Metcash FY2022 Results

Metcash, the parent company of the Independent Hardware Group (IHG) and Total Tool Holdings (TTH), has released results for its FY2021/22, which ended on 30 April 2022.

It's worth noting that there are a number of complexities to the report of these results. This includes the need to account for charge-through revenues, which result from Metcash services that are transaction-only, as well as FY2021/22 including 53 trading weeks. Metcash's advice has been to pro-rate the extra week, which means that results are reduced by around 1.9% when comparing to previous, 52-week years. According to a footnote in Metcash's presentation:

> The 53rd week comprised 4 business trading days over the week ended Sunday 1 May 2022 (Anzac Day was on 25 April 2022). One-week of sales has been estimated on an annualised basis by pillar to display an FY22 sales number comparative to prior (52 week) periods.

Metcash has also, in the process of "normalising" results to 52 weeks for its Food business, removed sales from the comparative FY2020/21 year for 7-Eleven and Drakes. According to another footnote:

> The previous East Coast supply agreement with 7-Eleven concluded on 17 August 2020 and Metcash ceased to supply Drakes in South Australia from September 2019. A normalised sales growth has been calculated by adjusting sales in the relative comparative period to exclude sales to both 7-Eleven and Drakes, in addition to excluding the 53rd week from FY22.

HNN has not excluded sales from 7-Eleven and Drakes in our analysis.

It is also worth noting that, as far as we can tell from Metcash's report, while the revenue numbers have been pro-rated to 52 weeks, the earnings before interest and taxation (EBIT) numbers have not. The use of non-normalised numbers was explicitly mentioned in Metcash's FY2016/17 results, so we assume the continuation of that practice. In our numbers we have pro-rated EBIT.

METCASH OVERVIEW

The overview for the three main business areas at Metcash, Food, Hardware and Liquor, is provided in Table 1: Metcash Results FY2021/22 ending 30 April 2022 (following page).

Overall, Metcash's year was not outstanding, particularly when its gains are viewed in the context of 5.1% inflation. Hardware did perform well, but that was in large part due to further investments in TTH and other acquisitions.

It may be that Metcash might have been better served making similar investments in its other business segments, rather than funding the share buyback scheme initiated by the company's previous CEO, Jeff Adams. At the FY2020/21 results several analysts suggested the market remained fragile, especially as regards the Food segment. It would seem they were more right than wrong.

Mr Adams, who decided in late 2021 not to continue as CEO at Metcash so as to spend more time with family, has been replaced by

Doug Jones. Mr Jones is a chartered accountant, and is a graduate of the tough school of supermarket operations in South Africa, where he spent 14 years at Massmart.

Metcash overall had revenues of $17,405.7 million with charge throughs, $15,164.8 million without, for a 52-week normalised revenue of $14,878.7 million.

(All subsequent mentions of revenue will refer to non-charge through, 52-week normalised numbers; EBIT will also refer to 52-week normalised results.) This was an increase of $563.4 million or 3.9% over the previous corresponding period (pcp), which was FY2020/21.

Metcash's Food business did not fare especially well, with revenue of $8,221.2 million down by -1.1% on the pcp. Liquor had revenue of $4,662.7 million up by $288.4 million or 6.6% on the pcp.

Metcash's EBIT of $463.4 million was $62.0 million or 15.4% up on the pcp. However, its statutory profit for the year was $245.4 million, which would be $240.8 million as a 52-week year, an increase of $1.8 million or 0.8% on the pcp.

EBIT for the Food segment was $196.5 million, up by 2.1% on the pcp, while EBIT for Liquor was $95.6 million, up 7.7% on the pcp.

HARDWARE

Looking at the topline numbers for the Hardware segment, revenue was $1,994.7 million, up $370.0 million or 22.8% on the pcp. EBIT for Hardware was $187.7 million, up $51.7 million or 38% on the pcp.

To make an attempt to break out the "organic" (non-acquisition) growth from the "non-organic" growth, Metcash states that:

> An additional 20 joint venture and company-owned stores were acquired during the year which added ~$95m of sales.

That would mean organic revenues were around $1,900 million, which represents organic growth of 16.9% overall.

HARDWARE IN FOUR PARTS

To fully understand how Metcash's Hardware segment has developed, it's necessary to see it as four separate components: There is the charge-through business; TTH; the franchise component with independently-owned stores under the Mitre 10, Home Timber & Hardware Group (HTH), Thrifty-Link and True Value banners; and a separate group of corporate-controlled stores bannered as Mitre 10 and HTH.

