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"Others have seen what is and asked why. I have seen what could be and asked why not" Pablo Picasso

The Australian Supermarket Sector – Competition and Disruption: A Perspective

December 2015

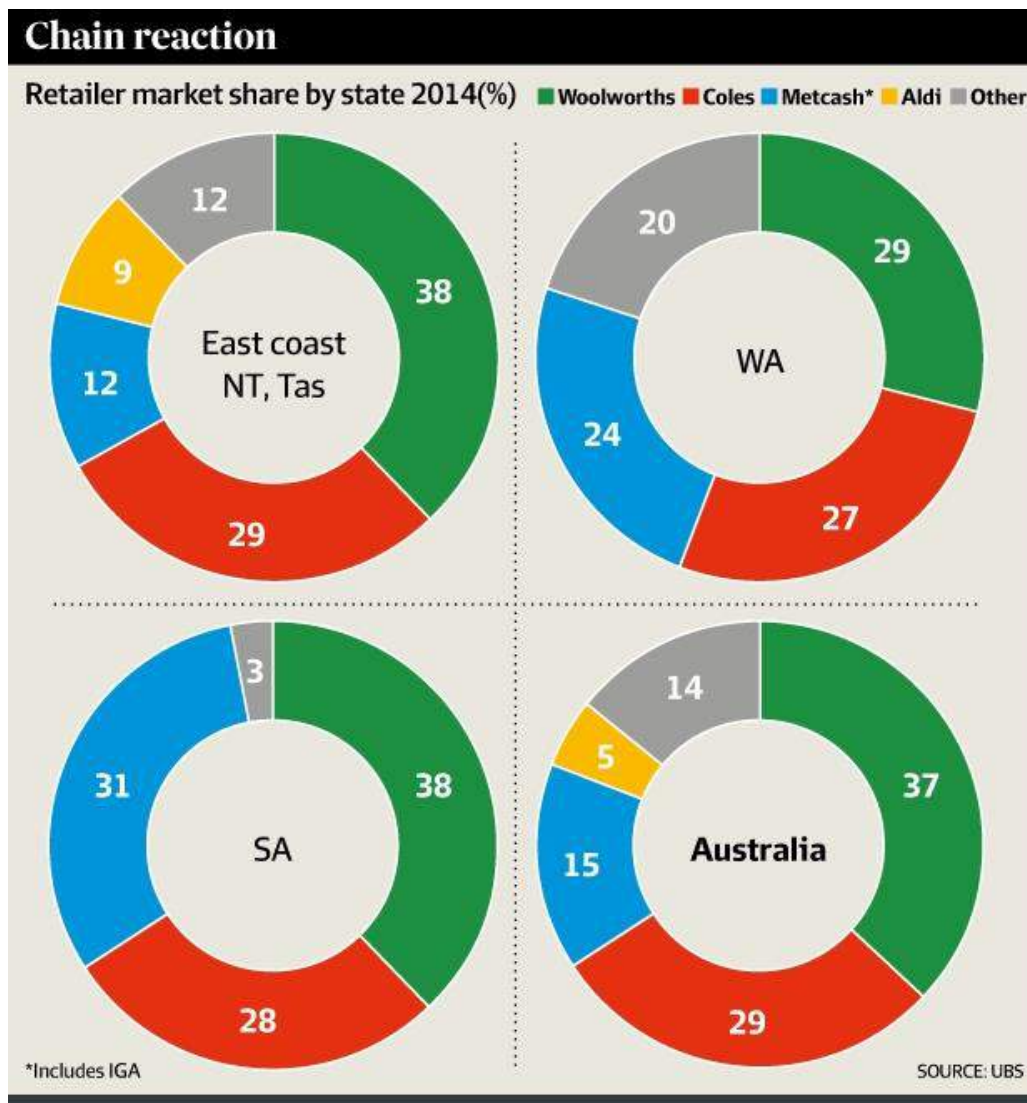
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The Australian supermarket industry is one of the largest, most competitive industries in Australia (IBISWorld, 2014). The Industry revenue is projected to grow by 2.3% annualised over the next five years to reach \$91.6 billion, including a forecast growth of 2.6% in 2014-15 (IBISWorld, 2014).

Global companies, like Aldi and Costco, have shifted the dynamics of the industry. The introduction of Aldi in 2001 meant the introduction of private label merchandise, with Woolworths and Coles implementing private-label merchandise as a cost-reduction method (Grant, Butler, Orr & Murray, 2014).

