HI NEWS

Vol. 8 No. 1

WESFARMERS
METCASH
HBT NATIONAL BUYING GROUP

THE ROAD AHEAD

HBT 2023

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022 & 023

A630N Low speed cutting disc

- An exceptional choice for the cutting of
- solid material. Bond optimized for universal use.
- Low thermal load. Minimum burr formation.

SMT 624 SUPRA ZIRCONIA FLAP DISC

- Aggressive stock removal rate& comfortable grinding behaviour
- For universal use in demanding grinding work on steel & stainless steel

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- With optimised recipe for use on steel.
- Also suitable for use on stainless steel.
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Contains belt clip, liner lock, thumb stud & glass breaker.
Blade & handle made of stainless steel.
Length open: 22cm, closed 12.7cm, weight 210g.

BONUS!

BUCKET "O" THINS

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- Low burr formation
- Long service life

Part No# - 693520

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DT600U Segmented diamond wheel

- Suitable for a various range of applications.
- First-rate cutting performance.
- Exceptional service life thanks to the use of premium grade raw materials and diamonds.
- Clean cutting edges.

BT 600 Z Knotted cup brush

- For aggressive brushing work on large flat surfaces.
- Stable knotted wire design for easy cleaning and removal of slag, rust, scale and concrete residue.

DT900UT Turbo diamond wheel

- Wave-shaped steel core.
- Use on construction material.
- Clean cutting edges.
- High aggressiveness.

BT 600 W Crimped cup brush

- Ideal tool for cleaning and clearing profiled or uneven surfaces like checker plate.
- For medium duty brushing work, removing rust, impurities and paint residue.

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CEMENT AUSTRALIA
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MIX
CEMENT AUSTRALIA
BUIL
CEME
CEMENT AUSTRALIA
20 kg
GENERAL PURPOSE CEMENT
MADE Right Here
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CEMENT AUSTRALIA

publisher's note

As I look towards this year's HBT conference by looking through hundreds of photos we took in Cairns last year, I am reminded of the authenticity of independent hardware retailers. You can put "independent" in the brand but it's different when it's in your bones.

In many ways, MBS Building Supplies, exemplifies some of the ideal traits of a HBT member. It is a family-run business with a long history as an independent with no group affiliations before becoming part of HBT. As co-owner Brad Rolls told me:

> *My mother and father bought it in 2001. It was called Martin's Building Supplies back then.*
>
> *My brother Nathan and I purchased the business from them about two years ago, in July, 2022.*

Before the brothers worked full-time in the business, Brad gained qualifications as a motor mechanic and Nathan went to university to get a degree in mechanical engineering.

They are focused on growth while managing MBS Building Supplies and its 25 staff. Brad explains:

> *If you're not growing, you're going backwards, they say.*
>
> *[For us] that might mean an extra staff member a year or a new bit of machinery. We try to invest everything we can back into our business to grow it.*

Most recently, that growth is expected to come from an expansion in its hardware offering. Brad explains:

> *We manufacture and design frames and trusses. We also sell and install B&D roller doors, sell and deliver PGH bricks, Austral bricks and pavers as well as a few other smaller bricks and masonry brands. Our building supplies also include timber, Gyprock, and doors.*

MBS Building Supplies is located in Young, NSW

In the last six months we doubled our hardware section.

A few building supplies stores closed their doors during COVID in our town. At MBS, we were lacking in hardware so we wanted to increase that and service our customers with everything they need.

We wanted to make ourselves a one-stop shop. We didn't want our customers to come into MBS, then go get their ventilation, brick-coloured silicones or that one pack of screws from Bunnings, which is our main competitor.

The local Bunnings store is less than a kilometre away but most of the trade generally come to MBS for what they need. As Brad puts it:

We'll service anyone at all but our main customers are trade and we do pretty much all the trade in town. All the trades will drive past Bunnings and come to us.

To maintain that, we've got to make sure we have better customer service and we try to make sure that our prices are the same, if not better than Bunnings.

MBS also services a large area beyond its base in Young (NSW). He adds:

We go basically anywhere we can get there and back in within a day. So we do a lot in West Wyalong, Cootamundra, Temora, Yass, Murrumbateman and Canberra.

The move to expand into hardware has also come directly from its customers when MBS did a survey of what they wanted and what they thought it was missing. MBS based its new offerings around that information, and an underlying strategy of being a "one-stop-shop". It's something that is being constantly communicated to customers.

The emphasis on growth has worked well for the brothers as they took over the business from their parents.

And like other retail businesses operating in the construction, renovation and home improvement sectors, MBS experienced a spike in growth during COVID. Brad said:

You could call that we had growing pains as such because we could have doubled our operations except that we couldn't get the staff, material or additional labour to be able to facilitate that. Also, probably for the first 12 months of the COVID era, we hesitated on making any large purchases or taking on additional staff due to the unknown. We were worried that we might not be able to afford to pay everyone ...

Looking back now, we probably would've put on staff early, and got some new vehicles and machinery early. But you can never anticipate what we went through.

We were lucky that we never had a shut down time at all. We could sell anything we had in stock and yet never had any real supply issues. There were lots of other people running out of timber. We were making sure we got the timber, but not selling it to anyone we didn't really know. We had people calling up from 700 kms away wanting to buy timber.

Maintaining a similar level of growth has become more of a challenge in the last six months. Brad explains:

> *Since the start of 2024, things have been a lot tougher compared to the past two years. In our opinion, this is due mainly to people backing off spending and [the economic situation] getting tighter.*
>
> *Margins have become a lot tighter to remain competitive in the market as builders and other trades look for places to maintain their own margin on jobs. In my opinion, this is due mainly to high interest rates putting pressure on the majority of people…*
>
> *It's been very hard to grow off last year's numbers when they were out of the ordinary, but that is what we are trying to do.*
>
> *We're trying to grow our sales, and we try to put everything through HBT, as much as we can.*

Some of the growth during COVID was a direct result of people moving from Sydney, Canberra and coastal areas into Young. He said:

> *They realised they could work at home in a rural town and have an easier lifestyle. A drive to work is only going to take a couple of minutes rather than a couple hours.*
>
> *People could sell their $2 million property in Sydney and buy a half a million dollar house here in Young and be relatively debt free. We're not seeing it as much now, it seems to have subsided or settled. We had a large influx of people from out of town, which boosted growth as well.*
>
> *I'd say we could have grown more if it had not been up to council, had it got its act together and got houses out of development a bit quicker.*
>
> *It's always been a problem. But it was amplified a bit more when there was an increase in demand in the town.*

According to Brad, housing and multi-dwelling units are continuing to be built, along with some commercial development. But it has slowed down.

It still remains promising that there are future developments coming up that will deliver growth in the future. As Brad said:

> *There are new subdivisions and industrial estates that can bring more people to town for work.*

Speaking with people like Brad is an affirming experience and makes me believe that smart retail operators continue to do smart things. The reinvestment back into the business after revenue growth during COVID is prudent and shows that management priorities are sound and the owners are thinking about the future.

Being cautious during COVID and concern over staff is a natural reaction when there is so much uncertainty.

The strong relationships and customer loyalty with trade means MBS is customer-centric and it was very savvy to do a customer survey that indicates where there may be gaps in the offering. Not enough retailers do this effectively, and prefer to dictate what their customers might want.

For HBT, MBS is an ideal member in the way they support its suppliers and regularly attend conferences. Brad looks at it the following way:

> *We get that extra kick of rebate and we also get to go to conferences. HBT has got a good team. I still regularly talk to Jason, and I would say he would be my main contact.*

From his perspective, Brad said the main reasons to attend a HBT conference include "networking with other like-minded people, seeing new products and meeting suppliers that may value-add to our store, conference specials from suppliers, inside information from industry professionals about the current market." He adds:

> *The conference is also a chance to get away from the physical workplace and enjoy the time away and enjoy the nights out provided by the team at HBT. We love the trade show, night events, trade focused talks and guest speakers.*

This year, Brad, his wife Lexie, brother Nathan and father Michael will travel to Adelaide to experience the latest from HBT.

I hope to see friends and acquaintances, both old and new, in Adelaide.

Until next time,

Betty Tanddo
Publisher

In retail, is data going to replace monopoly market power?

In this issue, part of the framework we've used in assessing major players in Australia's hardware and home improvement market has been to rethink what retail is. Is retail just about selling stuff to people, or should we re-envision it to be as much about helping people and businesses solve problems?

So, we could start by looking at the current "hot" market for hardware: small and medium house builders.

Probably about half the people reading this knew what was going to happen the minute they saw the house building market would run hot, back in 2021.

Yep, that's right: lots of small builder insolvencies.

The Australian Securities & Investments Commission (ASIC) puts the number of construction companies going insolvent in FY2024 at just under 3000. Insolvencies that were directly related to residential building were a little under 1000. (Though this is complicated, because ASIC lists these by the main occupation, and builders often do several types of work — and then there's the "construction services" category, which is a whole thing in itself.)

Also, according to Australian Bureau of Statistics (ABS) stats, over the four years to FY2024 about 18% of home builders had failed businesses. But, these were replaced by a further 20% of businesses, so that's a 2% gain. What we're seeing here is less an "industry in crisis", and more a lot of churn.

But, how did we know house builders were going to go bust at an increased rate precisely when the market is running hot? We knew this because house builders might be great with the nailgun and the cordless drill, but they are often lousy at finance.

That's especially the case when it comes to that semi-sacred number of numbers well-known to any accountant working on construction projects: cashflow. For construction, you really need to be able to project a weekly cashflow at least 12 weeks ahead and estimate monthly cashflow out to a year, if you plan to stay in business.

That's because, as with most manufacturing, at stages of house construction the cashflow goes strongly negative; the builder is effectively lending the client money. A construction business should always be aware of the forecast maximum negative cashflow, and ensure this can be financed.

So, how many builders are able to do that? We don't know, but at a guess during 2024 there were probably 3000 who weren't that good at it.

What they do instead — to simplify it somewhat — is to win bids on several house projects at once, and then use the initial deposit money paid on all the projects to finance the construction of one or two houses. As the project nears completion, it becomes profitable again, and the restored funds can be used to pay for the construction of other houses.

When we hear about high material costs, lack of skilled labour or other problems effectively shutting down construction companies, this is, on the surface, true. But this really masks the underlying too-fragile system. Any disruption is fatal, because it requires near-ideal conditions.

Supposing, however, that a retailer decided to help fix this problem. That would be quite involved, as the key to measuring cashflow is project management. You need to know when things happen on the project, the cost and payment dates. It's possible using modern technology, but it is also a lot of work. While it would create valuable loyalty, it would require some form of additional payment to just break even. Marketing to businesses that already have poor finances makes this a hard sell.

But this is failing to understand the potential. In helping businesses with project management and finances, a retailer would gain amazing access to business information, at scale (even if only at scale in a narrow geography, such as a major city). That means knowing what materials were being ordered when, the costs of services, the effectiveness of those services, the timing of those services, the workforce cost, timing and effectiveness — and so on.

By gathering that information, not only would the retailer find profitable outcomes, but it would be a de facto way of networking those businesses together, through the essentially anonymising function of the central retailer.

The profit picture on a business sector would shift, essentially, from being how much stuff the retailer could sell, to being based on a percentage of the overall business activity.

Here's the core insight. What monopolies do is to create predictable, shaped markets that can be manipulated in ways that favour the monopoly.

When you develop a certain level of intense data about a market, you reach a similar point.

The information is the monopoly.

Instead of shaping a market, you are able to predict it, and be super responsive to changes and shifts.

