



Australasian supermarket industry: Backwater, Behemoth, or Beachhead

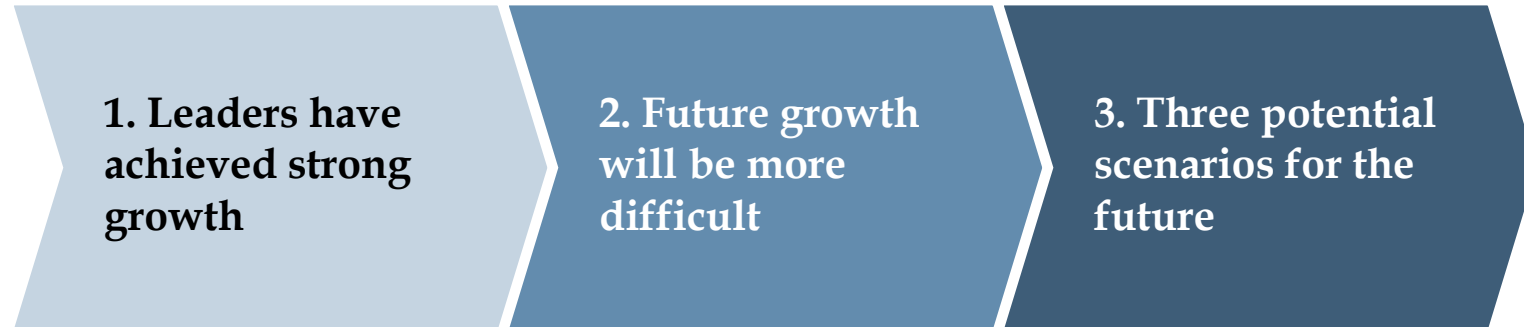
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Presentation to Future Retail Australasia
Wednesday May 21, 2008

OBJECTIVES, STRUCTURE & LIMITATIONS

- **Possibilities not predictions: case-studies & scenarios**
- **Looking into the medium-to-long term (5+ years)**
- **Not a share broker, no axe to grind**


PRESENTATION STRUCTURE

This presentation is structured into three sections as follows



PRESENTATION STRUCTURE

The first proposition is that the leaders have achieved strong growth to date



**1. Leaders have
achieved strong
growth**

CHANGING MARKET STRUCTURE

The structure of the Australasian market has changed dramatically in the past 35 years

Key Australasian market characteristics

(various; 1973v2008)

1973	2008
- Stores are generally small and poorly run	- Stores are medium size (by global standards) and generally run competently
- Market is dominated by independents without effective chain store control	- Market is dominated by a handful of chain store operators operating very similar stores
- Stores managed on a state-by-state basis	- Stores operated on a national or Australasian basis
- Technology plays a minimal role in supermarket operations	- Technology plays a major role across all aspects of the business
- Retailers are owned by a local owner-operator	- Retailers are Australian share market listed entities owned primarily by funds and other professional investors (or a co-op or store owners in NZ)
- Most products are manufactured locally by domestic manufacturers	- More and more products sold are manufactured regionally or globally
- Market and channel power rests with wholesalers and manufacturers	- Market and channel power rests with retailers

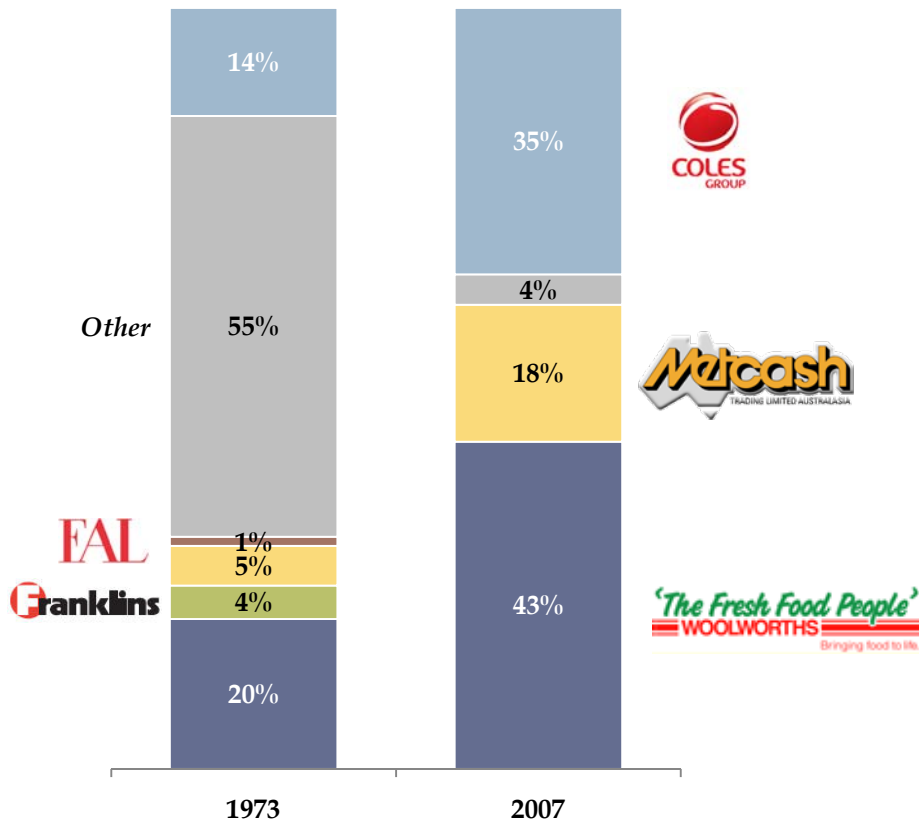
MARKET SHARE BY COMPANY

Both markets have consolidated into a handful of groups

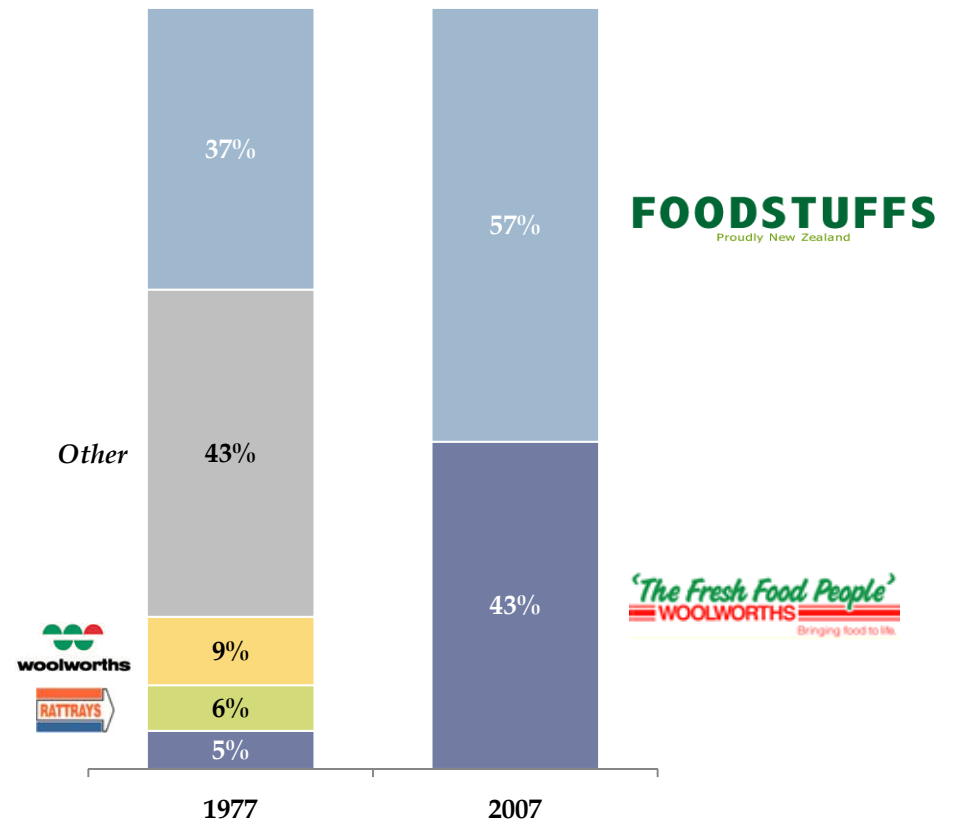
Supermarket market share by country

(% of scanned grocery sales; 1973/77-2007)