However, changes in the grocery sector have been unfolding relatively quickly during 2015. ALDI's expansion and the announcement that Lidl will be opening in Australia has threatened the duopoly to Coles and Woolworths, as well as to the shrinking market share for Metcash's IGA chain and independent retailers.

The best overview of the grocery sector in Australia is gained when looking at the industry dynamics in each of the states. The figure below demonstrates the significant differences in market share for some of the major participants, and it also shows that the four major companies in the sector control at least 85% of the total market spend.



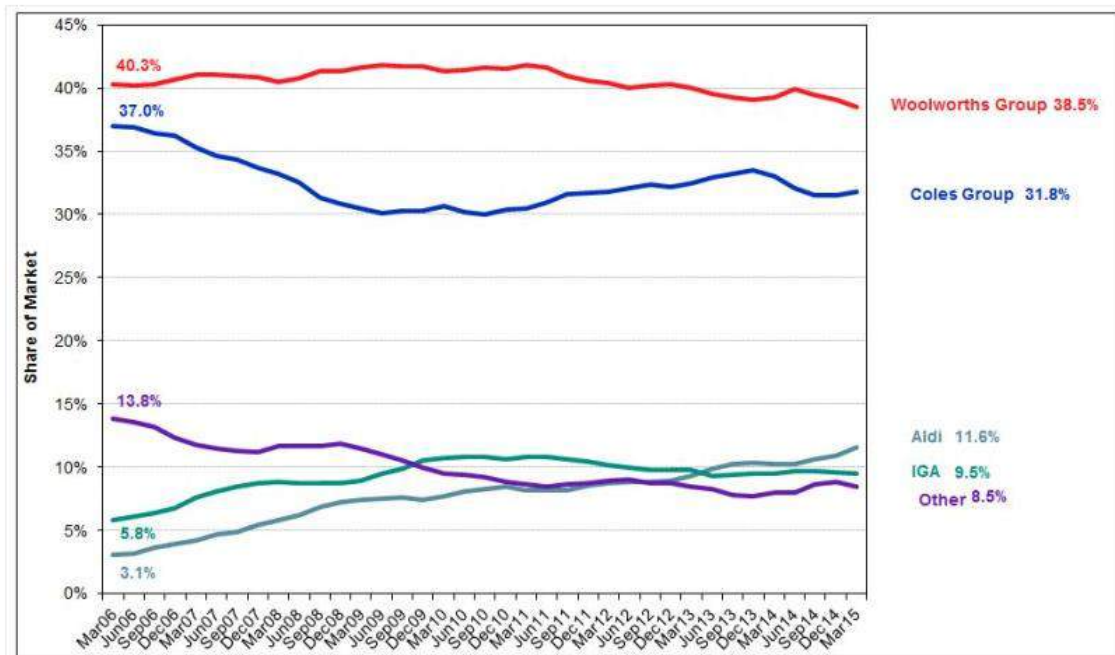
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In a report by Roy Morganⁱ, the change in the competitive landscape in the grocery sector can be seen due to the expansion of ALDI. ALDI has grown its market share from 3.1% to 11.6% in 2015. The combined market share of Coles and Woolworths has dropped from 77.3% to 70.3% in the same period. The change demonstrates the threat to the duopoly in the sector as well as to the shrinking market share for Metcash's IGA chain and independent retailersⁱⁱ.

Further, ALDI is continuing expansion plans across Australia. The company announced in April 2015 a long term plan to open up to 70 stores in Western Australia, with the first 20 to open by the end of 2016. ALDI also announced the intention to open 50 stores in South Australia, having already chosen 23 sites. According to a Roy Morgan report, ALDI's shoppers are more open to buying store brands, where they are likely to get value for money. These customers are also willing to travel further to obtain savings on their grocery shopping. In contrast, Coles, Woolworths and IGA shoppers are more likely to purchase established brands and not travel so far.

One of the reasons for ALDI's success is the relationship with suppliers. We understand from our sources that Aldi has also managed to build trusting and mutually beneficial relationships as part of their overall strategy. That may in the end ensure further market share gains for this innovative market disrupter.