The advantage of information over monopoly, is that most monopolies tend to start narrow, and become narrower over time. Information tends to be expansive; it is always producing new adjacencies and new opportunities.

That's the future of retail, in the less-industrial, digital age.

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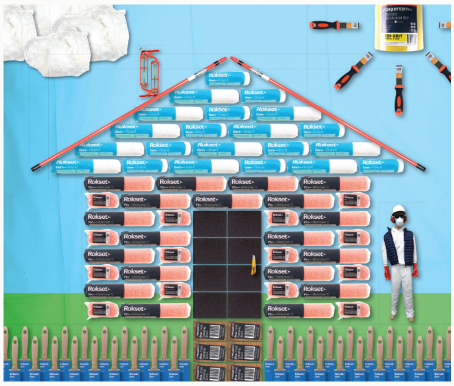

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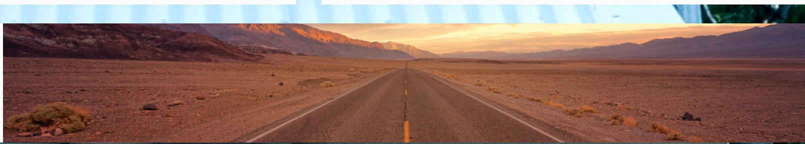

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HBT NATIONAL BUYING GROUP

HBT National Buying Group leadership team at the 2023 HBT Conference in Cairns. L-to-R: Greg Benstead, CEO; Jody Vella, General Manager, Buying; and Mike LoRicco, General Manager Member Services.

It's likely that the current financial year — FY2024/25 — will eventually be regarded as the first true "post-Covid" year, in both economic and cultural terms. While that is good news overall, as Covid introduced a degree of instability in a number of areas which has helped to slow growth in Australia, this "now we return to normal programming" also means that some of the harsher realities of the hardware retail industry are set to reassert themselves.

The "true independents" of the HBT Buying Group (HBT) — as well as less affiliated independents — typically find themselves on the hard end of changes such as the following five.

Interest rates

Even HNN, which was super-cautious in predicting one interest rate decrease in calendar 2024, will likely turn out to be wrong about this. One thing that people get consistently wrong about Australia's interest rates is that the intent is really all about slowing down consumption — including dwelling purchases. As one economics commentator put it, it's not collateral damage, it's damage damage. The way things look now, the earliest interest rate reduction is likely to be March 2025. That has effects on building activity and consumer consumption.

Building activity

We've seen building approvals and housing starts both slump during 2024, and it looks like that will continue well into 2025. There has also been a lot of attention given to the close to 3000 insolvencies in construction companies listed by the Australian Securities and Investments Commission (ASIC). Drilling down a little deeper into those stats, the numbers specifically for residential builders are:

- FY2022 435
- FY2023 723
- FY2024 980

That's not as dire as the 3000 figure indicates, but it is still high, and continues to increase. On the other hand, if we look at the stats for business entries and exits, it turns out that while something like 18% of house building companies have exited the industry over the past four years, there has been 20% replacing them for a net gain of 2%. So the situation is one of relatively high churn, rather than decline. But it is, of course, a concern for hardware retailers who may have been "carrying" debt for some builders.

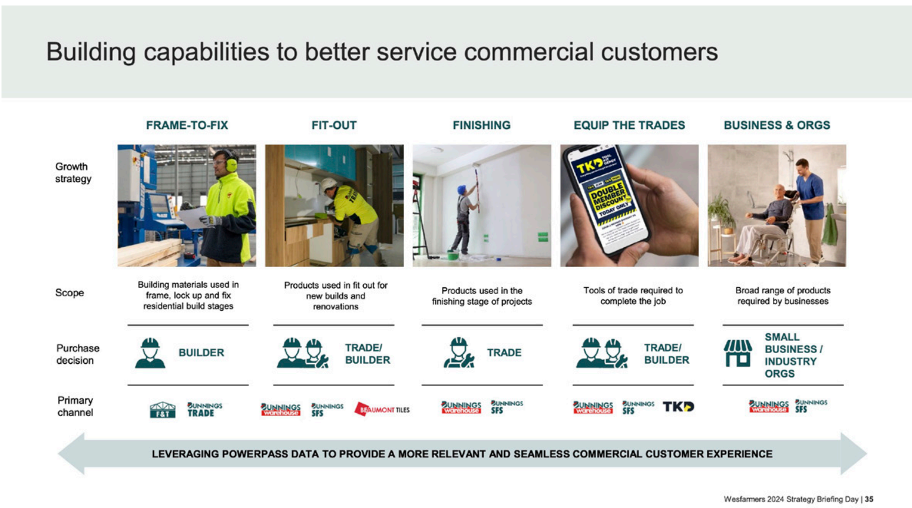
Wesfarmers/Bunnings

In the independent hardware retail world there seem to always be several rather dotty interpretations of what is going on at Bunnings, usually suggesting it is not as profitable at it seems. Meanwhile, of course, it keeps getting bigger and the Wesfarmers share price keeps going up. Really, from an independent viewpoint, the only numbers that matter relate to how much market share it has, where that market share is located, and how much it intends to grow in any given year. Perhaps the most honest assessment of Bunnings we've seen was given the CEO of Metcash's Independent Hardware Group (IHG), Annette Welsh. She was asked by an investment analyst why IHG did not grow DIY revenue, and she basically responded that Bunnings is too big to really compete with.

While it looks like Bunnings' results for FY2024 are not going to be very good, it still continues to grow. Bunnings managing director, Michael Schneider, reiterated at the May 2024 Strategy Day that it would continue to build out 10 stores a year — including rebuilds and refurbishments. That's one new store every five weeks or so.

On top of that, the corporate strategy is to continue to increase shelf space in existing stores through micro-management of space, so as to

Wesfarmers-owned Bunnings is continuing to grow its marketshare in the trade market, with a focus on small and medium builders.



carry a wider product range. (That's how they were able to expand into pet products.) And it would be wrong to discount the impact of the Wesfarmers OnePass "loyalty" program, which provides for free delivery, and faster click-and-collect pickups. The free delivery is limited in terms of products at Bunnings (less than one metre in length and under 0.25 of a cubic metre in overall size). While delivery within three days is guaranteed, in metro areas delivery is usually next day. Added to that, Bunnings is introducing ad hoc deliveries by store staff, probably along the lines that WalMart offers in the US, where floor staff detour on their drive home to drop off packages.

Added to that are Bunnings' acquisition of Beaumont Tiles and the ongoing (though slow) development of Tool Kit Depot. Bunnings is also being relentless in growing its builder-oriented trade business, driven by the PowerPass loyalty program (which exists separately to OnePass). In line with that, it continues to expand in truss and frame plants, introducing fully-automated systems.

Metcash/IHG/Total Tools

Similar to Bunnings, while in EBIT terms both IHG and Total Tools did not have a good FY2024, both are continuing to grow and expand. Note, for example, the recent acquisition of Bianco Construction Supplies for $82 million and Alpine Truss for $64 million.

Probably as much to the point, Total Tools gained a new CEO in March, and the current CEO of IHG, Ms Welsh, is due to step aside to assume other duties by the end of August 2024. Considering that the other two divisions of Metcash, Food and Liquor, have both gained new CEOs recently, it seems the relatively new Metcash CEO, Doug Jones, is hard at work refreshing the wholesale/retail conglomerate.

IHG has now fully taken on the form that most independents knew it would back when Metcash first acquired Home Timber & Hardware (aka Danks). Both True Value and Thrifty Link are almost gone, and will be history by the end of this financial year. Home Timber & Hardware is really just a rump to Mitre 10, with its name changed to Home Hardware. Ms Welsh suggested it might devolve into a DIY-focused retailer.

It's common for independent hardware retailers to insist that Total Tools really isn't producing the promised results, but what is more important is that it is taking marketshare, and

Metcash's Independent Hardware Group continues to seek further ways to sell into the trade market.

Metcash fully supports it. With a new set of CEOs in Hardware, it's expected they will continue expansion. It's HNN's opinion that we will see Mitre 10 increasingly move to opening its own greenfields stores in promising locations through calendar 2025.

Homes for Australia plan

It seems to be gradually dawning on a number of commentators that the goal to build 1.2 million homes in Australia, boosted by the $32 billion allocated to the Homes for Australia plan, could be something of a "stretch goal".

The reality is that if you really are going to build 1.2 million homes, it is going to be easier with large multi-unit dwellings, such as eight-plus storey apartment blocks, that have 50+ dwellings each.

Additionally, consider that in the pre-Covid four years from FY2015/16 to FY2018/19 there were building approvals for 403,679 dwellings while in the four years post-Covid from FY2020/21 to FY2023/24 there were only 271,147. That's a deficit of 132,532, representing a decline of 33%.

Simply to get back to even, it would be necessary over the next four years (to FY2028) to build 536,000 multi-unit dwellings, or 134,000 each financial year. (For FY2023/24, approvals for 56,150 dwellings in multi-unit buildings were issued.) All that adds up to there being a substantial increase in multi-unit dwelling construction, which will be aided by changed guidelines in most capital cities allowing taller "mid-rise" buildings.

As from both a technical and financial perspective these multi-unit dwellings will be beyond their reach, that's likely going to put the squeeze on the smaller builders that most independent hardware retailers service.

HBT

With that many forces aligned against them, independent hardware retailers will need HBT in the coming years more than they ever have before. The pandemic, even if diminished, still remains a background factor to many hardware retailers. Different businesses have taken different paths through the pandemic, as Mr Benstead sees it:

I think some of our members did clearly reinvest in their businesses, looked at buying additional footage next door, buying up the house that was next door and expanding their property into those areas. Some have put people on the road. So that's definitely happened. Others have just used it as an opportunity to consolidate their businesses. So it was a bit all over the place in regards to who's doing what.

One of the roles of the 2024 HBT Conference is to function as a kind of "circuit breaker" between the disruption of the pandemic, and a return to something more constant in 2025. HBT has adopted a specific conference cadence, alternating two different approaches, Mr Benstead explains.

We're planning to do one year of conference more about business. So this one, this conference [2024], will be far more focused around the trade fair and making sure that people get up to speed with HBT. The next one will have a lot more networking and social events and tours. That will be also be the year we'll run our study tour in.

Mr Benstead has had to concentrate on helping HBT itself move swiftly past its pandemic role to adapt to a new reality. In managing HBT through what could be a tough time, CEO Greg Benstead began by reassessing the buying group on a historical basis:

We identified that the market was going to come off the back of the Covid blip. The COVID blip was bigger in the hardware game because of the shortage of tradies as well as supplier shortages. It also extended for a longer period of time than many other industries.

Our COVID blip probably only stopped at the beginning of 2024. We identified early that we were going to see numbers coming down from that blip. The immediate opportunity that presented was: How do you hold on to as much business as you can during that window?

We've used a lot of analysis to have a look at what's been our sales growth trend from 2000, say 2000 to 2019 or 2020, where's that trend line? And if I extrapolate that trend line through to 2024, 2025, we are still above that line. So we're still tracking above where we need to be.

I can look at that two ways: a) that's great that we're doing that, or b) we've still got some way to decline before we actually hit back to the trend line.

It's not just HBT that is doing well, of course, but also the HBT members.

Western Australia seems to be strong. Queensland seems to be strong. SA seems to be strong. New South Wales seems to be a little flat and Victoria is in decline. I think Melbourne metro seems to be a bit quieter, but broadly speaking, things are still okay. If you're out of the Melbourne metro area, it's not too bad, it's still going okay.

After orientating HBT in this way, Mr Benstead has turned to developing HBT's "post blip" strategy.