Australia



New Zealand



DRIVERS OF CONSOLIDATION

Supermarket consolidation is occurring globally for a common set of reasons

Drivers of consolidation

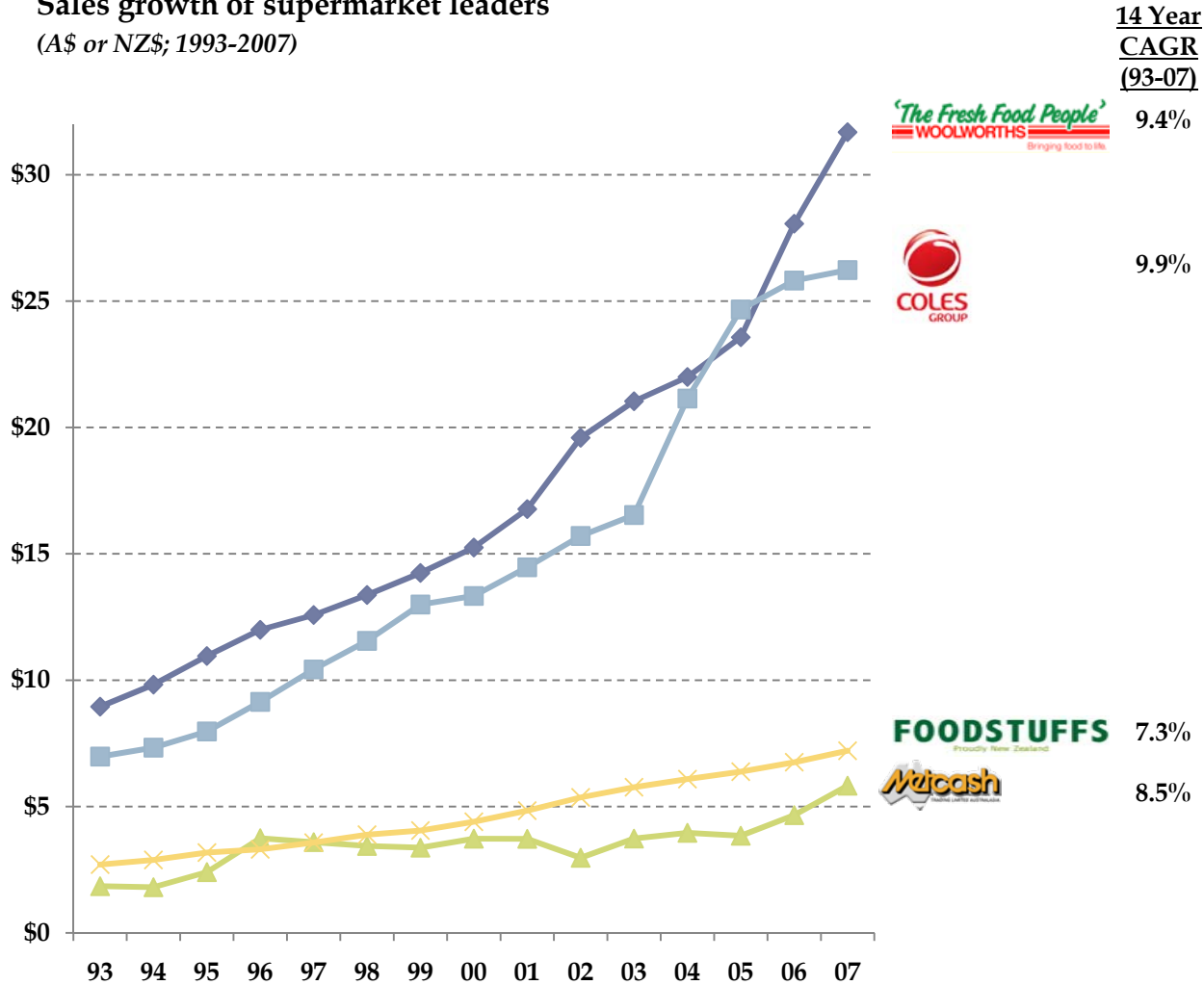
(model)

Driver	Details
Economies of scale	<ul style="list-style-type: none">- In buying- In technology- In supply chain systems- In management
Access to capital	<ul style="list-style-type: none">- Listed chains with strong access to capital investing in...<ul style="list-style-type: none">• New stores/sites and remodels (at the expense of unorganised independents)• Advanced supply chain and logistics systems
Private label	<ul style="list-style-type: none">- Chains with strong private label programs are acquiring chains with weak programs (<i>see Coriolis Towards Private Label Success report</i>)

SALES GROWTH

As a result of consolidation, the supermarket operations of leading groups have delivered on strong growth

Sales growth of supermarket leaders
(A\$ or NZ\$; 1993-2007)



Notes

- Woolworths uses Food/Liquor division
- Coles uses Food/Liquor/Fuel division
- Metcash uses Wholesale Distribution plus Retail division (97-00)
- Foodstuffs uses wholesale group sales

PRESENTATION STRUCTURE

The second proposition is that future growth will be more difficult

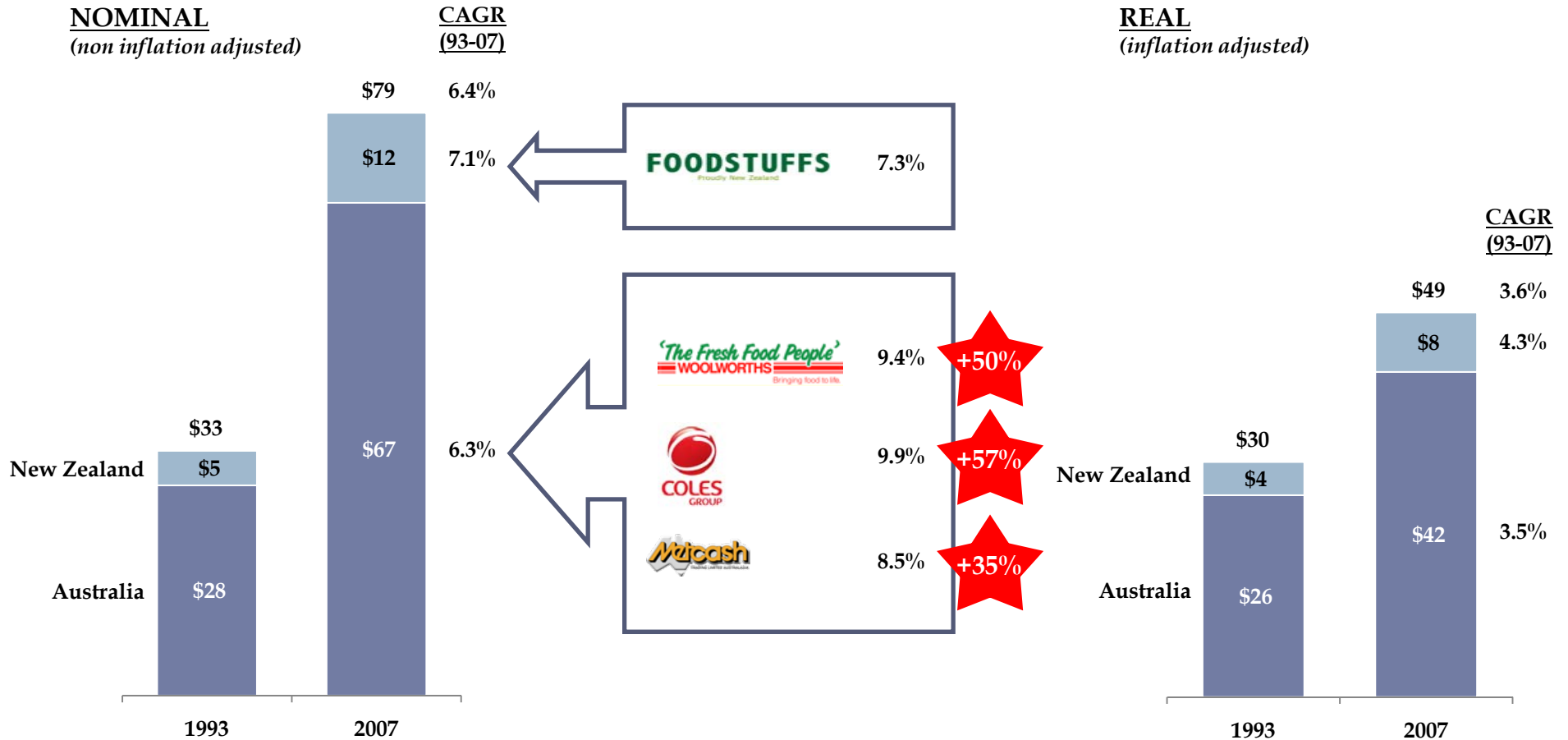
*1. Leaders have
achieved strong
growth*