Market share over time: supermarket grocery market dollars



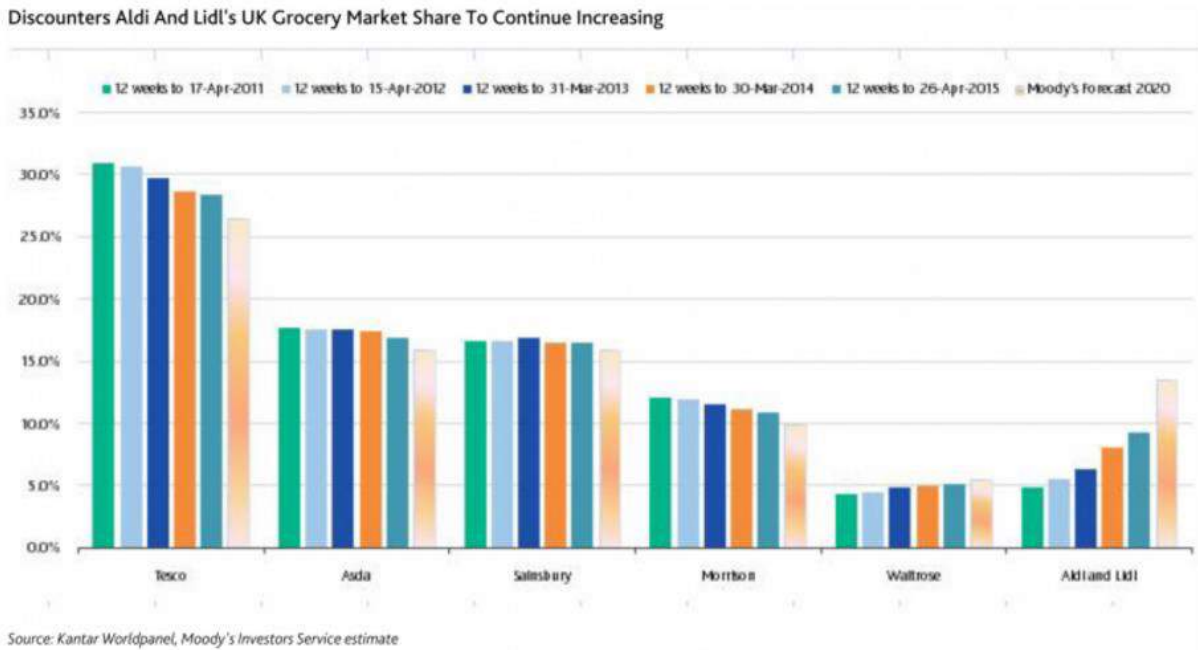
Source: Roy Morgan Single Source (Australia), April 2006 – March 2015 (average 12-monthly sample size n=13,134). Base: Australian grocery buyers 14+, weighted to Australian households

The announcement in mid-2015 that Lidl was entering the Australian market is likely to disrupt the market. Lidl was ranked by Deloitte as the fourth-biggest retailer in the world, with nearly US\$100bn in annual sales.

COMPARISON TO THE UNITED KINGDOM MARKET

Competition from Aldi and Lidl have changed the competitive landscape in the British supermarket industry over the past ten years. The shrinking market share of the United Kingdom’s (UK) once dominant supermarket Tesco is now well described, and often brought up as an example of what may happen in Australia.

The graph below by Moody’sⁱⁱⁱ shows the extent of change in the grocery sector over the past five years in the UK and with a forecast by Moody’s for the trend towards 2020.



Firstly, Lidl and Aldi now have a combined market share of 9.7% in the UK market. In a smaller timeframe in Australia, Aldi alone has already gained a market share of 11%, indicating Australian consumers willing response to a quality grocery offering at lower prices. This change may indicate a better growth trajectory for discount supermarket entrants, including Aldi, than that seen in the UK.

The second trend observed in the UK, is that many consumers have changed shopping habits, as they dispense with the big weekly shop and instead buy goods as and when they need them. This trend tends to support the discounters with their more limited but targeted product ranges. As our society ages, these changing shopping habits will become more widespread as consumers have more time, less capacity to manage large shopping and less disposable income.