What we've focused on is I guess going back – I'm calling it "going back to basics". We haven't changed our two key objectives, which is more sales for suppliers through HBT and increased rebates. Those two things are constants.

I started with, let's just look at our existing mem-

HBT holds regular state conferences around Australia. Below, the conference held in South Australia in early 2024.

bers and make sure that they've got all of the accounts that they can through HBT so they can maximise their rebates. Let's make sure that they've got the right suppliers in there that are supporting independents. So we're still doing a lot of that sort of work.

2025 to me is an opportunity. I said back to basics, but also I think we're back to our ground base. We're starting to go back to getting business working in relation to what this new norm is. Internally, we've still got opportunities for members to be moving accounts to HBT that they don't even know could be there.

Part of making HBT work better is supplying some services to members, to help them better engage with the opportunities.

Often our members need assistance or guidance or inspiration through HBT. When you're not in a corporate group, you're not being told what you have to do. But sometimes it helps members to be challenged and shown some possibilities. So we're putting in further work as regards improving our on-the-road network, and increasing our operational presence at store level. To me, that's worthwhile, to get someone to come into your store with fresh eyes and say, have you thought about this? Have you thought about that?

We want to give them a plan and say, guys, if you move these [products] across, here's the additional rebates you could be picking up. Do you want to do it? But remembering it's independents. They can make their own decisions. Mostly, however, 99% of them will say, they want to move the products. They just never realised it was possible before.

Suppliers

While focused primarily on the members, Mr Benstead has also noticed that HBT often seems to be doing better than many of the suppliers to the buying group.

I've been saying to our team, there are a lot of suppliers out there that are saying the market is going softer, and that's what's happening now. We're not seeing it as strongly, we're not seeing it as much as what they're seeing it. And we're looking at our numbers and saying our numbers are probably doing better than the market, which is most likely because we are very diverse and we are right across Australia in more rural areas that are probably a little bit insulated from the cost of living crisis and interest rate story.

The suppliers had their own struggles through the pandemic.

We found some of the suppliers have really invested in their business in regards to changing their model. Other businesses shut up shop and are just sort of struggling to get themselves back up to full speed again. And I think when we talk to suppliers, some are saying it's really busy and some are saying it's a bit quieter. But I think that's not to do with HBT, that's just broadly their own business.

But I think a lot of that has to do with who their customer base *was. That's one reason why suppliers really need to be supporting the little guys, because you need to have your business spread as wide as possible. It can shelter you from these highs and lows that occur through various reasons elsewhere. We tell them there's opportunities here for membership in some remote areas that they still aren't in. They need to be out there supporting these guys.*

So we're using that as a positive opportunity. When things are bad, often they're happy to come to the table with better deals than they would when things are good.

HBT has also long known it is necessary to cultivate good relations with suppliers where possible.

We still do our town hall meetings where we go out to more regional areas. Recently went to, we went to Bendigo, Western Sydney, Southern Brisbane or Logan in actual fact where we met members in suppliers' places. We went to Hume Door and we went to ITI and we went to various other places. We are mixing that around. So next year we've got a plan for a whole lot of other suppliers for people come and have a look at.

The pinnacle of this cooperation with suppliers is a planned study tour for members in 2025 that will visit suppliers overseas.

We are just in the middle of planning and putting together some study tours. We know that a lot of members do enjoy them and find them great. So we're currently in the process of talking with a whole series of suppliers that are very keen to get involved with it. It'll be either Thailand, Japan or China or a combination of those, where members can go up, visit factories that are actually building and constructing things, and have some days where they can have a look around those particular cities as well.

But also have a conversation with some suppliers about products that they've never seen before and maybe provide them some views into other retail in other parts of the world. We're trying to make it mostly subsidised by the suppliers, and HBT will even fund some of it as well. It's certainly not a revenue positive, it's a revenue negative component, but we think it's worthwhile. And we think particularly some of our varied members, particularly in the industrial area, would probably really enjoy that kind of tour.

HBT also makes regular visits to key suppliers, such as ITI Australia. Below, a visit to ITI St Mary's & Port Adelaide facilities earlier in 2024.

Technology

Technology has long played a key role in the development of HBT. That began with the development of its members' portal, which led to HBT buying the company that developed the portal as well. The latest addition to the portal is Gap Maps.

We're about to introduce a new mapping and information tool. At the 2023 conference we mentioned doing more HBT branding. We've had a lot of members put up special HBT signage on their stores. We want more members to do that because that allows us to start marketing HBT a bit stronger.

As part of that, our website, when you go to find members, there's a new map program called Gap Maps. This basically displays the member, then you can click on that particular store, and fo straight to the website for that particular store, which is handy.

When you go onto the portal as a member, also, it will have a Gap Maps there for your store. Members can look up their stores and Gap Maps can display the population of your area in a five to 10 kilometre radius. It also shows trades people within that radius. It shows the amount of construction and renovation that's occurring within your marketplace, based on loans for housing or renovation.

Gap Maps pulls together a lot of data from the census and lots of other sources. That gives a member a better idea of the market for their stores. So we are buying that program and implementing that for members.

HBT has also added a number of analytical tools to help with identifying opportunities.

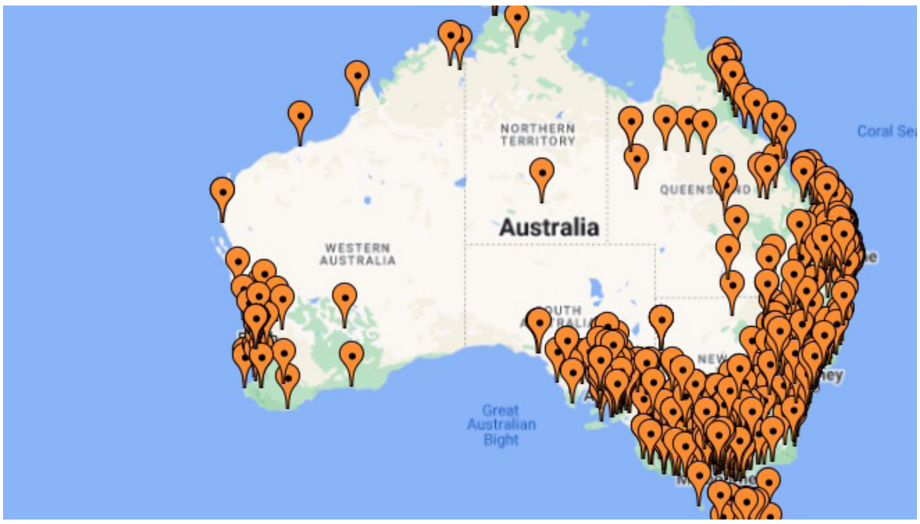
We recently brought Phocas on board into our business to do better analysis of opportunities for suppliers, which has been quite handy. We've also introduced AI into our IT hub, which is part of our business. It's an easy way to ask questions, and it can do some amazing analysis.

HBT also has a very active social media presence through a members-only Facebook page. It's been running for four and a half years with over 450 people onboard. It's a common place to share information about products, and provides feedback on suppliers that HBT finds useful.

Mr Benstead is also keen to see HBT continue to offer additional services. This includes the ongoing efforts by Mike LoRicco to help store owners better plan their stores.

We're trying to maybe offer some additional services to members. For example, Mike has been very, very good at going to stores, giving people a new store layout plan. We can actually get that done using Auto-CAD. We can send the finished plan to them and say, here's where you need to head now, you may not head there to-day, but over the next 12 months, 18 months, you should evolve your store

HBT offers an interactive map so that customers can locate their nearest HBT-affiliated hardware store.



to this because we think that's where it needs to be.

Another important advance, is making it even easier for new members to get started.

A new process, when a member comes on board, our embedding process now is that the member basically gives us all of the suppliers that they're currently using, and we open up those accounts on their behalf. It's a very easy process. People can join HBT, we do all of the process of getting them moved across and basically then the next thing they hear from HBT is they're receiving a rebate. So this makes it a lot easier.

Growth

One of the recent growth opportunities for HBT has been having AgLink Australia join as members. That's around 200 stores in total. This includes a range of brands, including TechLink, SeedLink, PastureLink, LivestockLink, HortLink, FertLink, BusinessLink, BroadacreLink and VitiLink. Their members include AGnVET Rural, Darling irrigation, Pursehouse Rural. AW Vater & Co, Muirs, Serve-AG, WesternAG, Agrishop, Farmer Johns, and McGregor Gourlay.

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WESFARMERS STRATEGY DAY 2024

Above: Bunnings Warehouse Hoppers Crossing is one of the retailer's stores that includes services aimed at the trade market.

By Scott Lewis

Wesfarmers is truly a unique company. This has frequently contributed to the outsize performance of the conglomerate — though sometimes its "one-off" nature can be other than strictly fortunate.

In particular, one part of that uniqueness is Wesfarmers' capacity to get into trouble for doing the right thing just as much as for doing the wrong thing. This talent was much on display for the Wesfarmers Strategy Day, held on 2 May 2024.

To start with actual "wrong" things, centrestage was Wesfarmers' long-term mis-management of its online-only discount retailer Catch. While the company freely admitted it had not done a great job with Catch, it also continued to hold out hope that it could retrieve a reasonable business out of the medium-term ongoing losses. Most investment analysts were, to say the least, less certain of this — and were convinced enough to persistently say so.

In fact, not only had Catch bungled, but the presentation of Catch at the Strategy Day was also less than perfect — in HNN's view. It was unfortunate that in the midst of attempting the best possible portrayal of a failing business, some real positives behind Catch went missing. There are unexplored strengths.

In terms of getting into trouble for doing "right" things, if the trouble was a little sharper than usual this year, this might have been because Wesfarmers had actually achieved not one, but two of these.

Its most visible strong move was the success of an own-brand developed by Wesfarmers' discount department store division, Kmart. The Kmart Anko brand launched in 2019. (Its name is derived from previous Kmart own brands that ended with "& Co." e.g., "Kids & Co", with the "c" changed to a Kmart "k".) Anko achieved notable success post-pandemic, to the extent that the company states this brand is now responsible for around 80% of Kmart sales. That success gained a major role in Wesfarmers results for FY2024 H1, when Kmart posted high earnings growth largely as a result of Anko.

Below, top: Michael Chaney AO, chairman, Wesfarmers
Below, bottom: Rob Scott, managing director, Wesfarmers

This result was the one shining star in a half-year report that was not so much disappointing as somewhat lacklustre. The brand's success brought with it an ongoing background question: if Kmart could achieve that kind of success with Anko, why haven't other Wesfarmers retailers (especially Bunnings) managed to duplicate Kmart's success?

The second right thing — somewhat more complex — is Wesfarmers' ongoing investment in digital technologies as a way to help boost the future success of its retail operations. Most of the uncertainty expressed about OneDigital (which encompasses OneData and loyalty program OnePass) concentrated on cost and benefit allocation.

While all that sounds contentious, and the discourse between Wesfarmers and the investment analysts was at times tense, it was also thoughtful and considered. Both sides of this debate about Wesfarmers' future were usually at least half-right. And both sides were — unusually not just for Australia but really globally — quite passionate in their opinions

Analysts asked some great questions. Wesfarmers provided some very good answers. The problem was that the answers and the questions never really quite matched up. The questions were based on assumptions that might be at least half right, and so were the answers, but while they were broadly associated with each other, there was often less overlap than would have been helpful.

The task here, then, is not so much to provide a critique, or even a fundamental analysis. It is instead to try to match up some of those questions with the answers, and find the places where those half-rights might better link to each other.