2. Future growth
will be more
difficult

MARKET GROWTH

The leaders have been growing faster than the market

Total supermarket industry turnover growth
(A\$b; 1993-2007)

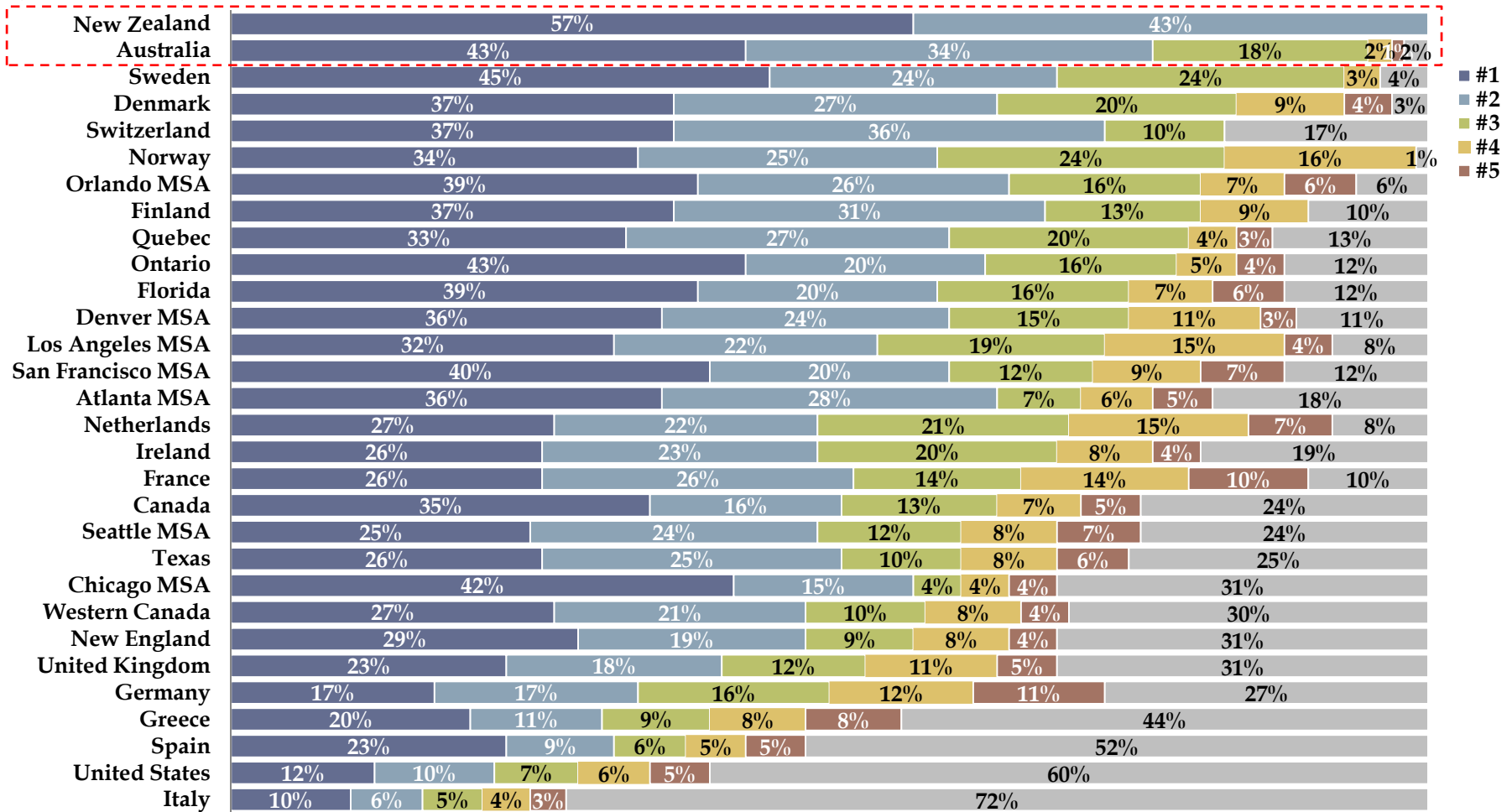


MOST CONSOLIDATED MARKETS IN THE WORLD

New Zealand and Australia are the most consolidated supermarket market in the world

Market share of top 5 supermarket retailers by country (or region)

(% of sales; various years 02-06)



BARRIERS TO FURTHER CONSOLIDATION

There are significant barriers to further consolidation

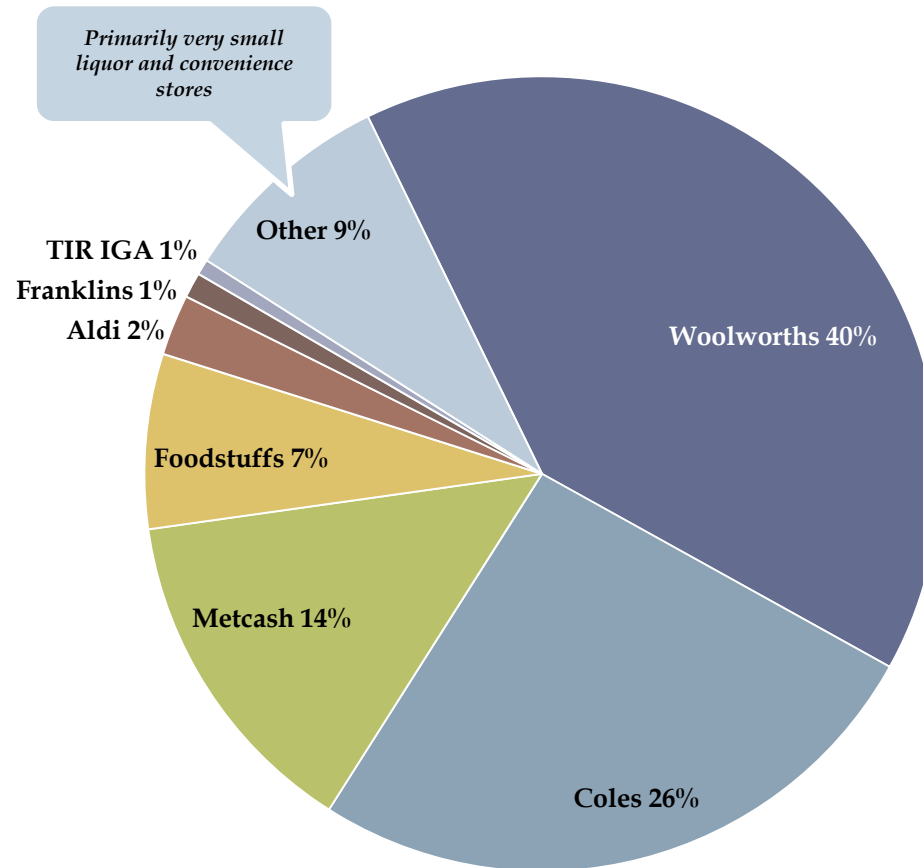
Barriers to further consolidation of Australasian supermarket sector
(model)

Barrier	Details
Ownership	<ul style="list-style-type: none"> - Aldi is privately owned by Karl Albrecht of Germany; Aldi has never sold any operations - Foodstuffs and TIR are cooperatives - Metcash is a wholesaler whose store portfolio is owned by independent owner-operators
Government	<ul style="list-style-type: none"> - The ACCC in Australia and the NZCC in New Zealand have demonstrated they would object to another major acquisition by any of the major players - "Creeping acquisition" on a store-by-store basis continues, though is attracting more scrutiny
Few remaining targets	<ul style="list-style-type: none"> - There are at most 3-4 supermarket acquisition targets of any size
Size of remaining targets is small	<ul style="list-style-type: none"> - Remaining targets are small (e.g. Franklins) and would represent tactical rather than strategic "game changing" market share gains

AUSTRALASIAN MARKET SHARE

There are very few smaller players left to acquire

Australasian supermarket/convenience/liquor retail market share
(% of retail sales; 2007)



Notes

- *Different definition to page prior; includes liquor and convenience*
- Represents supermarkets, grocery stores, convenience stores and liquor retailing
- Does not include petrol (incl. petrol convenience) or butchers, bakers, greengrocers or other food specialists