IMPACT ON COLES AND WOOLWORTHS

Moody’s changed Woolworths’ credit rating from Baa1 stable to negative on 5th November. Moody’s cited further weakening in sales and profit downgrade from Woolworths. The report highlighted that the deterioration in Woolworths’ credit profile during fiscal 2015 had exceeded Moody’s expectations, and Woolworths continued to experience difficulties in arresting the negative momentum in comparable-store sales. Also, Moody’s anticipated further price deflation due to price competition from Coles and Aldi.^{iv}

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Woolworths is now planning on spending more than \$600 million on reducing grocery costs and improving service in supermarkets. However at the end of October, Woolworths issued the third profit warning of the year. They now expect profits to fall as much as 35% in this half-year as food and liquor margins fall from 8.2% to 5.4%.

However, Woolworths has also suffered a significant setback as a consequence of the disruption of the sector. Some sources have argued the Board of Woolworths and perhaps significant numbers of the Senior Management team lost connection with the business and the customers. Retail is a very complex and changeable industry sector that requires management's constant attention. Sources have suggested management could benefit by being more regularly in the supermarket outlets themselves, thus sharing the shopping experience with their customers.

However, the story at Coles is different, having reported a 3.6% increase in same-store food and liquor sales in the September quarter^v. Coles aims to compete against the other supermarkets by eliminating excessive home brands, replacing it with a single delivery called Coles, featuring a distinctive red ribbon.^{vi} Coles further aims to create a simple and identifiable product^{vii}. According to IBISWorld, private label is an opportunity for supermarket chains with expected penetration to grow from the current 20% to 35% of all food and grocery sales by 2020-21^{viii}.

IMPLICATIONS FOR LEADERSHIP

We have already witnessed changes in Chairmen, Chief Executives and a number of Directors in the industry. It is clear that the scale and speed of change in this sector will continue, and as such leadership will need to keep pace. While expertise and experience in grocery management remain fundamentally important, other leadership experience in previously disrupted industries could be of equal value.

Fresh thinking is essential in this sector, especially if changes continue at such a quick pace, observed over the past ten years. However, it would be risky to assume that fresh thinking is only going to come from internal veterans. It is probably time to start looking very seriously at other relevant industries and, in particular, the leadership teams they have developed to prosper in very uncertain times, with notable track records of performance.

A Summary of Retail and Consumer Board and Executive Movements for 2015

AP Eagers Ltd: Chief Financial Officer and Chief Information Officer Stephen Best transitioned into the role of Chief Commercial Officer. Sophie Moore was appointed as Chief Financial Officer.

Ardent Leisure Group: Deborah Thomas was appointed as Group Chief Executive Officer to replace Greg Shaw. Melanie Willis has been appointed as an Independent Non-Executive Director.

Australian Careers Network Ltd: Samantha Martin-Williams has resigned from the Board.

Automotive Holdings Group: Greg Duncan has been appointed to the Company's Board. Head of Business Development, Hamish Williams, has retired. Deputy Chairman Michael Smith and Director Tracey Horton did not stand for re-election at the 2015 Annual General Meeting.

Bega Cheese Limited: Raelene Murphy has been appointed as a Director of the company and will become the Chair of the Audit and Risk Committee. Ms Murphy has replaced Joy Linton, who has resigned.

Billabong International Ltd: Matthew Wilson resigned as a Director.

Blackmores Ltd: John Armstrong was appointed as a Non-Executive Director.

Breville Group Ltd: Jim Clayton was appointed as Chief Executive Officer. Mervyn Cohen returned to his role of Chief Financial Officer. Sam Weiss retired as a Director at the conclusion of the Company's AGM.

Cash Converters Ltd: Kevin Dundo was appointed to the Board of Directors. Reginald Webb retired from the Board following completion of the 2016 financial year. To assist in the transition, Stuart Grimshaw was appointed as interim Non-Executive Chairman. Additionally, Mark Reid has been appointed to the position of Chief Executive Officer, Australia.

Coca-Cola Amatil Ltd: Nessa O'Sullivan left her role as Group Chief Financial Officer following the completion of year end processes and the February EGM. Peter Kelly, Managing Director of SPC, left his role. Reg Weine was appointed as his replacement. Martyn Roberts was appointed as the Group's Chief Financial Officer and commenced his role during CCA's third quarter. John Borghetti was appointed to the Board as a Non-Executive Director.

Collins Food: Robert Kaye has been appointed as an independent, Non-Executive Chairman of the Board and Graham Maxwell has been appointed as Managing Director. Nigel Williams has been appointed Group Chief Financial Officer.

Costa Group Holdings Ltd: Tiffany Fuller has been appointed as an Independent Non-Executive Director, effective 1st October 2015.