There is a total of 513 Mitre 10 and HTH stores, and Metcash has 102 fully-owned and joint-venture stores, or 19.9%. It makes sense to treat the controlled stores as their own entity. Some analysts have suggested – as a rough estimate – that the full EBIT earned by the company-controlled stores is almost as much as the EBIT Metcash earns from all the fully independent stores – though HNN cannot confirm this. While treating these separately would be a more accurate representation of Metcash's Hardware segment, the corporate-controlled stores are instead treated as a "regular" part of IHG.

Equally, there is only limited insight into the charge-through business, in terms of how much EBIT it generates, and other details. About all we can do is to take out the revenue from the overall numbers. The one comment that Mr Jones did make about this business in his prepared remarks was:

> There's been strong growth in charge through sales, as retailers recognise the value in accessing a broader range, and suppliers continue to take advantage of Metcash as an effective route-to-market partner. Just remember, these sales are not a shift from one channel to the other, they're sales that we otherwise wouldn't have got.

So charge-throughs are significant, and part of Metcash's ongoing

Metcash Results FY2021/22 ending 30 April 2022

	Total	Without Charge Throughs	52 week year	Previous year	Percentage Change
			REVENUE		$millions
Metcash	$17,405.7	$15,164.8	$14,878.7	$14,315.3	3.9%
Food	$9,522.3	$8,379.3	$8,221.2	$8,316.3	-1.1%
Hardware	$3,119.5	$2,033.1	$1,994.7	$1,624.7	22.8%
Liquor	$4,800.0	$4,752.4	$4,662.7	$4,374.3	6.6%
			EBIT		$millions
Metcash		$472.3	$463.4	$401.4	15.4%
Food		$200.3	$196.5	$192.4	2.1%
Hardware		$191.3	$187.7	$136.0	38.0%
Liquor		$97.4	$95.6	$88.7	7.7%

strategy, but we have little insight into aspects of how they work, including the EBIT derived from them.

That leaves HNN with the sole option of analysing only the entire IHG business and TTH. That's a pity, because it means we have only limited insight into what seems an interesting strategy.

INDEPENDENT HARDWARE GROUP

While tracking down the IHG numbers is a little complex, it should be noted that there is at least greater clarity to these figures as compared to when Metcash combined Hardware with its automotive operations.

Revenues

Metcash states that:

> [S]ales in IHG increased 12.5% (+32.6% 2yr basis) to $2.8bn reflecting the impact of inflation and volume growth in Trade.

Evidently, the $2,800 million number includes charge-throughs and represents a 53-week trading year. Rectifying those elements, the sales revenue would be roughly $1,681 million.

Metcash does not seem to have provided IHG revenue without charge-throughs for its reporting on the previous year, FY2020/21. We can, however, reverse into those numbers. If the $2,800 million represents a 12.5% increase over FY2020/21 total revenues, then total revenues for FY2020/21 would be around $2,489 million. There is an indication that charge-throughs for hardware in FY2020/21 were $975 million, which would give us IHG revenue of $1,514 million, for that year.

This means that IHG's growth would be roughly 11.0%. That accords fairly well with the other statements Metcash has made about IHG growth. Metcash states that:

> The IHG banner group continued to perform strongly with retail LfL sales increasing 10.5%, with Trade sales up 12.7% and DIY sales up 6.7% (+21.8% on a 2yr basis, with Trade +11.6% and DIY +39.1%).

In the slide presentation accompanying the results, slide 14 notes:

> 22 new or expanded sites across the network, adding 39,000m2 of floor space (10 IHG stores/23,000m2 and 12 TT stores/16,000m2).

It's likely the extra 0.5% over the like-for-like (comp) figure is a result of the new sites added to IHG.

It is worth noting that in terms of the background growth in the hardware retail industry, the comparative figures for the Metcash FY2021/22 were overall growth in Australia of 2.2%, indicating that IHG has outperformed the background market.

Metcash states that:

> DIY demand continued to be elevated, but volumes declined slightly against the exceptional prior year comparative.

This led to a shift in the proportion of DIY/Trade sales, from 40/60 in the pcp to 36/64 in the reporting year. In response to an analyst's question as to which DIY categories were seeing a decline, IHG CEO Annette Welsh responded:

> [DIY] is really coming off the very heightened level that we saw through lockdowns and the need for consumers to invest in their homes as they were spending more time there. I would say some of our decline is probably in that area of garden and paint, which were the two heightened and really peak elements [during lockdowns].

EBIT

Regarding EBIT for IHG, Metcash states:

> IHG's EBIT increased $15.8 million or 14.1% to $127.8 million reflecting the strong sales performance, and the contribution from company-owned and joint venture stores acquired during the year.