POTENTIAL EXPANSION CATEGORIES

While there are clearly opportunities to both improve the existing offer and increase the number of departments on offer, expansion is limited by available in-store space

Opportunities to improve supermarket range and offer

(model)

	Opportunity	Global Best Practice	Results to date
Products (food)	Improved fresh food	Carrefour	Woolworth's "The Real Fresh Food People" advertising campaign Continued strength of perishables specialists suggests further opportunities exist
	Liquor	Numerous	Massive acquisition binge by leaders has given them a leadership position in sector However, in a deregulated environment, liquor is an in-store department not a stand alone format; did they buy stores to close them? Deregulation continues in Australasia, at different rates in different states
	Petrol	Tesco	All leaders now have some form of fuel format and fuel strategy Supermarkets now major petrol retailer across Australasia
	Tier II private label	Tesco	All major Australasian retailers have launched a 2 tier private label system See Coriolis report "An Overview of Private Label in Australia"
Products (non-food)	Entertainment Household Clothing	Tesco	Some one-off specials (similar to Aldi) Challenge of cannibalising existing Kmart/Target/Big W stores Limited space availability in existing store portfolio
Services	Pharmacy	Wal-Mart	Resistance of politically strong independent pharmacists Still prevented from offering in-store pharmacy in Australia despite intense lobbying of government; Current New Zealand partial deregulation sub-optimal and yet to deliver results for in-store pharmacy trials
	Banking	Sainsbury's	Launched Woolworths Ezy Banking In store ATMs and kiosks in stores
	Insurance	Costco	-

PRESENTATION STRUCTURE

The final section looks at three potential scenarios for the future of the Australasian supermarket sector

1. Leaders have achieved strong growth

2. Future growth will be more difficult

3. Three potential scenarios for the future

THREE SCENARIO'S

We propose three scenarios: (1) Backwater, (2) Behemoth and (3) Beachhead



1. Backwater



2. Behemoth



3. Beachhead

SCENARIO 1 - BACKWATER

The “Backwater” scenario assumes that Australasia remains on the periphery of the ongoing globalisation of supermarket retailing (effectively the story of the past 20 years)



Key Scenario Elements

- *Market is highly consolidated into a handful of players, and historic growth rates slow*
- **Industry remains primarily locally owned**
- **No further international arrivals**
- **Australasian supermarket retailers do not venture overseas**

Model Countries

- **Denmark**
- **Finland**
- **Norway**
- **Sweden**
- **Switzerland**

- **Japan (sort of...)**
- **Korea (sort of...)**

SCENARIO 1 - POTENTIAL OUTCOMES

From our research, we believe the potential outcomes of the “Backwater” scenario would include:



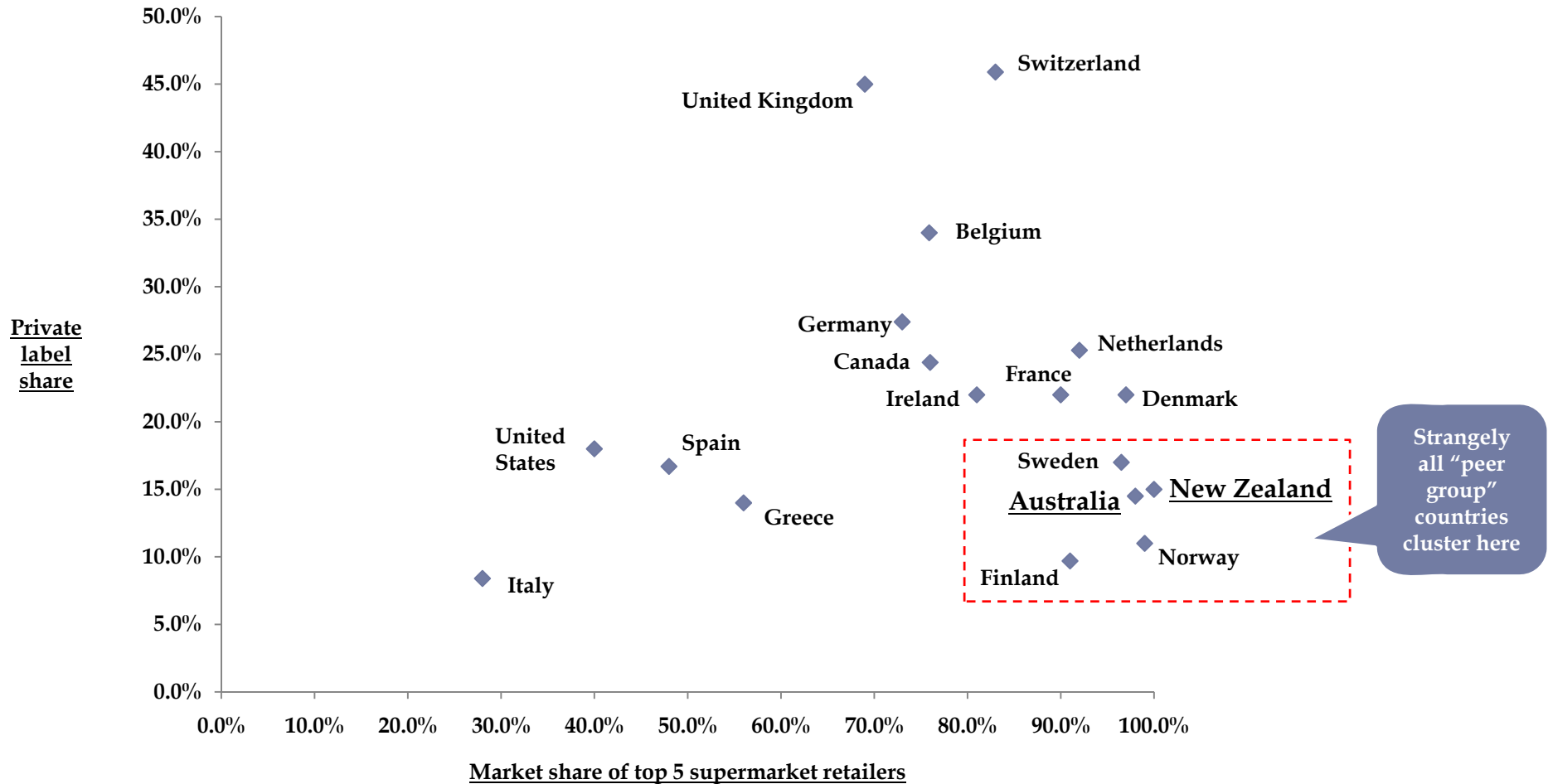
- A. Growth of private label product, but maybe not as much as you expect
- B. Retailers scramble frantically to find growth
 - i. Offer full range of retail supermarket formats
 - ii. Horizontally integrate into department stores and other areas of retailing
- C. Limited innovation in channel going forward
 - i. Sleepy and sloppy - duopolies/oligopolies not conducive to innovation
 - ii. Consequent flattening/decline in consumer spend in channel
- D. [Strangely] All long-term backwater model countries have a strong presence of cooperative retailer structures

A. PRIVATE LABEL VS CONSOLIDATION

Retail consolidation leads to the growth of private label product, but strangely not as strongly in Australasia or our peer group countries

Retail concentration vs. private label penetration

(% share of top 5; PL % of sales; various years 02-07)



Bi. OFFER A FULL RANGE OF SUPERMARKET FORMATS

Tesco in the United Kingdom offers the best example of diversifying from conventional supermarkets into the full range of store formats

Range of store formats at Tesco
(2008)