Dick Smith Holdings Ltd: Phil Cave AM has resigned as Chairman of the Board and has been replaced by Rob Murray. William (Bill) Wavish resigned as a Non-Executive Director. Jamie Tomlinson was appointed as Non-Executive Director.

Domino's Pizza Enterprises Ltd: Lynda O'Grady has been appointed as Non-Executive Director following the retirement of Barry Alty.

Flight Centre Ltd: Chief Financial Officer, Andrew Flannery, became Executive General Manager of Flight Centre's Australian corporate travel business. Adam Campbell has been appointed as Chief Financial Officer.

Fonterra Co-operative Group Ltd: Managing Director for Global Brands and Nutrition, Jacqueline Chow, stepped into a new role as Chief Operating Officer, Velocity. Rene Dedoncker will fill the position for Managing Director Global Brands and Nutrition, effective from 1st June 2015. Johan Priem has been appointed as President and Managing Director for Asia, Middle East and Africa region. Sir Ralph Norris ended his term on the Fonterra Board on 25th November 2015. Sir Ralph also resigned from the Board of the Fonterra Shareholders' Fund from 25th November. Clinton Dines has been appointed as an Independent Director. Judith Swales was appointed as Managing Director, Oceania, effective 1 November 2015.

Funtastic Ltd: Craig Mathieson, a Non-Executive Director of Funtastic Ltd resigned, effective from 26th May 2015.

G8 Education Ltd: Mark Johnson has been appointed as Chairman, effective 1 January 2016.

Godfreys Group Ltd: Sophie Karzis has been appointed as Company Secretary.

GrainCorp Ltd: Andrew Baker has been appointed as Chief Information Officer, Marcus Kennedy appointed as Chief Development Officer and Phil Caris has been appointed as Group General Manager Human Resources, effective September 2015. David Trebeck retired from the Board at the Annual General Meeting. Peter Richards was appointed to the Board as a Non-Executive Director, effective 9 November 2015.

Grays eCommerce Group Ltd: Bernie Campbell has been appointed as a Non-Executive Director. David Grbin has been appointed as Chief Financial Officer and Joint Company Secretary.

GUD Holdings Ltd: Peter Hay, Independent Non-Executive Director, resigned from his post, effective 1st August 2015. Anne Templeman-Jones was appointed as an Independent Non-Executive Director, effective 1st August 2015.

GWA Group Ltd: Ian Brannan has resigned from his position as Group Chief Financial Officer.

Helloworld Ltd: Peter Spathis has been appointed as a Non-Executive Director, effective from 18th May. Stephen Bennett announced his retirement as a Non-Executive Director, effective 18th May. Current Chief Executive Officer, Elizabeth Gaines, is leaving the company. She will continue serving for six months from the date of her announcement as a notice period and until a replacement is found for the role. Rob Marcolina has been appointed as a Non-Executive Director, effective 18 September 2015.

InvoCare Ltd: Aliza Knox has resigned as Non-Executive Director, effective 31st August 2015. Joycelyn Morton has been appointed as an Independent Non-Executive Director, effective 19th August 2015.

iSelect Ltd: Chris Knoblanche AM has been appointed to the role of independent Chairman, effective 1st July 2015. Chairman and iselect Co-Founder Damien Waller transitioned into the role of Non-Executive Director. Les Webb has resigned as a Non-Executive Director of the Company. Alex Stevens, Chief Executive Officer has resigned from the company, effective immediately. Scott Wilson has been appointed to the

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position of Chief Executive Officer. Paul McCarthy has tendered his resignation as Chief Financial Officer and will remain with the Company until the end of January 2016.

JB Hi-Fi Ltd: Simon Page was appointed as Chief Information Officer and commenced his role in September 2015. Wai Tang has been appointed as a Non-Executive Director, effective 14th September 2015. James King retired as a Non-Executive Director following the Company's AGM on 29th October 2015.

Kathmandu Holdings Ltd: Xavier Simonet has been appointed as Chief Executive Officer. Jolann van Dyk has been appointed as Chief Information Officer following the resignation Grant Taylor. Acting CEO, Mark Todd, assumed his previous role as Chief Operating Officer, and subsequently resigned as Chief Operating Officer and Finance Director, stepping down from the Board.