Background economics

It says something about both the current state of the local economy and mainstream economic analysis in Australia that it's necessary to start an analysis of Wesfarmers by re-framing the economic context.

In the past HNN has used the analogy of lawncare to describe the economic choices facing Australia. If you put on lots of fertiliser (economic stimulus/low interest rates), the grass (economy/GDP) grows, but so do the weeds (inflation). If you put on weedkiller (higher interest rates) to get rid of the weeds, then the grass will also start to die.

What works (somewhat) is a combined weed-and-feed supplement (productivity). However, that weed-and-feed supplement seems to be in short supply in Australia. Hence, just about the only way forward for the Reserve Bank of Australia (RBA) is to continue to apply the weedkiller in judicious amounts, so that the grass, though affected, does not actually die out.

In real terms, the famine/feast cycle of the COVID pandemic has caused inflation to lift above 4.0%, which, coupled with very slow growth, means that interest rates are set as high as possible at just under 5.0%. That's despite interest rates going above 6.0% in the past when inflation has crossed over 4.1%.

The largest emerging concern is productivity. The core point about productivity is that it enables growth without creating the scarcity that fuels inflation. You do more with less. Productivity growth is low in Australia because the nation continues to over-invest in those industries that do the worst by this measure. That takes place on both the state and federal levels of government.

Take, for example, the federal government's "A Future Made in Australia" program launched in the 2024 Budget. Here's the list of the industries selected under that budget policy for stimulus:

- Renewable hydrogen
- Critical minerals processing
- Green metals
- Low carbon liquid fuels
- Clean energy manufacturing, including battery and solar panel supply chains

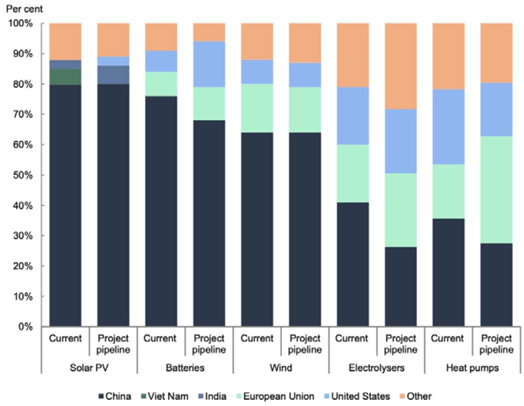
That's basically a selection of all the low productivity growth options from the list of possible "green" tech developments over the next decade.

To be mildly political for a moment, there's much the same motivations behind the federal Opposition's boosting of nuclear power — though this has the added downside of being decidedly fact-poor.

Unfortunately, corporate Australia is not doing much better than Australian governments in facing up to new economic realities. The underinvestment in digital was

From: Future Made in Australia National Interest Framework Supporting paper
Download

Chart 5: Production is relatively highly concentrated for solar and batteries



Source: International Energy Agency, 2023.

pointed out by in a report by Australia's Productivity Commission released in early 2023 entitled "5-year Productivity Inquiry: Australia's data and digital dividend".

The two following charts compare Australia to a range of other OECD nations, on the basis of percentage share of businesses adopting these technologies.

Perhaps one of the most damning statements in this report is this:

> *Only 6% of Australian businesses were using data analytics (such as working with big data or geospatial technology) in 2019-20 and an even lower share were using AI – in both cases, Australia's adoption is low compared with other countries in the OECD. Some other studies have suggested that Australia performs relatively well in AI; for example, Zhang et al. (2021) ranked Australia at 8th in the world in 2020. However, this high ranking is partly due to Australia's performance in AI research (such as journal citations and publications), which does not necessarily translate to more use of AI by businesses.*

So, in short, the capacity to make use of these technologies exists in Australia, as noted by a high level of academic involvement, but businesses are unable to transfer that knowledge base through investment.

Which is, in the end, very much what Wesfarmers is engaged in with OneDigital. The problem for the company itself is that this requires a shift in culture. The difficult part of that shift is the move — in some areas — from doing things "at scale", to doing things that have "scalability". Alongside that is the need to move from pure-form capital investment, to using capital more along the lines employed by venture capitalists.

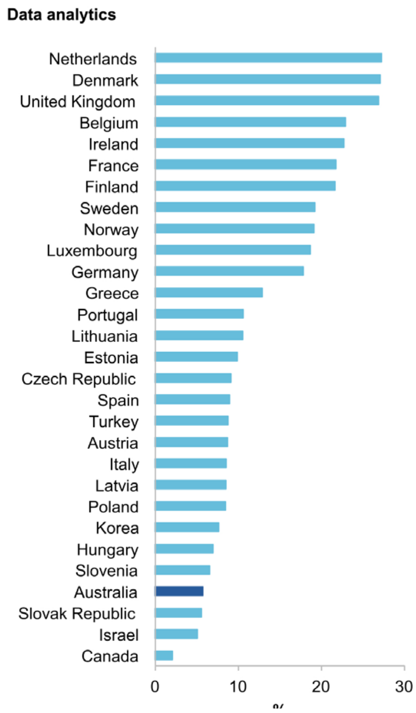
Wesfarmers background

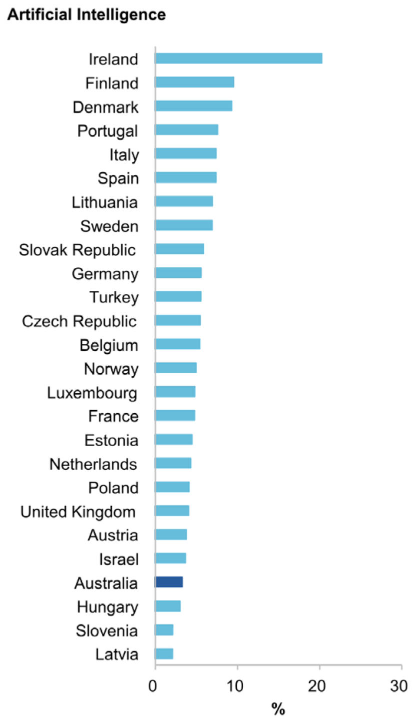
Before moving to the Strategy Day itself, it's best to quickly go over Wesfarmers' results for FY2024 H1, the period from 1 July 2023 to 31 December 2023.

For Wesfarmers overall, during a period of relatively high consumer inflation, the results were relatively subdued. Overall revenue grew by 0.5% on the previous corresponding period (pcp), which was FY2023 H1, to reach $22.67 billion. Earnings before interest and taxation (EBIT) grew by 1.6% to $2.20 billion, and net profit after tax (NPAT) went up by 3.0% to $1.43 billion.

The retail divisions will be covered in more detail later, but Bunnings saw earnings up by 0.3%, Officeworks by 1.2%, and Catch lost half as much as in the pcp, at -$37 million. The Kmart Group, including Kmart and the underperforming Target, saw earnings increase from $475 million in the pcp to $601 million for the current period, a lift of 26.5%.

Below: Charts from Australia's Productivity Commission report: "5-year Productivity Inquiry: Australia's data and digital dividend". Top Data analytics. Bottom Artificial intelligence





About growth

While the numbers posted by Wesfarmers for FY2024 H1 were not stellar, they are relative to the background growth in retail revenue in Australia, which itself was subdued on the comparison with the pcp. Overall growth for retail revenues at Wesfarmers came in at around 2.2%, while the Australian Bureau of Statistics (ABS) reported background growth in the categories where Wesfarmers contributes (excluding food, food services and miscellaneous) actually went backwards by -1.5%. However, some individual divisions, notably Bunnings, did not match the background rate, with the hardware retailer managing growth of 1.7%, while the ABS reports growth for hardware retail turnover in the comparative periods hit 2.9%.

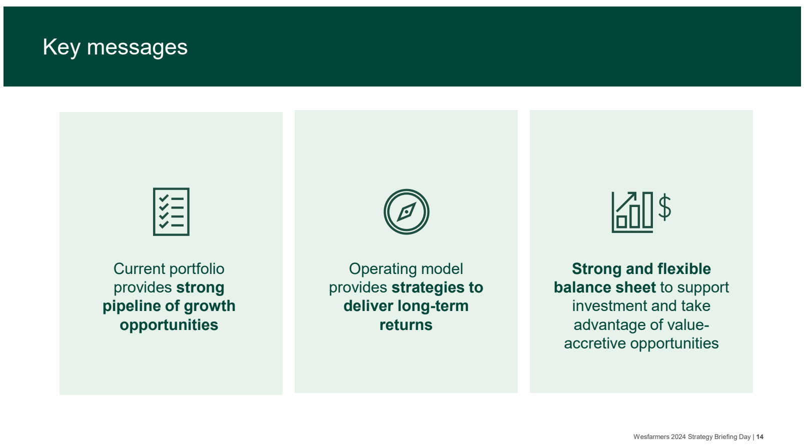
On one hand, it's expected of all corporations — and especially conglomerates — that they find a way around economies locked to lower growth to grow profits. On the other hand, that could at times lead to instability, with companies creating short-term "growth" at the cost of higher future growth. As Wesfarmers managing director (MD) Rob Scott outlined in his introduction to the Strategy Day, his view is that the conglomerate is very well-positioned, and can expect its past investments to pay off handsomely, if not in the immediate future. In his introductory remarks he stated:

To summarise, we have a portfolio of market leading retail businesses with strong value-based offers, broad customer appeal and growing addressable markets. Our globally competitive industrial businesses offer products and services that support some of our most critical industries in Australia. The health division provides the group with exposure to the attractive and growing health and wellbeing sector and the ongoing development of the Covalent lithium project is one of the ways our businesses are supporting global decarbonisation, with these all underpinned by the group's strong balance sheet, which enable us to make disciplined investments with a long-term focus.

…

Today you'll hear many examples of growth-focused initiatives from our divisional MDs. And ahead of that I wanted to make some overarching comments. Firstly, we have a strong set of businesses with good growth opportunities and very broad customer appeal. And I think that point of broad customer appeal across our retail businesses is probably not as well understood as it could be. The divisions continue to expand their addressable markets and to develop new products and service offerings. Population growth and demographic changes also provide opportuni-

Wesfarmers Strategy Day presentation: Slide p14



ties to grow our retail networks and to expand our offer. And there are many opportunities for continuous improvement in delivering productivity and efficiency gains.

Specifically as it relates to demographic changes, our divisions are developing their offerings, our retail divisions in particular to capture a greater share of spend from the younger generation, notably Gen Zs, while continuing to meet the needs of the growing base of retirees, which is also a very important base of our customers. It's estimated by the end of this decade, millennials and Gen Zs will combined represent about 50% of total retail spend, and we have made some great progress across our retail divisions through investment in data and digital and through new category and product developments to take advantage of this trend.

We know this demographic like to engage with brands digitally and across multiple channels and our investments at OneDigital and the development of digital capabilities in the divisions are having a positive impact. And meanwhile, the continued extension of products, notably the Anko ranges that Ian [Bailey, MD Kmart] will talk about in youth fashion, health and beauty, just to name a few, the continued expansion of Bunnings range in more consumables, products for renters and so forth, and Officeworks' very deep engagement and expansion of their offer to students are all examples of this.

Our retail businesses have developed low cost scalable business models, often supported by investments in direct sourcing and own brand capabilities. And their focus on reducing costs and improving productivity and efficiency over time has enabled this reinvestment into price, range and customer experience.