This would mean EBIT for a 52-week equivalent trading year would be $125.4 million, or a 12.0% increase on the pcp.

TOTAL TOOL HOLDINGS

Revenues

Metcash states that TTH sales were up by 160.4% to reach $367 million, which would be $360 million in a 52-week trading year, and would represent an increase of 155% on the pcp.

(Just to reconcile these figures, if we have total hardware revenue adjusted for a 52-week trading year of $1,994.7 million and IHG revenue of an estimated $1,681 million, that would, however, indicate TTH revenue of under $314 million. It seems to be the case, then, that Metcash has in its revenue number for the Hardware segment accounted for holding only 85% of TTH.)

Much of that increase is due to expansion, of course. Metcash acquired an additional 15 TTH joint-venture stores, which contributed an additional $67 million to Hardware sales revenues.

Metcash stated in a footnote that:

> Total Tools sales include exclusive brand sales, franchisee fees, joint venture and company-owned store sales and other services.

The entire TTH network had sales of $972 million for the year, or $954 million for a 52-week trading year, an increase of 9.9%. The network was expanded by a further 11 stores, to reach 100 in total. Metcash reports that comp sales were up 5.0%.

EBIT

Metcash states that TTH has increased EBIT by $39.5 million to $63.5 million. That would be $62.3 million for a 52-week trading year, an increase of 160%.

HARDWARE STRATEGY

IHG

The attitude that Metcash expresses towards the hardware market is that it has been constrained by elements other than demand:

> Residential construction and renovations activity was adversely impacted by tight supply conditions, tight labour supply and unseasonal wet weather, leading to a further strengthening of the pipeline of future activity.

Categories that struggled due to supply shortages included timber, LVL, plaster and insulation.

While there were certainly constraints that contributed to lower background market growth, it is also a fact that the market did continue to grow, despite record-breaking growth in the previous financial year.

It is also worth noting that the language used includes the suggestion that work not completed in the reported year is merely delayed for subsequent years. That has become a common assumption across the hardware and construction industry. However, it seems just as likely that, facing higher interest rates, increasing inflation and sustained resistance to wage increases, much of that work, if delayed beyond calendar 2022, could end up being cancelled or put off until subsequent years by clients.

The company has confirmed it is moving rapidly to a two-brand strategy, sidelining both the Thrifty-Link and True Value brands. It reports that 20 Thrifty-Link stores were converted to HTH in FY2021/22, with a further 30 conversions planned for FY2022/23. The company states that it had 154 HTH stores at the close of the reporting year, down from 157 in the pcp. However, it had 359 Mitre 10 stores at the close of year, up from 340 in the pcp. The combined Thrifty-Link and True Value store fleet is set at 123, down from 145 in the pcp. Overall store numbers went from 642 to 636. Metcash's stated goal is to build a network of 400 Mitre 10 stores and 200 HTH stores.

The company is also planning to expand in categories such as kitchen, laundry and bathroom. Part of that plan includes a further build-out of its "Design 10" showrooms, developed as a project by Ms Welsh. These help showcase building elements, creating a design space for tradies and builders to better collaborate with their customers. There are currently five of these centres, in Hobart, Geelong, Melbourne, Coffs Harbour and Orange, as well as a website.

In his prepared remarks at the results conference, Mr Jones stated:

> This [strategy] includes continuing to win new DIY shoppers. And doing this through highly effective recruitment and store reinvestment programs. We've got a clear focus on a relevant range and competitive prices, as well as on emerging categories like bathroom, kitchen and laundry.

That said, Metcash is also clearly committed to its trade business, as Mr Jones explained:

> As we look to consolidate our leading position in the building trades, we'll focus in on our extensive footprints of trade-focused trade centres, as well as the whole of house strategy, which is underpinned, as I've said, by the now 10 frame and truss plants, as well as continued steady investment in leading trade technologies.

The company is also continuing its Sapphire program, with 300 stores planned for completion by 2025, and 161 currently up and running. Sapphire for trade centres is targeting 50 completions, with 37 currently in operation.

No explicit mention was made of Metcash's plans to further expand its joint-venture and wholly-owned IHG stores, but it seems likely that it will maintain at the very least its current 20% share of stores, so if the network expands to 600, Metcash would obtain a further 20.

Total Tool Holdings

Metcash probably would not agree with this blunt statement, but it seems fairly clear that the overriding strategy for TTH is to get big as fast as possible, and hope that Bunnings' Tool Kit Depot (TKD) doesn't catch up. It does seem likely that one factor which triggered the partial sale of TTH to Metcash was concerns over competition from TKD.