Lovisa Holdings Ltd: Neil Osborne was appointed as a Non-Executive Director of the Board in April, and resigned in November 2015. Paul Cave was appointed as Chairman.

McPherson's Ltd: John Clifford resigned as Non-Executive Director while Jane McKellar joined the Board to replace him. David Allman has stepped down as Chairman. Graham Cubbin has been appointed as Chairman. Patricia Margaret Payn has been appointed as a Non-Executive Director.

Metcash Ltd: Brad Soller has been appointed as Chief Financial Officer. Fergus Collins resigned as Chief Executive Officer of the Supermarkets division. Mick McMahon has retired as Non-Executive Director. Steven Cain has been appointed as Chief Executive Officer Supermarkets, effective 1st August 2015. Mark Hewlett has been appointed as Executive General Manager, New Channels effective 12th August 2015. Helen Nash has joined the Board of Directors.

Myer Ltd: Bernie Brookes stepped down as Chief Executive Officer and Managing Director and Richard Umbers, Chief Information and Supply Chain Officer, succeeded Brookes in the role. Daniel Bracken has been appointed Deputy Chief Executive Officer in addition to his current role as Chief Merchandise and Marketing Officer. Mark Ashby resigned as Chief Financial Officer. Grant Devonport has been appointed as Chief Financial Officer. Acting Chief Financial Officer Tom Coleman will continue to work closely with the executive team. Richard Amos has been appointed as Chief General Counsel and Company Secretary following the resignation of Marion Rodwell from the position. Mark Cripsey has been appointed to the newly created role of Chief Digital and Data Officer. Deputy Chairman, Rupert Myer AO, did not seek re-election for a fourth term and as such retired from the Board. David Whittle has been appointed as a Non-Executive Director.

Noni B Ltd: Luke Softa has been appointed as Chief Financial Officer and Company Secretary.

Oroton Group Ltd: Eddy Chieng resigned as Non-Executive Director while Maria Martin was appointed as a Non-Executive Director. Sam Weiss has retired from the Board.

Pacific Brands Ltd: Anthony Heraghty has resigned from his position as Group General Manager of Underwear. David Bortolussi has been appointed as Acting Group General Manager Underwear.

PaperlinX Ltd: Andrew Price's employment contract as Managing Director and Chief Executive Officer has been terminated and Robert Kaye assumed the role of Executive Chairman. Andy Preece has been appointed as Managing Director and Chief Executive Officer. Joost Smallenbroek is no longer the Chief Financial Officer. Wayne Johnston assumed the role of Chief Financial Officer effective 1st May 2015.

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Michelle Wong has resigned from her position as Company Secretary. Wayne Johnston, Chief Financial Officer will continue in his additional position as Company Secretary.

Premier Investments Ltd: David Crean has been appointed as Deputy Chairman following the retirement of Frank Jones.

RCG Corporation Ltd: Leanne Ralph has been appointed as Company Secretary. Michael Hirschowitz has stepped down from the position as Company Secretary.

Retail Food Group Ltd: Kerry Ryan has been appointed as an independent Non-Executive Director. Tracy Bartley has been appointed as Joint Company Secretary.

Ridley Corporation Ltd: John Spark has retired as Chairman. Dr Gary Weiss has been appointed as the new Chair.

Ruralco Holdings Ltd: Adrian Gratwicke has been appointed as Chief Financial Officer. John Maher stepped down as Managing Director. Travis Dillon has been appointed as Chief Executive Officer and Managing Director. Susannah Ball has resigned as Company Secretary.

Specialty Fashion Group Ltd: Chairman, Geoff Levy, and Non-Executive Director and co-Founder, Ian Miller, resigned at the Annual General Meeting.

Super Retail Group Ltd: Rob Murray has resigned as Non-Executive Director following his appointment as Non-Executive Director at Metcash Ltd. Launa Inman and Diana Eilert have been appointed as Non-Executive Directors.

Surfstitch Group Ltd: Jane Huxley has been appointed as Non-Executive Director.

Tassal Group: Raelene Murphy has been appointed as a Non-Executive Director.

The PAS Group: Company Secretary, Derrick Krowtiz, resigned as Company Secretary and was replaced by Steven Milicevic. Steven Milicevic subsequently resigned as General Counsel and Company Secretary. Kwong Yap has replaced Steven as General Counsel and Company Secretary.

Thorn Group Ltd: Andrew Stevens has been appointed as a Non-Executive Director.

