

Commercial in Confidence

COLES EXPRESS

SENATE ECONOMICS & LEGISLATIVE COMMITTEE INQUIRY INTO PETROL PRICES IN AUSTRALIA

Introduction

Coles Express is a fuel and convenience retailer, delivering one of the best value fuel offers in Australia through the provision of quality Shell fuels at competitive board prices as well as a 4-cent per litre fuel discount off the pump price of fuel.

Every month more than eight million Australians vote with their feet and visit Coles Express to redeem their 4 cent per litre fuel discount and in doing so demonstrate the immense popularity of the Coles Myer fuel discount offer.

Coles Express was formed in 2003 following the development of an alliance between Coles Myer and Shell. Under this alliance Shell supplies fuel products and Coles Myer, under the banner of Coles Express, operates the fuel and convenience retail business independently of Shell.

Today, Coles Express operates 600 fuel and convenience stores Australia wide, equating to approximately 9% of the 7,000 service stations or fuel retail sites in Australia and a fifth of Australia's retail fuel sales. Coles Express employs over 5,000 people.

Coles Express, Fuel Retailing and Shopper Docket Schemes

Coles Express delivers one of the most competitive and popular fuel offers in Australia. In addition to providing competitive board prices, Coles Express also offers a 4-cent per litre discount to customers who spend \$30 or more at Coles, Bi-Lo or Liquorland retail outlets.

Coles Express is also an integral part of the Coles Myer loyalty rewards program, which includes the Coles Myer Source Mastercard and FlyBuys. This program provides opportunities for customers to earn further discounts on fuel prices.

Australian consumers have enthusiastically embraced shopper docket schemes. In excess of three million docket redemptions occur in the industry each week, and there are now well in excess of 100 fuel discount schemes operating in Australia, offered by retailers and other businesses both large and small.

We estimate that consumers across Australia are saving more than \$180 million off their fuel bills annually through the various shopper docket schemes thus helping to lower the cost of living for many Australian households.

The Coles Express pricing strategy across Australia is to at least *match* the board price of the lowest priced competitor as often as possible. Successful

Commercial in Confidence

execution of this strategy provides consumers with confidence that whatever the retail price, they can be assured that Coles Express provides best value. In addition of course, Coles Express also offers a 4 cents per litre discount for those consumers who choose to shop and save at Coles, Bi-Lo and Liquorland outlets.

COMMITTEE INQUIRY INTO PETROL PRICES - TERMS OF REFERENCE

TOR 1: The relationship between the landed price of crude oil, refining costs, the wholesale price and the retail price of petrol.

As the Committee would appreciate, retail petrol prices in Australia are determined largely by factors beyond the control of retailers themselves. These factors include:

- The **price of oil**, which is set internationally and oscillates on a daily basis in response to international political events and economic drivers of demand and supply. The price of oil over time is well documented and is the key determinant of petrol prices. Oil prices are currently at historically high levels.
- The value of the **Australian dollar** directly impacts the purchase price of oil (usually sold in US \$ per barrel) and therefore the price of products like petrol.
- **Government taxes**. Taxes form a substantial part of the retail board price for petrol. These include fuel excise of over 38 cents per litre plus GST of 10% on the retail price. At today's prices this means consumers pay over 50 cents in tax on every litre of petrol.
- **Refiner margins** have reportedly increased in recent times (Coles Express only entered the retail market in 2003) which we understand reflects limitations to the refining capacity in Australia and internationally.
- Periodic **price support** provided to retailers by oil companies so as to increase or maintain their respective market shares of petrol volumes. This price support drives the discounting cycles prevalent in the retail sector.

Petrol retailing is a high volume, low margin business. Retail petrol prices are the outcome of a complex interplay of competitive and operational factors. These factors are peculiar to individual markets and sites. They start with the wholesale prices or the Terminal Gate Price (TGP) set by fuel distributors or refiners of oil - Shell, BP, Caltex and Mobil - paid by retailers. Plus taxes; freight; operating costs; site rental; site throughputs; trading terms; promotions; legislative compliance obligations; investment, safety and maintenance needs; competitor initiatives, and of course, consumer demand.

Metropolitan fuel prices at Coles Express have tracked broadly in line with each other for the past twelve months. Chart one demonstrates this point (note: average fuel price for Brisbane as compared to other cities is lower as a result of the Queensland Government fuel subsidy)

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Refer to Chart 1 attached. Data Sourced from Coles Express

Charts Two – Six highlight the competitive nature of the retail fuel markets in Melbourne, Sydney, Brisbane, Adelaide and Perth.

Refer to Charts 2 - 6 attached. Data provided by Informed Sources, Australia's leading independent fuel price monitoring company.