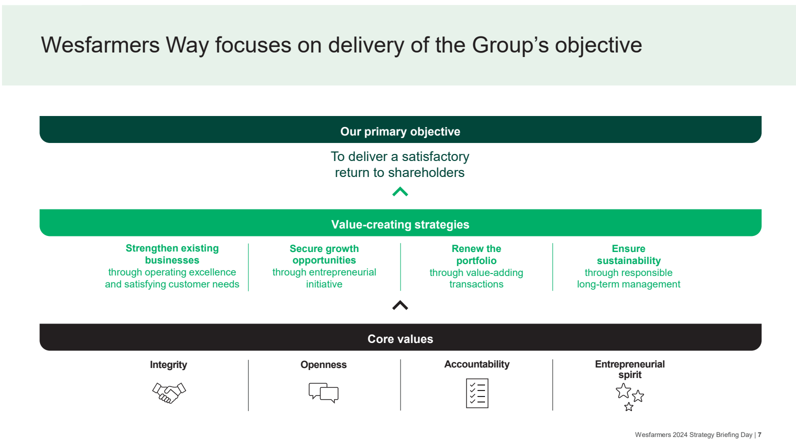
To put this in some context, part of what Mr Scott seems to be saying is that Wesfarmers has both positioned itself in the direction that the economy (and customer demographics) is set the go, and that the retail businesses are responsive to customer needs.

While he neither implies nor hints at this, we could think of the economy he's pointing to as the "recovered" economy. It's the economy that arrives after the post-pandemic economy we're currently still in — with its high interest rates, aversion to multi-unit dwelling, low public transportation usage, and persistent inflation — has faded further away.

The response

However, with the very first response offered from analysts, these conclusions were called into question. While the well-known analyst David Errington of Bank of America was the first to give voice to these concerns, other analysts were quick to add their own.

Wesfarmers Strategy Day presentation: Slide p7



Can I just ask two quick questions. The first one, if you go to slide eight, if you can bring slide eight up on the screen. It's with regards to your shareholder value creation, I suppose, through acquisitions and incremental investments. Without being too critical, I'd say that the majority of the value being created by Wesfarmers is in that bottom category [Bunnings, Kmart, Target, Officeworks], history of portfolio renewal and capital reallocation. That's where the value's being created. But the top two buckets, Wesfarmers Health and the other buckets, the incremental investments, I'd say that they're being drags on value. I mean the return on capital – leave Covalent out of it for the moment. I mean that's going to be heavily commodity price driven if we could leave that out. But the other ones I'd say are probably drags, some of them pretty material drags.

So my question to you is, your point is when you look at the demographics and you look for a good business, then you make an investment. Now the problem with that is I remember Mike Cheney saying a good business can be a bad investment if you pay too much. So how do you get that tactical part right with effectively wanting to be in the right logistical business? Because at the moment where those incremental [investments are], I'd say health and the bottom six, they're just not getting the job done for you. In fact, they're heavy drags.

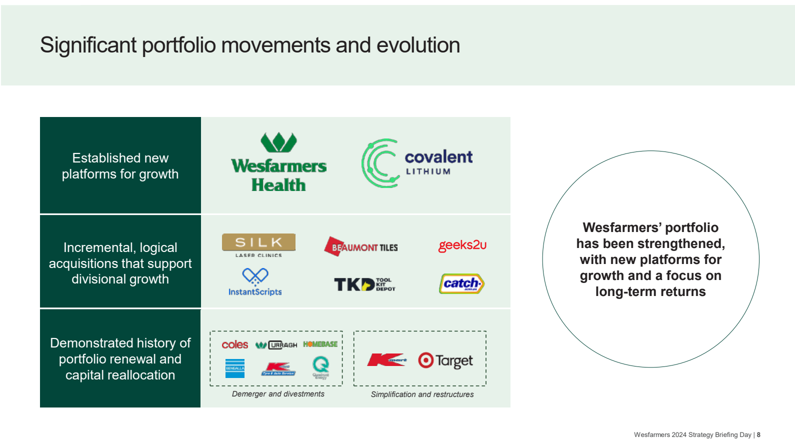
This is a clear example of what we've suggested is two half-truths that somehow don't connect. What Mr Scott has to say about the structure of investment at Wesfarmers is well thought-out and very much a reflection of strategy — about as far from pure corporate spin as you're going to get.

Equally, though, Mr Errington's comments are accurate and highly targeted — this is anything but a "broadside". He is absolutely correct in pointing out that, currently, recent acquisitions are a "drag" on EBIT.

So, where do these two connect? Ultimately, it is less about direct capital allocation, and far more about timing. Wesfarmers does historically rely on investments in the longer medium term of over five years for the most part. This applies to internal investments as well as external acquisitions. For example, Kmart initially launched Anko in 2019, which means it started development in FY2018 — at least. It has taken six years to reach headline status.

For those investments to continuously deliver, they need to be constantly layered into the company. That constant layering has been interrupted by three events. The first was the failure of Wesfarmers' investment in Bunnings UK & Ireland, which sunk over a

Wesfarmers Strategy Day presentation: Slide p8



billion dollars. The second was the divestment of Coles, and the third was, of course the COVID pandemic.

Tool Kit Depot (TKD) started with the announcement of the acquisition of Adelaide Tools in late 2019. After more than four years there is a total of 14 stores, with only two stores for the entirety of the biggest part of its potential market, New South Wales, Victoria and Queensland. (The original target was 75 stores.)

Something similar could be said about Beaumont Tiles, with that acquisition started in early 2021. There has been an expansion of its stores into Western Australia (for historical reasons WA — and to some extent South Australia as well — has been cut off from the east coast tile industry). But overall, it will take several more years before any real change will be possible in what is a relatively moribund area of construction materials.

TKD might be slow to develop, and Beaumont Tiles might not be the ideal acquisition target, but the selection was heavily affected by the COVID pandemic — there just were not that many options.

The problem is that lack of good medium-term investment in the past, as understandable as it is, has now introduced a period of between three and five halves where there will be little or no contribution to growth from external acquisitions, and only an unknown contribution to growth from internal sources.

On digital

Which brings us to the role of digital, and investment in the Wesfarmers division known as OneDigital. Also begun in 2021, in the midst of the pandemic, OneDigital is Wesfarmers' key internal investment for the current decade. It assumed its present shape back in April 2022, when Nicole Sheffield was appointed its MD, also taking responsibility for Wesfarmers' online discount retailer Catch.

The second question that Mr Errington posed was directed toward this division. He asked:

> *The second question, I was listening to Nicole [Sheffield] and I just don't understand why you're keeping OneDigital separate. I mean I listened to her and I just want to hold you guys to account with how your investment in OneDigital is actually leading to a business in dollars and cents. And I see the only way you can do that is to allocate the cost of OneDigital to each individual business. It's the only way you can do it because at the end of the day, we are never going to be able to hold you to account as to how this investment is actually increasing your value to your business.*

The key part of this is the clause "I just want to hold you guys to account with how your investment in OneDigital is actually leading to a business

Below, Nicole Sheffield, MD OneDigital

in dollars and cents". It's not about the accounting structure at all. The focus is on the viability and contribution to revenue of OneDigital.

Here again the situation is one of half-truths, each of which are valid, but which also (at first) seem to lack any kind of significant overlap. In general, from Mr Errington's point of view, if a corporation is entering into a period of earnings that are likely to be impaired due to its investment cycle, then it makes sense to reduce expenses wherever possible. From the Wesfarmers' perspective, the investment in OneDigital cannot be delayed any further. That means taking something of a hit on earnings, but better to face a moderate hit now, rather than a larger hit in FY2028.

While that's more or less the public stand Wesfarmers has taken, HNN's analysis is that there are additional goals behind OneDigital. Thirty-plus years ago, Michael Chaney — the current chairman of Wesfarmers' board, and MD of Wesfarmers from 1992 to 2005 — changed the nature of the company through the introduction of Bunnings . Bunnings opened up the firm to further investment in retail, most notably in Coles and its associated retailers.

Similarly, OneDigital — which is really a compendium of digital resources, techniques and skills — might have the immediate goal to develop a digital booster to its current retail operations, but OneDigital is also designed to help Wesfarmers take advantage of more general digital-centric opportunities. That would include external digitally-based acquisitions, as well as internal expansions.

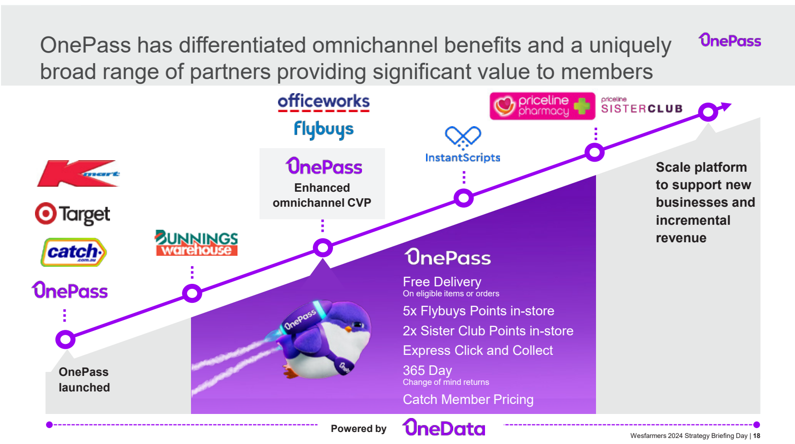
In effect, really, one goal of OneDigital seems to be bringing about a near Chaney-level redevelopment of Wesfarmers. It's hard to put a price on that.

The OnePass blues

While these are worthwhile goals, in HNN's opinion Mr Errington's comments do pick up on the strong possibility that in terms of producing an actual viable product, OneDigital's efforts to date have been less than a success.

One way of looking at this is to consider that OnePass has set out to be a customer acquisition tool, rather than accepting a more modest role as a customer loyalty tool. That's understandable, as the two main comparators in the market are Amazon's Prime and Kogan's First. First offers free delivery on most items, Prime offers free, expedited delivery — next day in most urban areas. First also offers discounts on some goods, while the Prime program is the only way to access Amazon's Prime video streaming service.

Wesfarmers Strategy Day presentation: Slide p18



While OnePass tries to present itself as a unified program, it is actually somewhat Balkanised across the retail groups. Subscribers have to individually link every retailer. With Officeworks, business credit accounts were not at first eligible (though this may have changed). Bunnings PowerPass accounts are also not eligible. Before subscribers can add Priceline to OnePass, they first need to, separately, subscribe to Priceline's "Sister Club".

The benefits also vary. While click-and-collect is boosted to two-hours for Bunnings and Kmart, standard click-and-collect is already two-hours for the other retailers. Shipping is free, except at Bunnings, where there is a size limitation on free shipping (e.g., length of parcel must be under one metre, volume under 0.25 cubic metres).

While much of this is not promising, there are four more essential obstacles to OnePass working as a customer acquisition tool. The first is that as of 29 June 2024, the Disney Plus streaming bundle ended. (The deal was announced in mid-May 2024; this cancellation was not mentioned at the Strategy Day.) The second is that one of the main other benefits of OnePass is price discounts at Catch, but Catch has declining revenues and ongoing losses, meaning it faces— at best — somewhat mixed prospects for the future.