Express



Metro



Extra



Superstore

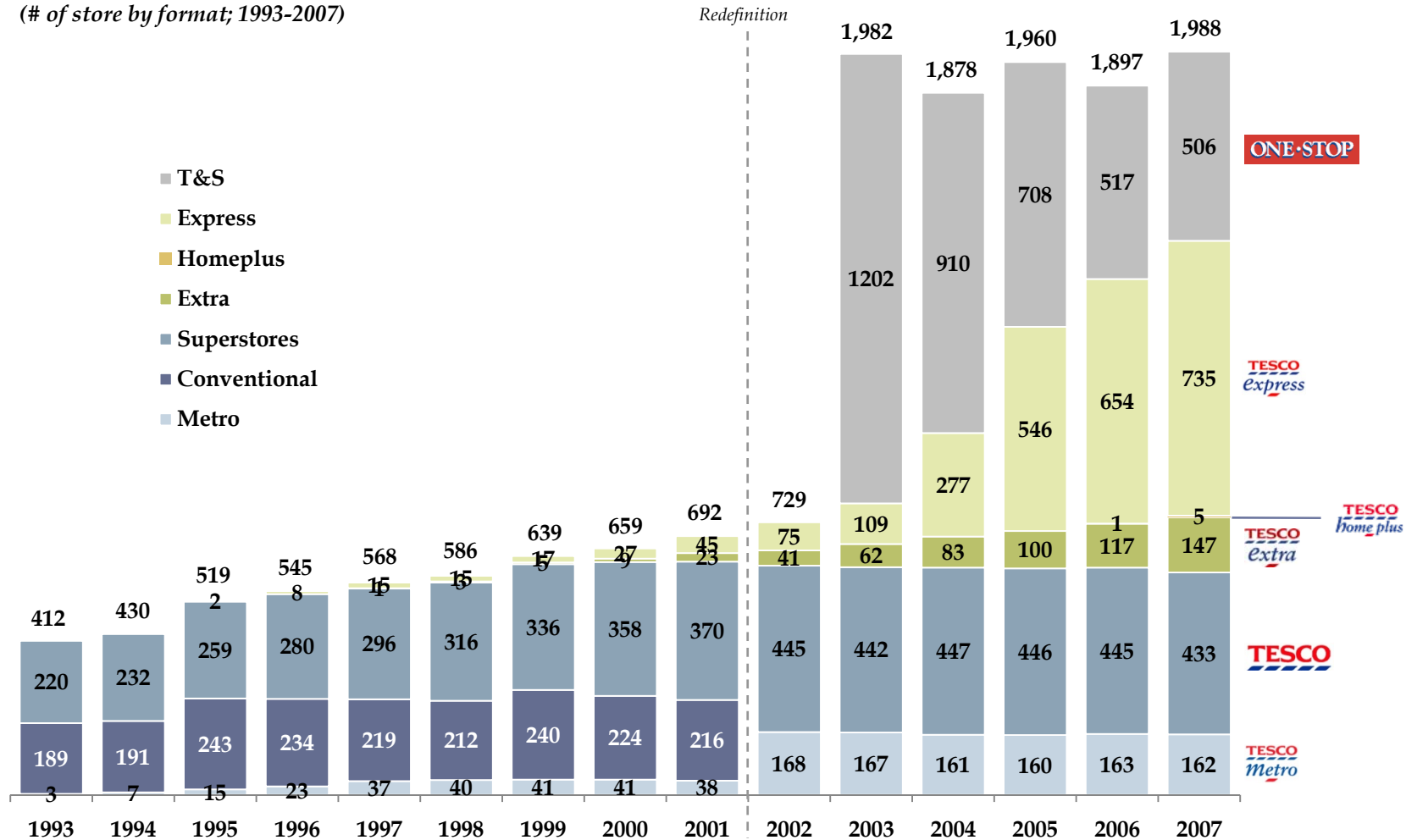


Bii. OFFER A FULL RANGE OF SUPERMARKET FORMATS

Tesco has achieved growth in a saturated market through diversifying its store offer rather than opening more and more conventional supermarkets

Change in structure of Tesco store portfolio

(# of store by format; 1993-2007)











Bii. HORIZONTAL INTEGRATION – AUSTRALASIA

A benchmarking of store formats indicates limited opportunities for new concepts

Presence of store format by retail group

(2008)

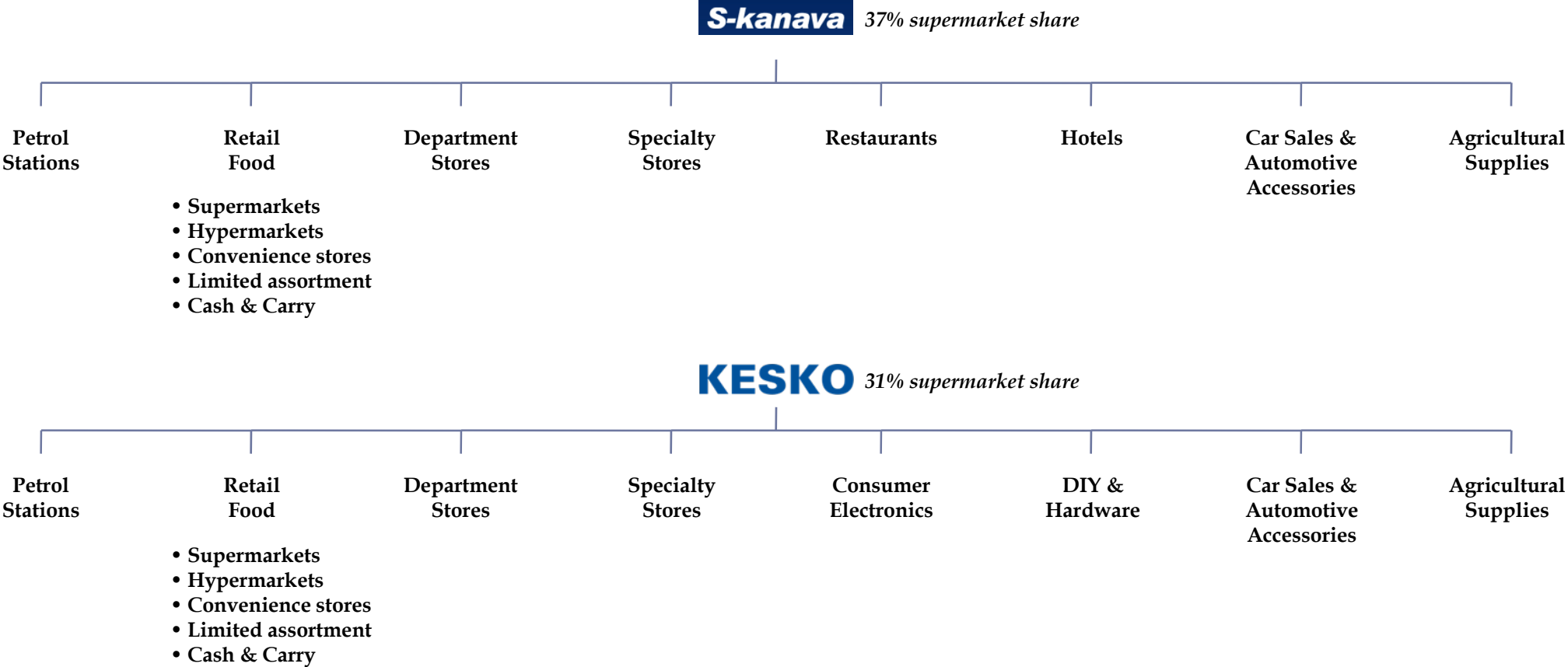
Format								
Supermarket - Full Service	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>			
Supermarket - Metro Format	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>				
Supermarket - Extended Range Discount	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>			
Supermarket - Box Warehouse				<input checked="" type="checkbox"/>				
Limited Assortment						<input checked="" type="checkbox"/>		
Convenience Store / Petrol	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>				
Hypermarket/ Supercentre	Planned	Failed and discussed ³						Planned
Cash & Carry			<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>				
Warehouse Club Store								Planned
Liquor Store	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>				<input checked="" type="checkbox"/>
Discount Department Store	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>						<input checked="" type="checkbox"/>
QSR/ Fast Food	Failed ¹	Sold ²						

Clear parallels with Australian situation

Bii. HORIZONTAL INTEGRATION - FINLAND

If you don't achieve growth through going global, you horizontally integrate into other areas of retailing, often forming sprawling conglomerates

EXAMPLE: Horizontal integration in Finland: S-Group (Finland #1 supermarket group) & Kesko (#2 supermarket group) (2007)