The retail petrol industry is very, very competitive. Petrol retailers of all sizes compete with each other for patronage by motorists seeking the lowest petrol price in the market. It is a market driven by transparent price signals with motorists keenly aware of even the smallest price differential – a price measured in tenths of a cent. The retail petrol discount cycles - based on price support from oil companies – that is evident in the Australian market demonstrates the rapid competitive response between oil companies and between retailers and the equally swift response by motorists to board prices which can change multiple times within a single day.

Average margins on retail fuel sales are extremely small, such that retailers' pre-cost share of the price of fuel is measured in single digit cents in the dollar, the lowest in the retail industry. Charts 7 to 11 demonstrate this point, showing average prices as compared to the Terminal Gate Price (TPG) in Melbourne, Sydney, Brisbane (before and after the Queensland Government fuel subsidy), Perth and Adelaide.

Refer to Charts Seven to 7 – 11 attached. Data provided by Informed Sources, Australia's leading independent fuel price monitoring company.

TOR2: Regional differences in the retail price of petrol

In regional Australia, retail fuel prices tend to be higher than metropolitan ones because of the smaller volumes sold in regional and remote locations. Due to the smaller volumes higher fuel prices are necessary to cover the fixed costs of operating a service station in these locations.

For example, it is generally accepted in the industry that the larger urban fuel outlets require at least a 3 cents per litre (cpl) gross margin to cover fixed costs. All other things being equal, a typical regional site, selling half the volume, will require a per litre margin twice that amount to cover fixed costs. This is before an allowance for a commercial profit is made and does not take account of other factors such as business risk and costs associated with remoteness (freight, maintenance, higher working capital and extreme seasonal conditions).

Charts 12 to 16 demonstrate this point showing the 12 month average price comparison between Melbourne and Traralgon; Sydney and Dubbo; Brisbane and Toowoomba; Perth and Albany; Adelaide and Ceduna.

Refer to Charts 12 – 16 attached. Data provided by Informed Sources, Australia's leading independent fuel price monitoring company.

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TOR 3: Variations in the retail price of petrol at particular times

Petrol retailers of all sizes compete with each other for patronage by motorists seeking the lowest petrol price in the market. It is a market focused on very visible and transparent price signals, with motorists keenly aware of price differences between retail sites. The retail petrol discount cycles evident in the Australian market demonstrate the rapid competitive response between retailers and the equally swift response by motorists.

Discount fuel cycles tend to vary in intensity and duration from location to location and depend on the number of competing sites in the geographic market and where sites are located in key locations (eg along main arterial roads) within markets and the degree of price support provided by oil companies to retailers in these markets. Typically petrol-discounting cycles are more intense in metropolitan areas than regional areas because of higher volumes (which help offset lower margins) and closer proximity to a larger number of competitors.

TOR 4: The industry's integrated structure

Coles Express is not qualified to make an assessment of the industry's integrated structure.

TOR 5: Other related matters

- **Profitability and Transparency**

Coles Express is one of the few Australian fuel retailers that report bi-annually information on its turnover and earnings before interest and tax (EBIT).

For the latest financial year (2004/05), Coles Express reported a profit of \$36.8 million on sales of \$5.56 billion or 0.66 cents in the dollar profit, further emphasising that fuel retailing is a high volume, low margin business.

- **Alternative Fuel Sources and E10**

Coles Express in conjunction with our alliance partner Shell, launched a new premium fuel, Shell **Optimax Extreme**, formulated with 5% ethanol in 2005. This fuel has a 100 octane rating (ULP has a rating of 93) and is aimed at driving consumer acceptance of ethanol as a high performance, quality fuel component.

We believe that consumer confidence in the quality and performance of bio fuels is critical and given the negativity associated with ethanol-based fuels in the past, the premium positioning of Optimax Extreme is playing a key role in the industry wide challenge to overcome negative consumer sentiment regarding ethanol blended fuels.

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Conclusion

Coles Express is proud of its record in providing a competitive fuel offer to Australian motorists, and seeks to offer competitive prices in every market where it operates. Coles Express also offers motorists the opportunity to save a further 4 cents per litre if they choose to shop at key Coles Myer retail outlets. Offers such as this are helping reduce the price of fuel, and we aim to continue developing innovative offers for the benefit of Australian consumers. Customers taking advantage of our low grocery prices and the Coles Express shopper docket scheme are reducing their household expenses.

While petrol prices remain at historically high levels, fuel retailers have very limited capacity beyond shopper dockets to reduce the price of petrol. Most fuel retailers earn less than one cent in the dollar profit on each litre of petrol sold. Therefore, retailers' capacity to reduce the price of petrol for motorists is limited.

Coles Express appreciates the opportunity to provide the Committee with these observations on fuel pricing in Australia.