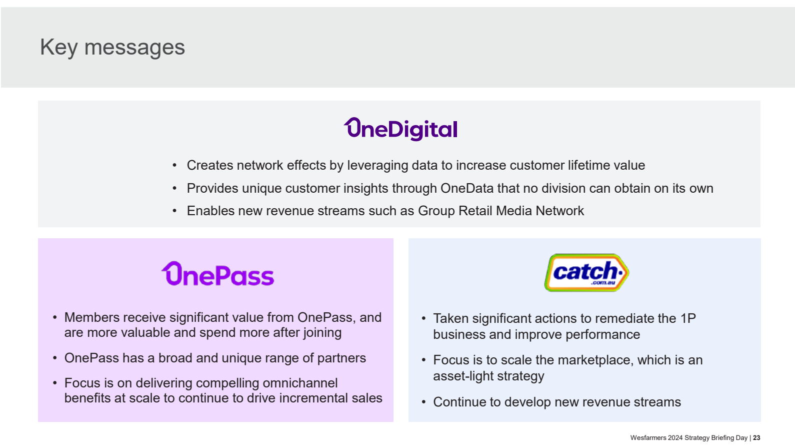
The third obstacle is that when it come to delivery, OnePass somewhat underdelivers. This is something that Jarden's head of Australian research, Ben Gilbert, brought up during the Strategy Day:

> *You talk about the different generations coming through and we look at Amazon who's putting another half a billion dollars in New South Wales at the moment, half a billion down in Victoria and probably going to over 200 million SKUs on their site now. Wesfarmers have done a great job around leveraging scale on sourcing obviously what's happening with OneDigital, but supply chain to me just seems the area where you're a bit, I don't want to say absent, but you just haven't put the investment.*
>
> *If you want to do fulfilment by Catch, you want to push range and compete on that and you want to break down same day delivery, like Amazon's got 85% coverage now, when do you guys take the decision to do a bigger fully automated shed, endless aisles being able to have that investment from national base?*

Mr Scott responded, in part:

> *I think it is important to remember, it's not a like for like comparison, we have an enormous benefit of well over a thousand stores that can act as fulfilment centres in their own right and can often get product to customers either through click and collect or home*

Wesfarmers Strategy Day presentation: Slide p23



delivery faster than others with dedicated centralised fulfilment solutions. We also have a very wide range of distribution centres with fulfilment solutions there that we're continuing to invest in an upgrade. As it to the marketplace fulfilment capabilities that Nicole talked to, we have a fair bit of excess capacity in our Morebank facility. We also have a site in Melbourne with excess capacity.

Again, we're somewhat in the world of partial truths that don't quite overlap enough. Mr Gilbert is, of course, correct to point out that Amazon's next day delivery is important. Mr Scott is also correct in pointing out that Wesfarmers is capable of next day delivery as well. In fact, in tests of OnePass delivery that HNN has run, next day happens with surprising frequency.

But the difference is that Amazon can guarantee next day, and Wesfarmers cannot. For consumers, that's a very big difference. The choice becomes, do I drive 20 minutes to the shopping centre, take (at least) another 20 minutes to park, go into the store, find the product, buy the product, then drive back another 20 minutes — or do I click on the button, and have the product show up my front door the next morning? That's what customer acquisition looks like. If next day is only a possibility, it doesn't work.

Equally, though, Mr Scott's point about having a thousand stores really counts as well. Which leads us to the fourth obstacle to OnePass's success, which is that it is very much centred on online commerce. As the MD of Bunnings, Mike Schneider, has been telling anyone who would listen for the past six years, the major role of online for Bunnings (and the rest of Wesfarmers retail outside of Catch) is customer acquisition for the physical stores. Stats show that something like well over 80% of shopping journeys begin with online searches. And OnePass, as it is constituted today, doesn't really help all that much with this important function.

The OneDigital presentation

Criticising tech executives doing presentations on less-than-successful businesses is really somewhat bootless. It is really a very difficult task, and tends to provoke executives to deliver somewhat obscure statements that don't always stand up to analysis.

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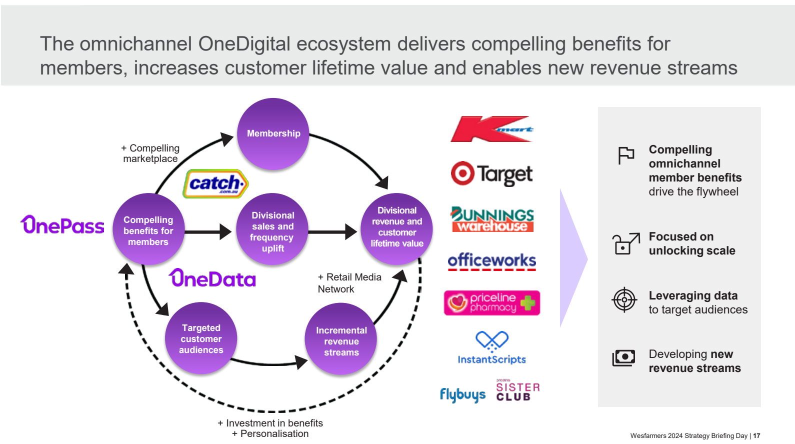


One big question, of course, is the extent to which OnePass is failing or succeeding. What is known, however, is that Catch is failing, and Catch is supposed to be the "poster child" for OnePass overall. While it is not possible for outsiders to accurately account for how much OnePass — or the other elements of OneDigital —

contribute to revenue for Wesfarmers' retail, the failure of Catch does cast a shadow over OnePass itself.

All that said, the ultimate purpose of OnePass is something more than boosting current retail operations. As we'll discuss later, it also is aimed at enabling new forms of retail at Wesfarmers.

It is also the case that when it comes to loyalty programs, some rather odd numbers are frequently produced by retailes. For instance, Ms Sheffield makes this statement:

> *So while we continue to build out OnePass, it's worth noting that OnePass members are already more valuable than non-members. Members shop 2.7 times more frequently across our brands. They spend more with our brands, so three times more in the case of Catch and 2.7 times more across the group, they cross shop 1.4 times more across the group and they are much more likely to be omnichannel shoppers. In fact, three times more likely.*
>
> *Importantly, members are benefiting from their membership and so they're changing how they shop. After joining, members increase their spend with us by more than 25%. This demonstrates that not only are we getting incremental benefits from the program, but that members are seeing value and choosing to shop with us more.*

This is typical of the overall language used by retailers to "boost" their loyalty programs at results announcements. We've heard similar from Metcash in the past. One would suppose a first comment would be, if all this wonderful stuff is happening, why does Catch remain such a failure?

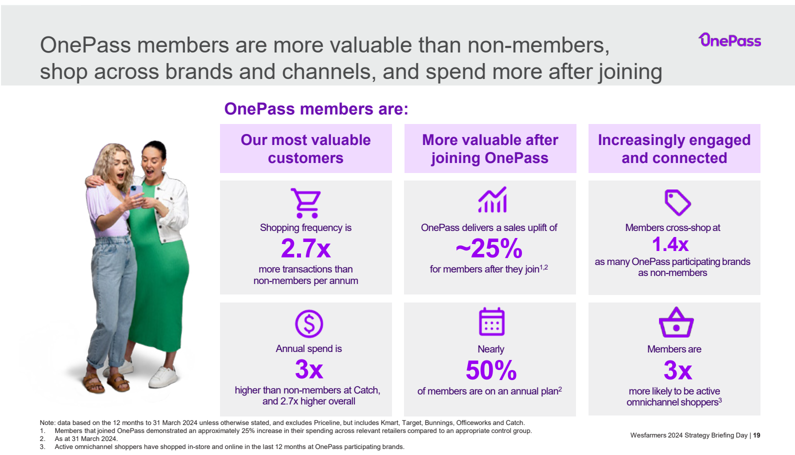
Specifically, though, it's important to note that the boast about the 2.7 and three times expenditure boost is a comparison of OnePass members with average shoppers at Wesfarmers retail and Catch. It seems obvious that shoppers with a higher rate of expenditure are going to be the ones who do sign up with OnePass (and endure the laborious linking process) as they benefit the most from free delivery. If there is an implication that joining OnePass somehow triggers higher levels of spending, that claim does not seem to be strongly supported.

It is also, of course, the case that when a family creates a OnePass membership, this is then shared. So where expenditure might have been split across two or more individuals, it becomes consolidated, which might create an apparent increase in spending.

To point to another curious use of numbers, there is this statement by Ms Sheffield:

> *OnePass is also introducing new and valuable customers to our brands. For example, since the*

Wesfarmers Strategy Day presentation: Slide p19



launch of the Priceline partnership in March, nearly 20% of members linked to Priceline via OnePass were new to Sister Club.

OK, so what does that actually mean? The implication is that, then, 80% of members "linked to Priceline via OnePass" were already Sister Club members. Wesfarmers states the Sister Club has around eight million members, around 38% of the adult population. Given those numbers, the really interesting figure is the number of OnePass members who don't bother to link to Priceline, or, having linked to Priceline, don't want to go through the mandatory process of also signing up for the Sister Club.

HNN is not suggesting that there has been any deliberate misstatement of fact in the above statistics. However, from our view it's just very difficult to work out what exactly is being discussed. That lack of clarity was something that the analyst Lisa Deng from Goldman Sachs tried to get at in her question for Ms Sheffield:

Just out of interest, how do you actually attribute incremental benefits that's been driven by OneDigital versus just good execution? For example, the Black Friday event, what would it have been if we didn't have it and then therefore looking two, three years out, what do we think the incremental benefits of OneDigital should be?

To paraphrase, how do you compare the performance of something like the Black Friday discount event with and without the influence of OneDigital?

Ms Sheffield responded in part:

The benefit of having OneData is they've actually created an attribution model and understand what is incremental and work with the divisions to actually assign that. So for example, the early access to Black Friday came up, for example, was a significant beneficiary because it was early access. We could actually see which OnePass members went online, actually bought those products before it was available to all customers.

But again: the comparison needs to be an based on overall generated revenue. OnePass members might take advantage of early access, but does that increase the overall revenue gained from the promotional event?

There are a few other such points raised in Ms Sheffield's presentation, and it is not worth going into all those. But to outline just one statement which seems to best represent this no doubt unintended obscurity, Ms Sheffield stated:

The OneDigital ecosystem creates network effects by leveraging data to increase customer lifetime value across the group.

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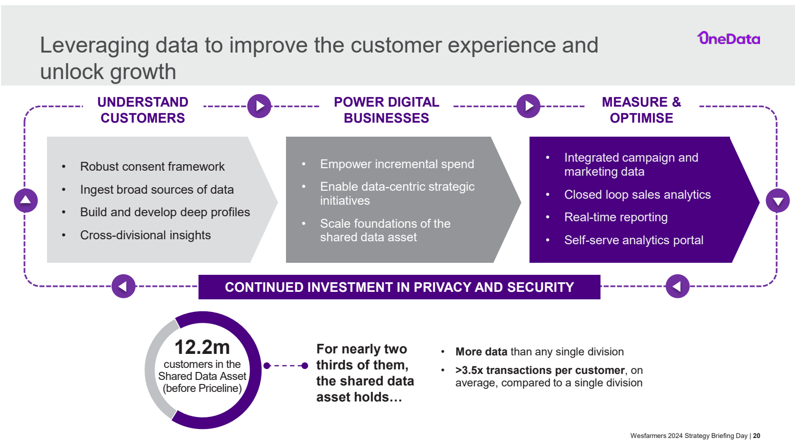

This is the kind of statement that lends itself to so many interpretations that it fails to communicate anything specific. One suspects there is a not quite valid grasp of graph theory at work here. There could be network effects at work in this kind of situation, but it would require there to be a kind of latent network already there, as in B2B businesses.

For example, if a company were selling dishwashers, and had access to how much each customer spent for dishwasher instalation, the company could give guidance on average installation fees, and that would be a genuine network effect. That's based on a proxy link (edge) between customers.

