery industry returns and margins

Tanya Barden OAM
Chief Executive Officer, Australian Food and Grocery Council

Slide 1: Return on invested capital

- Retailers' ROIC is higher than suppliers' ROIC (opposite to USA)
- Australian operations of multinationals achieve a ROIC similar to domestic suppliers of 10% (upper end of WACC)
- ROIC needs to be higher than WACC to justify investment.

Return on invested capital (most recent financial year)



Groupwide figures shown above.
Source: Company reports, FactSet

Slide 2: ROIC break down

- Manufacturing entities have a higher capital investment (machinery), higher margins and slower asset turns. The capital invested by grocery suppliers is likely more than $60 billion. Retailer investment is likely $25 - $35 billion (both include leases).
- Food retailers have higher rental expense, lower margin and faster asset turns. The capital investment is lower than for retailer suppliers.

ROIC break down

	Sales / Invested Capital	X	NOPLAT / Sales	=	ROIC
Metcash	7.1x		2.4%		17.3%
Woolworths	3.1x		4.2%		13.1%
Coles	3.5x		4.4%		15.3%
Aus ops of Multinationals	2.4x		4.1%		9.8%
Domestic owned	1.9x		5.2%		10.0%
Multinational Global	1.3x		14.2%		18.2%

Groupwide figures shown above.
Source: ASIC, company reports, FactSet

Slide 3: EBITDA margin analysis

- EBITDA margin for domestically owned suppliers similar to multinationals operating in Australia.
- Australian operations of multinational suppliers operate at a lower margin than global owners.
- Metcash trails Woolworths and Coles on EBITDA margin, reflecting the wholesaling it does.

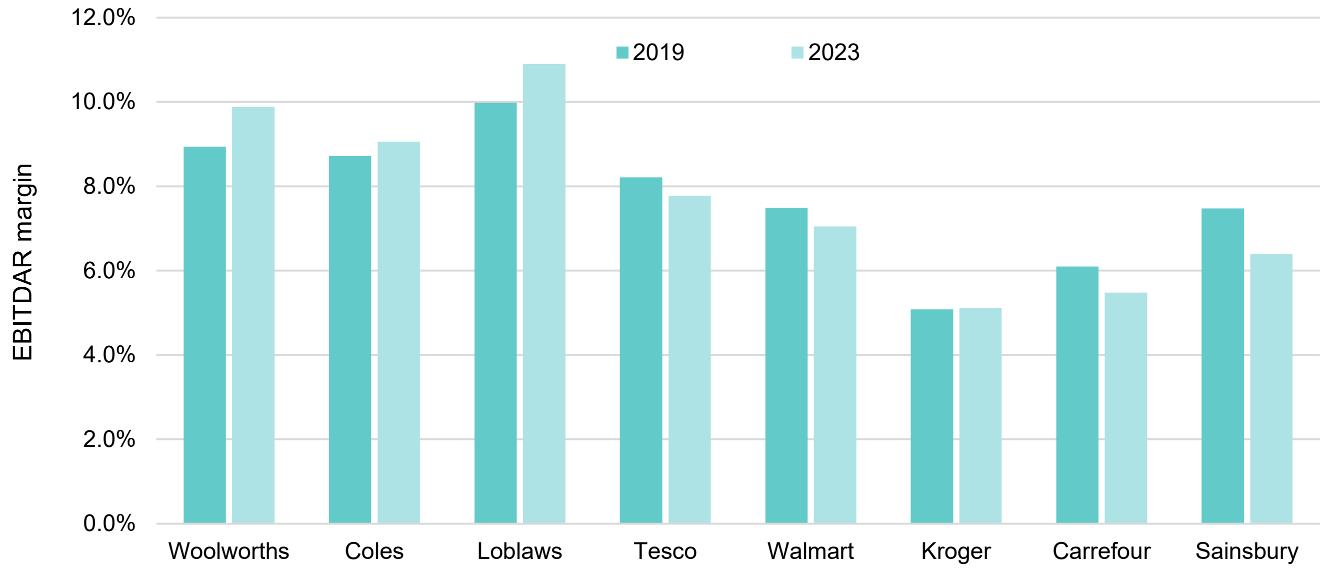
EBITDA margin comparison (most recent financial year)

Groupwide figures shown above.
Source: ASIC, company reports, FactSet

Slide 4: EBITDAR margins for supermarkets

- The EBITDAR margin accounts for difference in rent and property ownership and allows for a direct comparison.
- Australian EBITDAR margins are towards the upper end of global peers. Note that cost of land and rent is higher in Australia than some markets.

EBITDAR margin comparison for global supermarkets 2019 v 2023



Calendar year shown above.
Source: Company reports, FactSet

Clarification about the data and analysis

- Data reflects total corporate operations, which will include some sales to non-supermarket customers and exports.
- Retailer profit margins shown on slides are done on a group-wide basis.
- Each of the companies may have a slightly different year end. Some December, some June, some August.
- We have adjusted for royalty payment to offshore entities if separately disclosed.
- We have adjusted for significant items where appropriate.
- Profit margin metrics for EBITDA is presented on a post AASB-16 basis (lease expenses are disclosed as lease amortisation and lease interest expense).
- Listed company data sourced from FactSet. Local private company data sourced from ASIC accounts.
- Tesco data is consensus for yet to be reported 2H23. Results due first-half of April 2024.
- Australian supplier coverage estimate at 20-25% of total supermarket sales (per ABS).