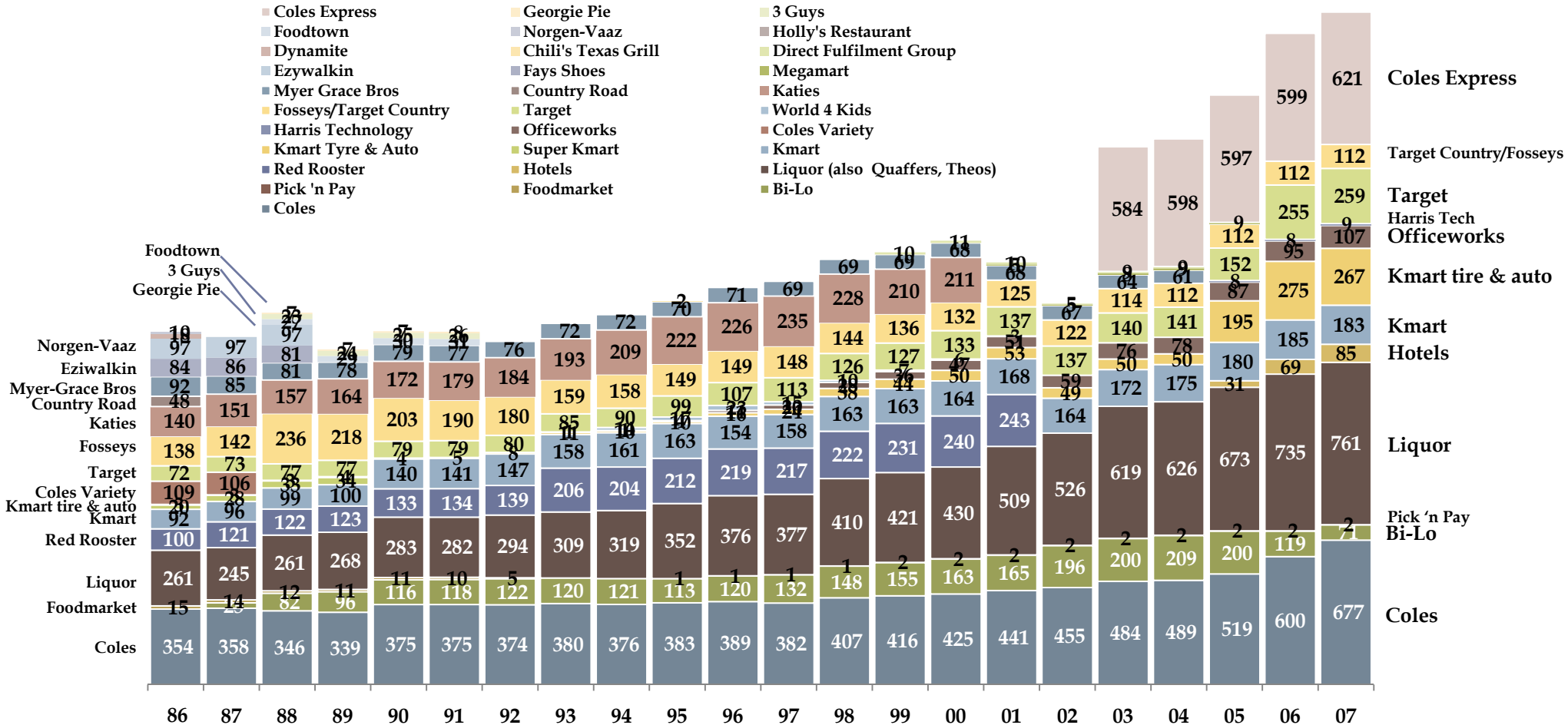


Bii. HORIZONTAL INTEGRATION - COLES EXAMPLE

However, as twenty-one years of changes in the Coles Myer store portfolio demonstrates, horizontal integration is an easy concept to describe, but harder to implement successfully

Change in Coles Myer store numbers by brand

(units; actual; FY 1986-2007)



SCENARIO 2 – BEHEMOTH

The “Behemoth” scenario assumes Woolworths and/or Coles expand into other international markets



Key Scenario Elements

- *Market is highly consolidated into a handful of players, and historic growth rates slow*
- (?) Superior Australasian supermarkets operators have world class store formats and capabilities (?)
- Profits from strong position at home available to finance international expansion
- Australasian leaders expand internationally and become global leaders

Model Countries

- Belgium (Delhaize)
- Chile (D&S)
- France (Carrefour; Auchan; Casino; Leclerc)
- Germany (Aldi; Metro; Lidl; Tengelmann)
- Hong Kong (Dairy Farm; AS Watson)
- Netherlands (Ahold)
- United Kingdom (Tesco)

SCENARIO 2 – POTENTIAL OUTCOMES

From our research, we believe the potential outcomes of the “Behemoth” scenario would include:



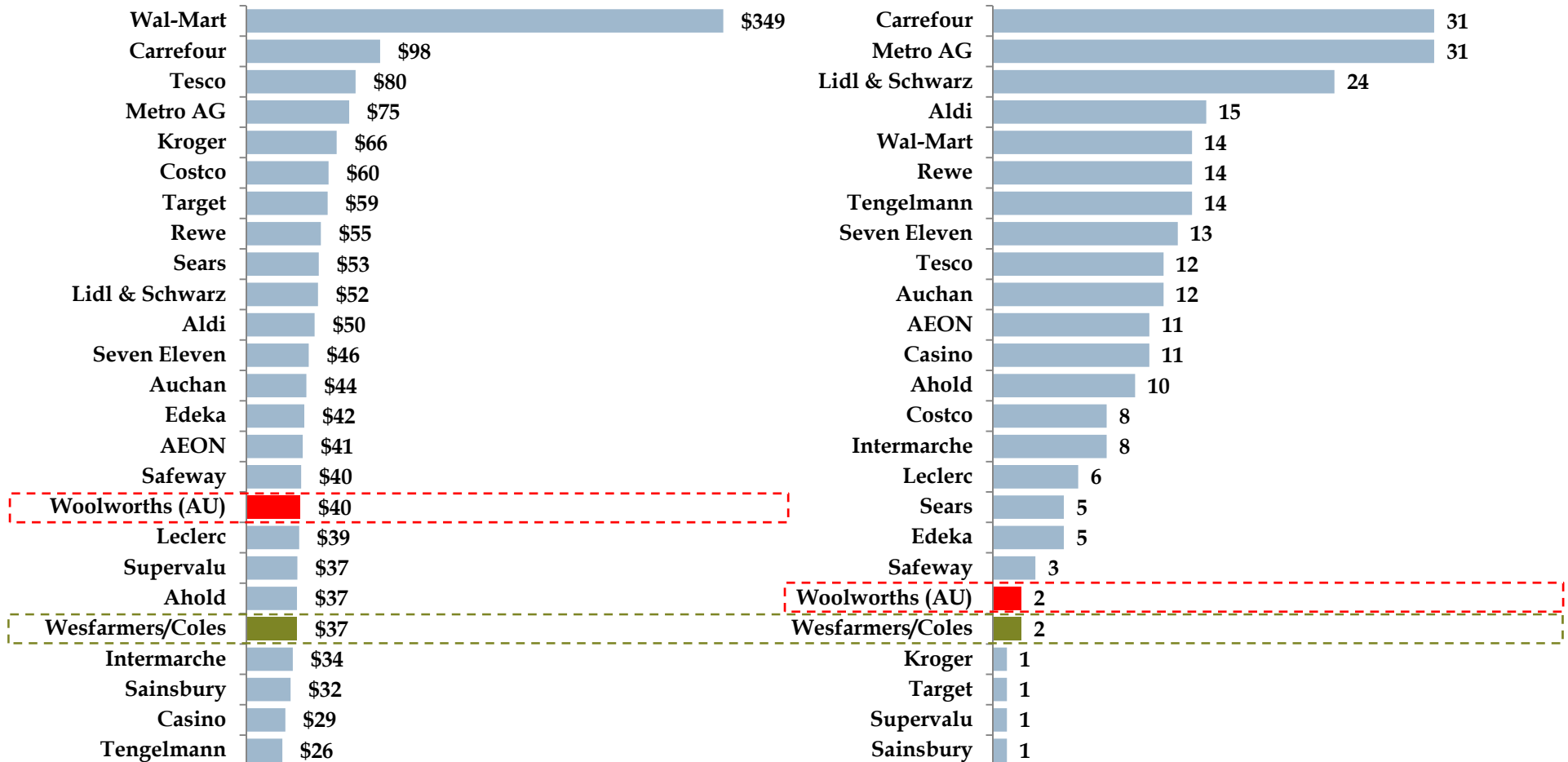
1. **Growth is an imperative for publicly listed companies; in a consolidating industry you must eat or be eaten**
2. **Key characteristics of successful global expanders include:**
 - a) **Leadership position in home market**
 - b) **World class retailer overall**
 - c) **Initially export a single store format (e.g. hypermarket) for which they are global best practice (or very close)**
3. **Generally (but not always) expand into geographically close and culturally similar countries first**
 - a) **United States into Canada**
 - b) **French into Belgium**
 - c) **Western Europeans into Eastern Europe**