Metcash and TTH are certainly executing to this plan, or one that is similar. TTH had 81 stores in its network when acquired in July 2020. It now has 100 stores, and the company says it is on track to complete 120 stores by 2025. As importantly, the stores are being upgraded, with 83 completed to date, and a further 11 planned by 2024.

Veteran analyst Brian Raymond of JP Morgan poised a question about the pace of acquisition of TTH stores by Metcash at the results announcement:

> My first one is just on the Total Tools conversion, 15 last year, 12 the year before. That is slowing to eight next year. I just wanted to understand the drivers of that slowdown, but also the produc-

tivity of the stores you converted this year relative to last. Is the incremental store a bit smaller in terms of sales per store, or have you converted the obvious ones first, and is it now just the tail of the network?

Ms Welsh responded:

> Yes, you'd be pretty much right in your assessment there. When we first invested in the joint ventures it was with the larger joint ventures and those that were probably the most significant in terms of their size. That will be the 12, 15 in terms of last year. Similarly, and as we run through the network we will pick up the investments of the joint ventures that seem appropriate, but they are on the slightly smaller scale as we continue that investment.

Metcash's chief financial officer, Alastair Bell, chimed in with an additional, enthusiastic comment:

> And I'll just add one, one thing about the JV stores. We've acquired these a lot quicker than they originally envisaged. You'll recall my comments about the Total Tools put option valuation increasing. And this is an area [which has] held the performance our business in good stead. And the year ahead, well, we'll look to execute eight, and thereafter take the opportunity to continue to own more of those stores.

Another strategic possibility that Metcash is exploring is combining Total Tool stores with Mitre 10 stores. Trial sites at Merimbula, Wonthaggi, Matraville and Richmond are already up and running. However, it's noticeable that while the slide describing this move states that these have been "successful" and there are opportunities for expansion, in his remarks, Mr Jones was considerably more cautious:

> It's early to draw conclusions on performance, but we like what we see so far, and we think there are more opportunities for the format.

Another highlight of the strategy is the development of the Marxman private label brand of power tool accessories. The trademark "Marxman The Mark of a Professional" was first applied for in January 2021. It consists of the expected accessories, such as drill bits and circular saw blades.

ANALYSIS

It's worthwhile noting that there was one response by Mr Jones which indicated the Metcash board has made a good choice in appointing him as CEO. In replay to an analyst's question about pricing, and price comparisons between IGA and the two major supermarkets, he had this to say:

> I think the first point that we want to make is that the proposition in the independent network is founded on more than just price competitiveness, which, as you point out and we have spoken about, has improved significantly. We also offer in the network the ability for retailers to arrange a wider range of national and local products that give customers a choice as to how they manage their own budgets. And so we don't rely simply on price competitiveness for our overall customer value proposition.

You only get to that understanding by having a lot of experience with retail, over years, and seeing how growth and development can take place. While it seems a very simple statement, it is also a very revealing one. It is really important, it seems to HNN, for two reasons. One is that it captures a particularly important strategic essence of what networks of independent retailers can do. Price is part of it, service is part of it, but smaller scale operations incur lower costs for specialisation than larger scale operations, on a comparative stocking basis.

The second reason is that this is precisely the transition that certainly the Food segment, and most likely the Hardware segment as well, need to undertake. Pricing is, in the vernacular, table stakes in retail now. What will differentiate retailers is a form of responsiveness to specific demand.

That said, though, there remains some questions over what path Metcash's Hardware segment will take to the future. The initial vision that Metcash seems to have had with Mark Laidlaw as CEO of Mitre 10, which was to acquire HTH, then use those scale advantages to gain a network of around 900 stores, simply hasn't worked out.

Instead it looks like is the industry is undergoing the development of a kind of "spectrum" of stores. On one end there is the fully corporate, wholly-owned and operated Bunnings big-box stores. At the other end are fully independent store buying groups, such as Hardware & Building Traders (HBT), which is entirely consent-based. Metcash's IHG is trying to find a space, it would seem, somewhere in the middle of that.

The real question is going to be exactly where does IHG end up on that spectrum? It would seem that TTH is headed for something like a 50+% ownership by Metcash, while IHG is currently around 20%. How much independence will really be left in IHG if Metcash moves to 30+% ownership of that network? Will HBT end up being the only way to go the "full surfboard" with independence in the future?

As importantly, Bunnings has

declared its intent to expand its trade business, and HNN has suggested that works out to gaining something like $1 billion a year from the overall market. In particular, TTH is going to compete directly with TKD, which will have advantages such as co-locating with Bunnings Warehouse stores, and the massive reach of Bunnings in the supply market.

It's not clear from the current strategy being presented that Metcash has planned to counter these difficulties.