Treasury Wine Estates Ltd: Bob Spooner has been appointed Chief Supply Officer and replaced Stuart McNab, who has left the company. Noel Meehan has been appointed as Chief Financial Officer, joining the Company on 1 December 2015, prior to taking up his position on 1 January 2016. Noel replaces Tony Reeves, with Tony's last day being 31 January 2016.

Vitaco Holdings Ltd: Anna Sandham has been appointed Joint Company Secretary. Sandy Lockhart has resigned as Company Secretary and will remain appointed as a Non-Executive Director.

Woolworths Ltd: Director of Liquor, Brad Banducci, stepped into the role of Managing Director, Australian Supermarkets and Petrol, with previous Managing Director Tjeerd Jegen resigning after almost four years in the role. Martin Smith, previously General Manager at Dan Murphy's, has been appointed as Director of the Liquor division. Dave Chambers has been appointed as Director, Supermarkets. Steve Donohue has been appointed as Acting Managing Director, Progressive Enterprises, until a new appointment is

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announced for the role. Chief Executive Officer, Grant O'Brien, has retired from the company but will continue serving until a replacement is found for the role. Penny Winn, Director of Group Retail Services, left the company in November this year. Rod Bordignon has resigned as Company Secretary. Kara Nicholls has been appointed as Company Secretary. Alastair McGeorge has resigned as Managing Director of Big W. Penny Winn will act in the role until a permanent appointment is made. Gordon Cairns has been appointed as a Non-Executive Director and has been elected as Chairman, effective 1st September 2015, and Ralph Waters retired as Chairman of the Woolworths Board and Non-Executive Director on the same day. Christine Cross and David Mackay did not seek re-election at the 2015 Annual General Meeting. Holly Kramer has been appointed as a Non-Executive Director, effective in the first half of 2016.

Wesfarmers Ltd: Ian McLeod has resigned as Commercial Director. Bob Every AO, Chairman stepped down from his position at the Annual General Meeting in November and was replaced by Michael Chaney AO.

Authors: Karsten M. Hansen & Clare McKenna

Karsten M. Hansen is a Partner, Research & Advisory with Blenheim Partners in Sydney and a Senior Member of the Thought Leadership Practice.

Clare McKenna is a Research Associate with Blenheim Partners in Sydney and is a Member of the Thought Leadership Practice.

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ⁱ <http://www.roymorgan.com/findings/6297-aldi-effect-australias-changing-supermarket-scene-201506220132>

ⁱⁱ https://www.moodys.com/research/Moodys-Aldi-poses-long-term-challenge-to-Woolworths-and-Coles--PR_319897

ⁱⁱⁱ <http://www.ibtimes.co.uk/aldi-lidl-consume-4-more-tesco-morrison-asda-sainsburys-marketshare-by-2020-1505572>

^{iv} https://www.moodys.com/research/Moodys-changes-Woolworths-Outlook-to-Negative-All-ratings-affirmed--PR_328133

^v <http://www.afr.com/business/retail/fmcg/woolworths-warns-firsthalf-profit-to-fall-as-much-as-35pc-20151028-gkl9bj>

^{vi} <http://www.theaustralian.com.au/business/companies/aldi-threat-sees-coles-revamp-home-brands/story-fn91v9q3-1227614489950>

^{vii} <http://www.theaustralian.com.au/business/companies/aldi-threat-sees-coles-revamp-home-brands/story-fn91v9q3-1227614489950>

^{viii} <http://www.theaustralian.com.au/business/companies/aldi-threat-sees-coles-revamp-home-brands/story-fn91v9q3-1227614489950>



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For Further information on Executive Search & Board Advisory please contact:

Gregory W. Robinson

Founder & Managing Partner, Search & Advisory

p +61 2 9253 0954

e gregory.robinson@blenheimpartners.com

Ian Smith

Partner, Search & Advisory

p +61 2 9253 0955

e ian.smith@blenheimpartners.com

Brett Wright

Partner, Search & Advisory

p +61 2 9253 0958

e brett.wright@blenheimpartners.com

Alison Tovey

Partner, Research & Gender Diversity

p +61 2 9253 0953

e alison.tovey@blenheimpartners.com

Karsten M. Hansen

Partner, Research & Advisory

p +61 2 9253 0950

e karsten.hansen@blenheimpartners.com