GLOBAL RANKING

Woolworths and Wesfarmers have joined the ranks of the top 25 global supermarket-type retailers; however they are only present in two countries

Global top 25 supermarket-type retailers by total turnover
(US\$b; 2006/2007)

Number of countries of operation
(presence; 2006/2007)



CHARACTERISTICS OF GLOBALISERS

Most successful globalisers initially export a single store format (e.g. hypermarket), for which they are global best practice (or very close), to a neighbouring market

Key characteristics of key globalisers

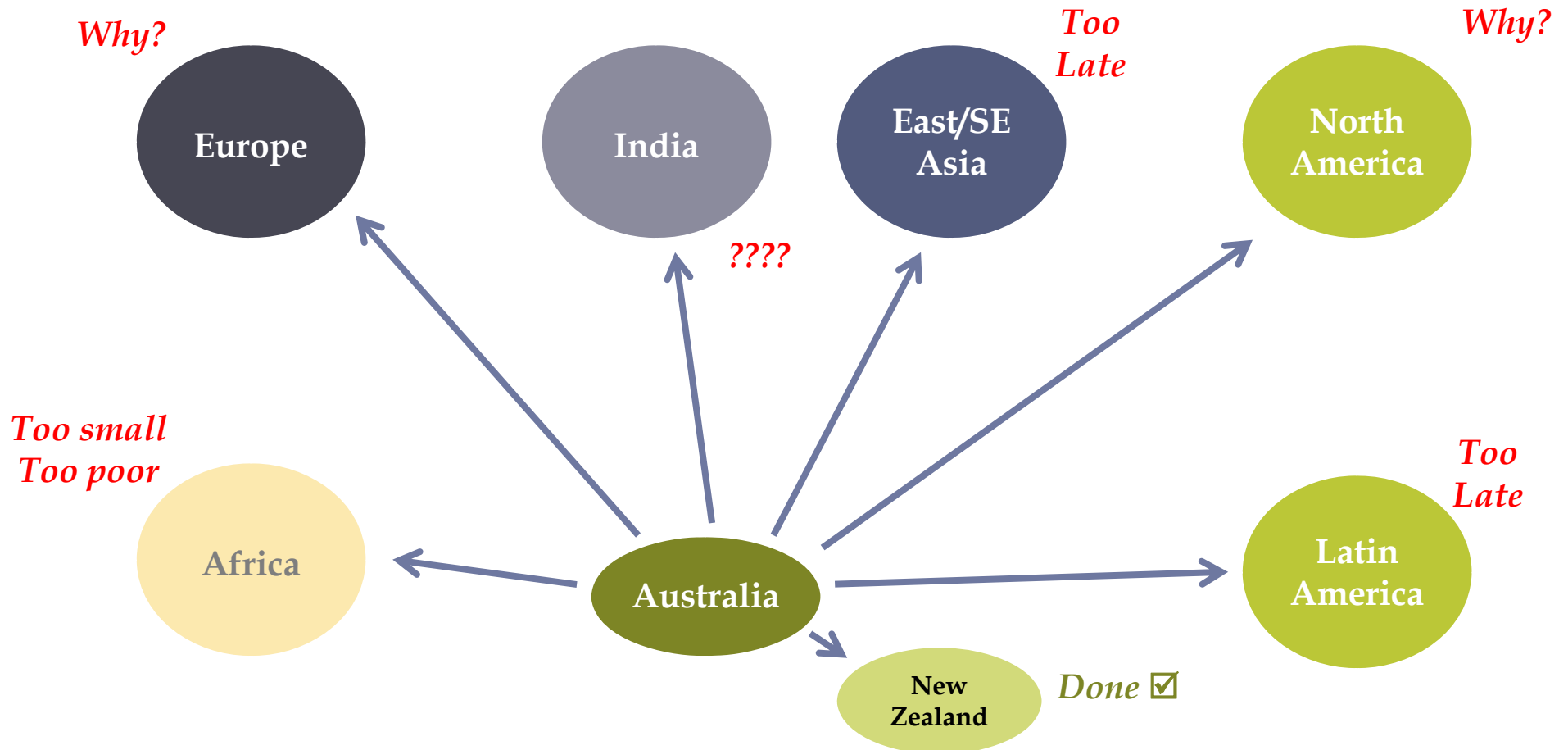
(various; 2007)

Company	Country	Markets share in home market	Initial format exported	First market entered	Growth method	Note
Carrefour	France	27%	Hypermarket	Belgium	Organic and acquisition	Carrefour invented the hypermarket in 1963
Metro (Germany)	Germany	17%	Cash & carry	Austria	Organic and acquisition	#1 C&C operator in Germany
Lidl & Schwarz	Germany	23% of discount	Limited assortment	Austria	Organic	#2 in Germany in limited assortment
Aldi	Germany	41% of discount	Limited assortment	Austria	Organic	Invented limited assortment; #1 in Germany
Auchan	France	24%	Hypermarket	Spain	Organic and acquisition	#2 in hypermarket in France; copied CF in 1967
Wal-Mart	United States	30% of DDS 15% of SM	Supercenter	Canada	Organic and acquisition	Early developer of DDS and US-style HM
Tesco	UK	31%	Hypermarket	Ireland (failed)	Organic & acquisition	Developed successful UK model for HM
Seven Eleven	USA (Japan)	n/a	Convenience store	Canada	Organic	Developed the modern convenience store
Costco	United States	51% of wholesale club	Wholesale Club	Canada	Organic	Invented the wholesale club format

WHERE NEXT?

If either Woolworths or Wesfarmers wants to expand internationally, what is the next step?

Potential growth paths for next steps in expansion
(model)



GLOBAL RETAILERS IN ASIA

Australian would-be globalisers are arriving “late to the party” and face a strong competitive set across all highly attractive markets as this example from Asia shows

Presence of global retailers in Asia

(various; 2007)

Country	Population	GDP	GDP/Capita	Global Retailers Present	Failed
Hong Kong	6.7m	\$186b	\$28,700	-	Wal-Mart, Carrefour
Japan	128m	\$3,550b	\$28,000	Wal-Mart, Carrefour, Tesco, Metro (?), Costco	-
Singapore	4m	\$105b	\$23,700	Carrefour, Wal-Mart, Delhaize	-
Taiwan	23m	\$406b	\$23,400	Carrefour, Tesco, Costco, Auchan	Casino, Makro
Brunei	0.4m	\$6.5b	\$18,600	-	-
South Korea	49m	\$931b	\$17,700	Tesco, Costco	Carrefour, Wal-Mart
Malaysia	24m	\$210b	\$9,000	Carrefour, Tesco, Makro	Ahold
Thailand	65m	\$429b	\$7,400	Carrefour, Tesco, Casino, Makro, Delhaize	Ahold, Auchan
China	1,310m	\$5,700b	\$5,000	Carrefour, Wal-Mart, Tesco, Metro, Makro, Auchan	Ahold
Philippines	88m	\$356b	\$4,600	Makro	-
Indonesia	242m	\$663b	\$3,200	Carrefour, Makro	Wal-Mart
India	1,077m	\$2,660b	\$2,900	Metro	Carrefour
Vietnam	84m	\$183b	\$2,500	Metro, Casino	-
Pakistan	163m	\$311b	\$2,100	-	-
Myanmar	43m	\$70b	\$1,900	-	-
Bangladesh	142m	\$239b	\$1,900	-	-
Laos	6m	\$9.9b	\$1,700	-	-
Cambodia	13m	\$19.7b	\$1,700	-	-

SCENARIO 3 – BEACHHEAD

The “Beachhead” scenario assumes that foreign retailers continue to have success and develop an appetite for Australia



Key Scenario Elements

- *Market is highly consolidated into a handful of players, and historic growth rates slow*
- Australian retailers are not best practice
- Foreign retailers have had, are having and continue to have success in Australia
- Domestic retailers struggle for a larger slice of a smaller pie

Model Countries

- Canada (?)
- China
- Italy (?)
- Greece
- Mexico
- All of Eastern Europe
- Most of South America
- Much of South East Asia

SCENARIO 3 – POTENTIAL OUTCOMES

From our research, we believe the potential outcomes of the “Beachhead” scenario would include:

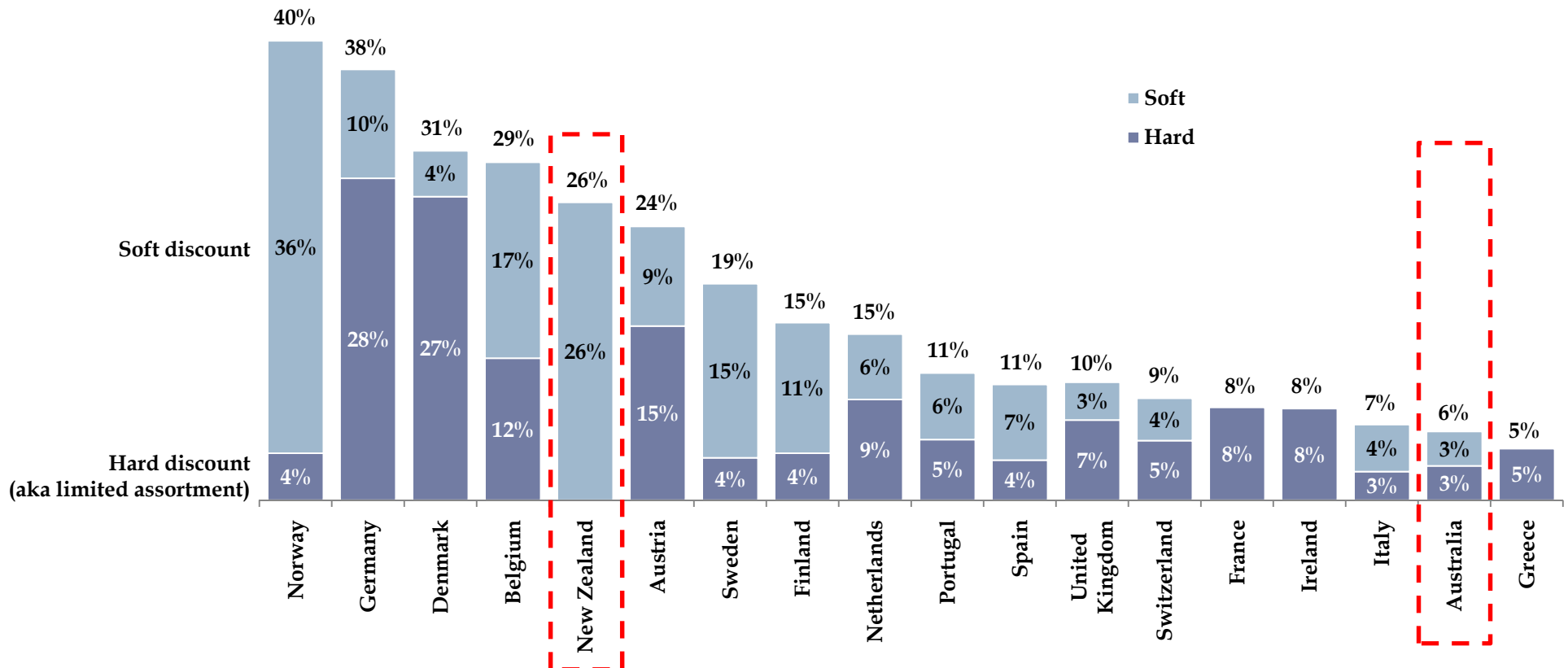


- A. Generally first arrivals are single-store-format specific retailers
 - i. Limited Assortment Discounters (Aldi, Lidl and Netto)
 - ii. Hypermarkets (Carrefour; Wal-Mart; Auchan)
 - iii. Cash & Carry (Metro/Makro)
 - iv. Wholesale/Warehouse Clubs (Costco; [Sam’s Club])
- B. Single format retailers are very good at what they do and rarely fail (other than new entrant hypermarkets into developed markets); their success can have a corrosive effect on the retail scene
- C. The success of single format retailers often triggers domestic players to launch a copycat format
- D. With slowing domestic market growth P/E ratio’s fall making the acquisition of local chains more attractive to global multi-format leaders

SOFT VS. HARD DISCOUNT

The success of discounters varies across countries; in addition the current discounter situation is very different between New Zealand and Australia

Share of discounters of supermarket retailing by type of discounter by country
(% of sales; various years 04-07)



ALDI IN OTHER MARKETS

The experience of other markets suggests (1) Aldi has achieved great success in Australia to date relative to some of its other markets and (2) it can continue to grow

Characteristics of Aldi's international operations




















(various; 2006-2008)

	Year entered	# of Outlets (07/08)	Population	Population per outlet	Market share
Germany	1945	4,010	82,210,000	20,501	19%
Austria	1967	369	8,334,325	22,586	16%
Netherlands	1972	405	16,426,371	40,558	8.4%
Belgium	1976	380	10,584,534	27,854	10.8%
United States	1976	818	304,080,000	371,736	~1.1%
Denmark	1977	244	5,482,266	22,468	4.5%
France	1988	680	64,473,140	94,813	2.6%
United Kingdom	1990	310	60,587,300	195,443	3.0%
Luxembourg	1998	12	476,200	39,683	n/a
Ireland	1999	37	4,339,000	127,617	2.1%
Australia	2001	160	21,287,919	133,049	3%+
Spain	2002	130	45,200,737	347,698	n/a
Switzerland	2005	58	7,612,800	131,255	n/a
Slovenia	2005	32	2,025,768	63,305	n/a
Portugal	2006	5	10,623,000	2,124,600	n/a
Hungary	2008	5	10,043,000	2,008,600	n/a

WAVES OF ARRIVAL

The arrival of global retailers occurs in waves, with the arrival of one often triggering the arrival of another (“suddenly on the radar”)

Examples of rounds of entry by foreign retailers in select countries
(presence; 1929-2009)

	Round 0	Round 1/2	Round 1	Round 2	Round 3
Canada	 (1929)	 (1963)	 (1985)	 (1993)	 (2004) cancelled
United Kingdom	 (1962)	-	 (1990)	 (1994)	 (1999)
Mexico	 (1981)	-	 (1991)	 (1992)	  
Australia	 (1963)	 (1968)	 (2001)	 (2009)	?

SUCCESS MATRIX

The success of new market entrants is not predetermined and there are multiple entry strategies dependant on the structure of the market

Success matrix for a retailer new market entry
(model)

		Does the country have a well developed retail market?	
		No	Yes
Do you have a unique new store concept? (for the market)	No	<p>Strategy: Organic or Acquire Usually late arrival to an already rapidly developing market</p> <p><i>Tesco in Czech</i> <i>Schwarz in Poland</i> <i>Auchan in the United States</i></p>	<p>Strategy: Acquire Impossible to build leading presence organically with copy-cat format</p> <p><i>Wal-Mart in the United Kingdom</i> <i>Sainsbury in the United States</i> <i>Tesco in Japan</i> <i>Dairy Farm in Australia</i></p>
	Yes	<p>Strategy: Enter organically Global competitors also rush; rapid expansion followed by shake out</p> <p><i>Eastern Europe</i> <i>East/SE Asia</i> <i>South America</i></p>	<p>Strategy: Enter organically Local competitors often launch copycat format</p> <p><i>Costco in Canada</i> <i>Costco in United Kingdom</i> <i>Aldi in Denmark</i> <i>Carrefour in the United States</i> <i>Pick'n Pay in Australia</i> <i>Tesco in United States</i></p>

COPYCAT FORMATS

The success of single format retailers often triggers domestic players to launch a copycat format (a strategy with a mixed success rate)

Examples of copycat format launches
(various)

Country	Entrant	Local Copy Cat	Result
Denmark (1970's)	Aldi	Dansk Supermarket launches Netto	Success Netto now #3 discounter in Europe
United Kingdom (1970's)	Carrefour	Tesco launches Tesco and others launch own hypermarkets	Failed; Succeeded 25 years later Tesco converted stores to other uses; UK returned to concept 25 years later with success
United States (1970's)	Price Club	26 clones launched by various retailer, including Wal-Mart and Kmart	Mixed Most fail to master the model and close or are acquired in a widespread industry shakeout; Wal-Mart's Sam's Club survives
Canada (1980's)	Costco	Loblaws launches "The Real Canadian Wholesale Club"	Limited success Concept achieved initial growth by now appears to have plateaued; does not achieve turnover/store of Costco
Australia (1970's)	Kmart	Woolworths launches Big W	Success Big W initially struggled, but is now profitable #3 player in DDS
Australia (2000's)	Aldi	Franklins launches Cheaper Choice	Failure Concept does not get beyond test phase; Dairy Farm sells total Franklins business in pieces

IN CONCLUSION

The Australasian supermarket sector faces three possible scenario's for the future; which one will eventuate is unknown