Getting to the heart of what has misfired at Catch for Wesfarmers, however, was this excellent question from Shaun Cousins of UBS:

> *Just secondly on Catch, Wesfarmers is quite concerned about its reputation. If I'm running a marketplace that might not be congruent with that in that I might be more willing to bring product on that's grey market that I want to move in and out quickly. Why is Wesfarmers given -- you're quite slow to bring product onto Catch. We've had feedback from suppliers that are selling on Catch. They can get their product onto other marketplaces quicker. Given that sort of very noble sort of approach that Wesfarmers takes, why is Wesfarmers the right company to own Catch, then?*

It is worth noting before getting into the details of this question and answer that Catch has a rating of 3.1 stars out of five stars on review website TrustPilot, with 27% of its 2518 ratings giving it just one star. On ProductReview, it has an overall rating of 3.7 stars out of five, with 26% of over 8000 ratings giving it just one star.

A key question to ask Wesfarmers. Ms Sheffield responded:

> *I think we are very committed to ensuring that we can provide a lot of seller tools. We're providing a lot of governance in terms of actually how we grow that marketplace. It's going to be very considered and we've got support in global experts that know how to do this. So to your point, we are very considered in how we're adding to that marketplace.*
>
> *The reality is what the marketplace offers at the moment, we have 11 million SKUs. As we grow those SKUs, we grow categories, we grow categories and SKUs that are available, which is valuable for our customers. And if you think about the digital ecosystem that we're building, they're actually product that broader products they can buy and there's more that they can do. So from our perspective, I think that it is the right strategy. We just need to be quite considered in the way we bring those marketplace sellers and we onboard them.*

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Mr Cousins followed up immediately by asking:

But you'll be less nimble than your peers and so you'll be sort of somewhat disadvantaged in the way you want to go about it. I'm just curious, is this not a business that's actually better in the hands of someone else?

Mr Scott responded for Ms Sheffield:

No, we feel that there's plenty of opportunity to build a really competitive and broad marketplace offer. In fact, I'd say in some ways I suspect that the regulators may well become more focused on other market-based providers and asking questions. Are they managing appropriate expectations around not just ethical sourcing but the way that the marketing occurs? So we feel that we have more than enough opportunity to build a really competitive marketplace in line with our ethical sourcing standards.

No one would ever accuse Mr Scott of being naive or making unconsidered statements — though he does seem to be, fortunately, a very hopeful person. One would hope that ethics would win out on the internet, but in a world where unhinged conspiracy theories are now free to roam on what was once Twitter, hope might best make a close companion of caution.

Bunnings

This year — more so than in the previous six years — understanding what Bunnings is doing strategically is a little difficult. Listening to the presentation by Mr Schneider, what is most striking is how conservative the hardware retailer's approach has become for FY2024/25.

In reaching for some description of that strategy, one which acknowledges some continuity with the past, we've hit on describing it as a strategy of "incrementalism".

The competitive advantage of Bunnings is, first and foremost, its scale and size. Incrementalism is all about building competency based on refining current practices, expanding current markets and expansion into closely adjacent markets. It is, pure and simple, finding the best way to utilise scale and size to dominate markets.

As Mr Schneider put it:

Our business model leverages our scale and finds cost savings through operational efficiency from the unique design and layout of our stores to our service model so we can invest in price and service.

The primary tool of incrementalism is rigorous adherence to everyday low prices (EDLP), allied with broad and expanding geographic presence of retail outlets. Enabling that market dominance is a focus on a high level of competency combined with ongoing cost-containment.

This is how Mr Schneider described Bunnings' strategy in his remarks on Strategy Day:

Mike Schneider, MD, Bunnings

We take a category by category approach, keeping our customer offer differentiated and compelling. It's centred around three value pillars: lowest prices, widest range, and, of course, the best experience.

He added later: "Our strategic agenda has four key themes: care, grow, simplify, and evolve".

What is perhaps most telling in these descriptions is the absence of the word "innovation" — not that Bunnings doesn't innovate, it does, but, excluded from the list of core values, it is a business technique that takes its place seemingly below other concerns.

That is largely because growth objectives under incrementalism are not achieved through the risky try/fail/redo/try framework of most innovation, but rather through continuous expansion along known pathways. New categories are added, existing categories are broadened or deepened, existing stores are rebuilt to be bigger and better, new stores are added in growing, under-serviced regions.

A classic example of this kind of growth through evolution and development is provided by Mr Schneider as regards space optimisation in Bunnings stores:

I'd now like to talk about a really important opportunity that we see at Bunnings: Space Optimisation, which we see as a driver of future growth. It's how we better use our retail space and make product ranging decisions across our network. So the in-store range is tailored to serve the local market, taking into account location, store size, layout and format.

When I reflect on our history, the absence of an omnichannel offer meant we had to carry wider ranges in our smaller stores, often meaning stock availability was compromised to ensure range width. The development of our online store and last mile capabilities along with recent investments in inventory and order management technology means we can reduce some range width in our smaller stores and ensure we have greater availability of the key products our customers need, with our full range of products available for customers online.

We've been trialing localising and curating range based on geographies, climate, customer demographics and trends. Our visual merchandise and data science teams have been using space planning technology in some small format stores to help us understand improvements to return on space as well as testing macro and micro range choices.

The results are really promising and we'll be keeping on building this so that we can compare the performance of our ranges and offer across our network and drive more relevant customer offers and increase sales density at scale and we'll look to deliver this capability

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across our 50 or so small format stores as a start point across our network in the year ahead.

This illustrates the best that incrementalism has to offer as a strategic framework. It takes a known, existing situation, sets a goal, and then works out how to achieve that goal by applying data, market intelligence, and practical solutions to that situation.

While this strategy is readily apparent in the above example, it is less so many of the other initiatives communicated by Mr Schneider during the Strategy Day. There is a danger, in fact, of seeing these as being a somewhat disassociated "laundry list" of items. They include:

- The introduction of the pet accessories range
- Expansion of products for rural living
- Expansion of automotive accessories range
- Expansion of bulk-sized offers for products such as light globes
- Smart home expansion, with an emphasis on security
- Cladding, joinery and window installation packages
- Development of products in captive brands, such as Matador barbecues, and Citeco ladders and PPE
- Further investment in frame and truss plants
- Localised delivery of goods from Bunnings stores via a fleet of specialised utes

One way of looking at these developments — and no doubt, these are exemplars, not a definitive list — is that aspects of incrementalism reflect some of the thinking behind the "lean" production techniques that were developed in Japan during the 1970s and 1980s. Lean production did not rely on broad, sweeping strategic changes, but rather on a constant daily attention to small actions directed at eliminating waste.

Individually, these were small changes, but cumulatively they helped create a world-beating automotive industry for Japan, boosting Toyota to overall leadership. In that sense, Bunnings seems to be constantly looking for that 2.0% to 4.0% advantage in category growth.

Beyond this attention to categories, there are two other key avenues to growth in the Bunnings strategy as described on the Strategy Day. One is the ongoing geographic expansion of Bunnings, as detailed by Mr Schneider:

We see lots of runway ahead for growth through the expansion of retail space at our existing sites and through new and replacement sites. In the year ahead, we've got 10 significant projects scheduled, a combination of new store replacements and expansions.

We anticipate growing our retail floor space by around 10% in the next five years. We expect to add

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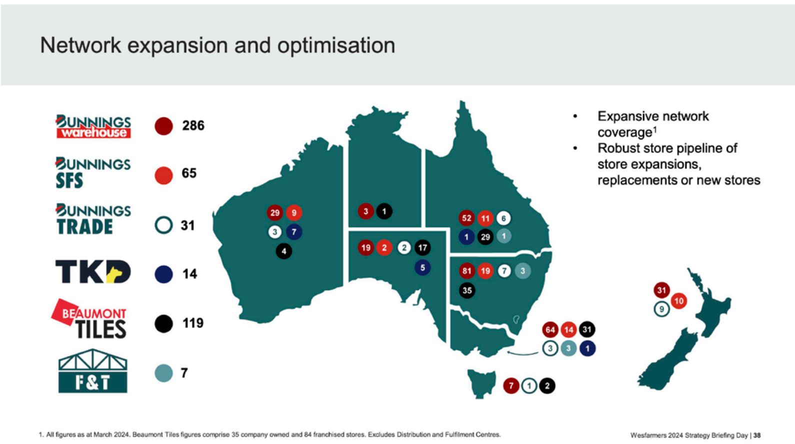

new Bunnings stores serving communities like French's Forest here in Sydney and expanded offers through replacements or expansions, such as Dubbo in Western New South Wales.

The other key avenue is continuous improvement of Bunnings' operations, particularly in terms of its staff. One of the defining aspects of Mr Schneider's time as MD has been an increased focus on internal operations. One could say that he seems almost as focused on Bunnings' staff as he is on Bunnings' customers.

We couldn't be more proud of our team and our culture. It's one of the important ingredients of our success and it's enabled us to grow and change over time, whether it's large scale tech transformation where range innovation, fresh formats or a step change in our commercial service offer and these things don't happen by chance.

We work hard every day to maintain and foster a high performing team. Ensuring our team stays safe and well in the workplace continues to be a very high priority. We continue to look for ways to improve how we handle stock in our stores and see results from our safety programs to reduce injury.

Our new EBA for our store team was implemented this financial year and provides industry leading benefits and combined with new rostering systems means we can much better match team hours to the demands of our customers.

We invest in training and development in product knowledge, commercial acumen and leadership skills, all as ways of investing in our talent and providing incredible career pathways.

!We're focused on building an inclusive and diverse workplace, reflecting the communities where we live and we work. These elements all come together to support our strong team culture, high retention rates, helping us build a knowledgeable and engaged team, which also gives us a cost of doing business advantage.

The cost of incrementalism

It could be argued that incrementalism as a strategy served Bunnings well for the first eight years or so after Mr Schneider became MD in 2016. He assumed full responsibilities directly in the wake of Bunnings' disastrous attempt to expand its operations into the UK via the acquisition of Homebase.

But post-COVID market conditions and the Australian economy itself have changed radically, and there are some questions as to whether the downsides of the strategy are at the very least now considerably eroding its upsides.

One of the main areas where those downsides are on display are with the growth acquisitions Bunnings has made in recent years. While we've mentioned

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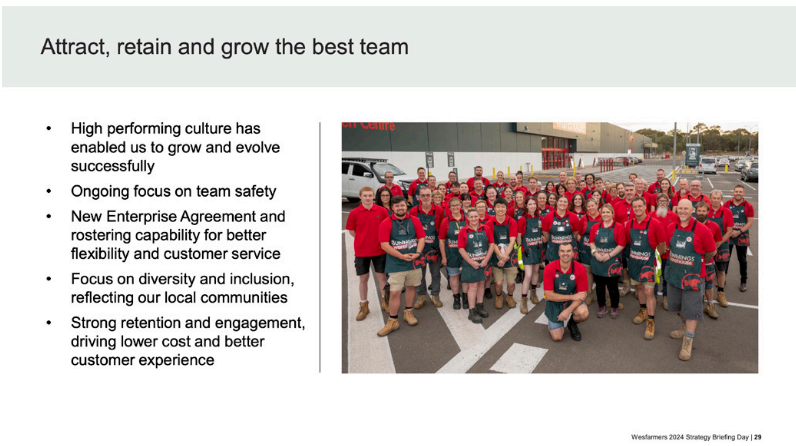


these acquisitions above in terms of some unlucky timing for Wesfarmers, here we want to concentrate on what they mean specifically for Bunnings.

For example the acquisition of Beaumont Tiles in April of 2021 now seems mostly puzzling. Mr Schneider did make one brief mention of the flooring retailer:

> *During fitout, we see real opportunity to grow the supply of kitchens, bathrooms, flooring, and installed appliances. Part of this strategy focuses on Beaumont Tiles. This is now well-established in Western Australia, rounding out its national presence, and its expansion into timber and hybrid flooring is resonating strongly.*

Generally speaking, acquisitions are made because they offer serious growth opportunities that are multiples of the acquisition cost. Beaumont's — which has been a struggling company since the global financial crisis (GFC) of 2009 — has been, instead, something of an "incremental" acquisition to date.

The same largely holds true for TKD. Adelaide Tools was acquired in April of 2020. In September of 2021, Bunnings announced it would form the basis of TKD, a competitor to single-category trade tool retailers such as Sydney Tools and Total Tools. The first TKD store was opened the next month in Western Australia.

To date, TKD has no stores in New South Wales, and only one store operating in Victoria, in the suburb of Mentone. This is despite rapid ongoing expansion of this category. During the strategy day, Mr Schneider did make one reference to TKD:

> *Our second opportunity for growth is in better equipping our trades with all their business needs, helping with all the tools, workwear and safety equipment that they need. We keep evolving our commercial tool offer across warehouses and small formats and at Tool Kit Depot we're doubling down on online to accelerate our national reach while leveraging the Bunnings network for fast fulfilment.*

The thing is, if people are ordering online through TKD — so not through a physical store — and the goods are being delivered through Bunnings, well, what is the actual point of TKD?

That, to some extent, was part of a question asked by Mr Cousins at the conclusion of the presentations:

> *Mike, can you just talk a bit about Tool Kit Depot. [I'm] conscious around the online effort that you've played, the role that Bunnings is playing there for store collection … but you had indicated some time ago that there was an ambition*

Tool Kit Depot and Beaumont Tiles share space in Seaford, South Australia

maybe to get to 75 stores in the medium to longer term. Does that still play? Is that still an ambition?

And then just what are you seeing in broader the competitive dynamics in the tool space in that there's a lot of stores being opened by Sydney Tools and Total Tools as well, please?

Mr Schneider replied:

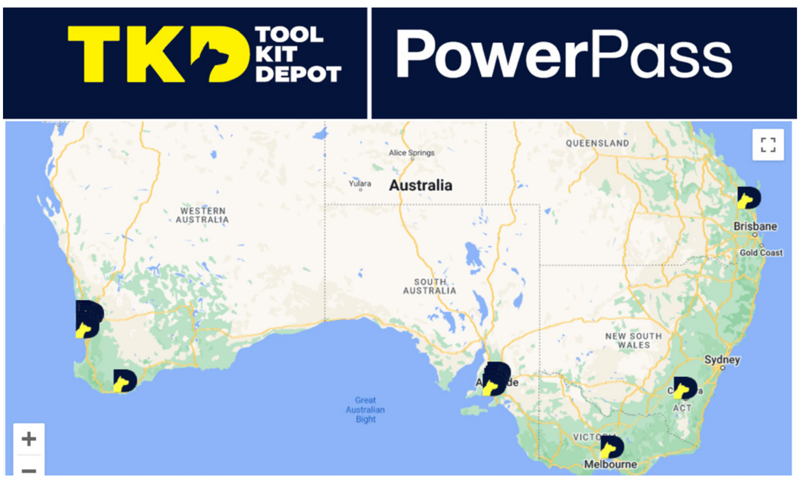
Yeah, it's a great question. Look, what really has surprised us is the engagement online and in markets where we haven't [any] physical presence, like here in New South Wales ,or Queensland where we've got just the one store. So [we] continue to optimise the model. There's a little bit more work to do for us in private label through the accessory space and we'll continue to optimise the network as those opportunities present.

But one of the things that we were really clear on very early in the journey was to let Tool Kit Depot standalone and not sort of try to integrate some of the big corporate pieces into what's a very different operating model, which is reflective of the industry in which we're playing now. We've established that we are able to sort of integrate Power Pass. So you can now use your Power Pass card at TKD, that's a million customers straight away able to engage in store [and] online with TKD. We've been able to leverage the marketing power and marketing spend of Bunnings. If you're searching for products, we don't sell at Bunnings, but we do sell at Tool Kit Depot on the Bunnings website, it will now take you to the Tool Kit Depot website.

These are really big steps and that online-led piece is actually really giving us a significant opportunity to engage thousands of new customers in those markets. So it may well be over the next 12 to 18 months, we actually rethink that even more and the ability to be pretty capital light. We haven't got a lot of stores, but we've got a lot of reach [that] is allowing us to be incredibly competitive on brands like Milwaukee, bringing incredible value to the trade customer base. So it's an exciting time for that team. It is a really small business as Rob said earlier today, so it gets plenty of attention because it's an important customer base. This is a white hot market in terms of competition and we are really enjoying the fact that we're bringing some new value into that space.

There isn't a direct answer in that as to the original target of 75 stores, but the implication is this is no longer a goal. What is clear is that Bunnings has effectively found a way to sell Milwaukee tools, even if it's not directly through Bunnings itself. (In the deal Bunnings made with Techtronic Industries, owner of both Milwaukee Tool and Ryobi, the retailer gained exclusive access to

Tool Kit Depot locations



the mid-range consumer power tool brand Ryobi. However, it has also been precluded from selling the high-end trade power tool brand Milwaukee.)

This seems like incrementalism again, it's just that what is being incremented is the original Adelaide Tools, which was a tiny operation by national hardware standards.

The Adelaide Tools acquisition was described by Mr Scott, in answer to a question by Mr Errington, as not that much larger than "a rounding error". Yet it is possible that TKD does have a negative effect as well, displacing efforts that might be better spent online innovation elsewhere.

But the most fundamental flaw to incrementalism is that the delta incrementalism tracks is oriented towards the past, not the future.

Incrementalism relies on a comparison with past results. But true market conditions are not based on history, but rather on potential. And in those terms, Bunnings might have historically seen overall growth, but compared with the broader market, it's likely it has not really kept up.

That's very much the point of a question poised to Mr Schneider by Mr Errington at the close of the presentations.

I think now that we're through Covid, we've gone through the Covid period, we've done two and a half years from Bunnings. You've consolidated – I suppose is a good way of putting it. Sales and earnings have been relatively flat-ish. So this question I'm asking is with an optimism glass half full rather than as a glass half empty criticism.

But when you look at your sales density sales per square meter, you look at your online penetration, you probably look at … when I listened to Ian [Bailey, MD Kmart] on the Anko direct sourcing model, I mean, geez, that's a powerful model that he's created with Anko. Whereas your direct sourcing is fairly very light, very low. So these are opportunities I think. And you mentioned today [regarding] space intensity, but you only talked about 50 small stores. I gather, I'm trying to figure out the next three to five years, how big a prize can you go after by narrowing the gap in sales per square metre because you're about two-thirds of what the global leader is.

Your online sales is less than 2%, whereas the leader's 15% and your direct sourcing's what, 15, 20%. When you look at someone like Ian's up around 100% and you look at the way Anko is going, it just is really powerful.

So is that a realistic target that we can map for you that you could probably do this for Bunnings? Because at the moment the last two and a half years has been pretty modest and … Kmart has got stronger growth prospects than Bunnings at the minute.

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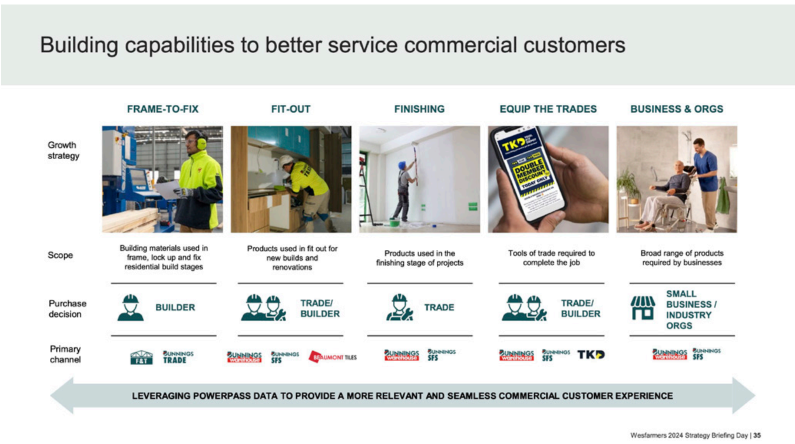

Mr Schneider's response to this is mostly a reiteration of the points he made during his presentation. To provide just the start of that answer:

> *Look, they're all really exciting opportunities and I think bringing it right back, our go-to market position is fundamentally different [than Kmart's]. Say for example to Anko, we are a very open and proud house of brands and we think we can really drive value. Certainly the brands are responding very well to that because we are providing a really meaningful channel to market for those brands.*
>
> *A lot of those brands are exclusive. You won't find them on our international competitor list when they're playing in the online space in Australia. We've got brands coming to us enjoying the opportunity to work with an organisation that wants to work with brands. Many others are going down the private label strategy for all the right reasons, particularly if you listen to what Ian's doing with Anko. The way I think about global sourcing though is it's an enormous opportunity for us.*

A difficulty that HNN would point out with this response is that the brands get a lot of mention, and they are certainly happy, but what about the customers? The point of Kmart's Anko brand is that it is actually disrupting established brands by providing a value proposition not based on lowest price. Anko, in the end, is almost a form of de-branding.

Which brings us to something of a closing statement on this overview: what if the famous Bunnings claim "Lowest prices are just the beginning" ceases to have the resonance it once held? What if what people have started searching for is not lowest price, but highest capability?

Changing retail

It would be a mistake to see the transformation Wesfarmers is undertaking as being driven by the new technologies it is adopting. It's more likely that technologies are enabling a shift in overall strategy.

So, what is that transformation all about, really? From HNN's perspective, it seems that what Wesfarmers is engaged in is a move away from the "standard" business model for large Australian corporations, towards one based on higher growth areas.

In plainer terms, many (but not all) large Australian corporations exhibit to some extent a form of monopolistic behaviour. Much of that monopoly behaviour is no doubt due to the dynamics of the Australian marketplace, such as geographic isolation, and a small population spread mostly about the coast of a large continent.

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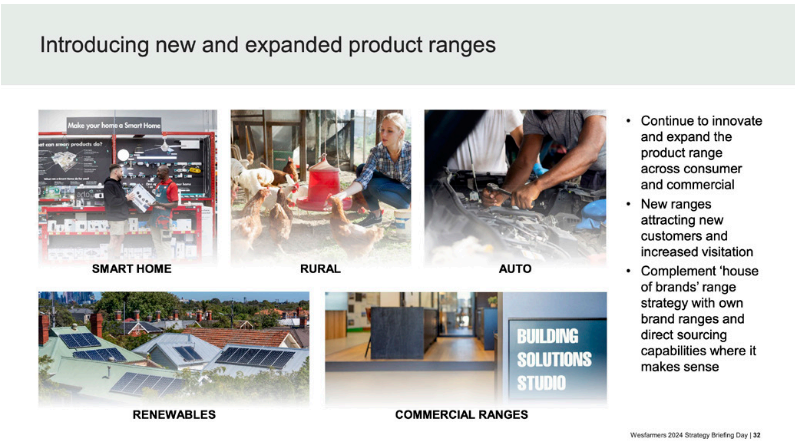

What has changed over the past decade, as growth has moved from the tangible markets of industrial mass production to intangible markets largely driven by software development, is that monopoly behaviour has become associated with slow growth. Modern monopoly is less a matter of price-fixing, and more a matter of gaining control over the inputs to the market. Innovation disrupts that control, and so is intentionally or unintentionally (as an outcome) discouraged.

One clear sign of this move towards a post-monopoly business model is the development of the Anko brand by Kmart, as mentioned above. Home brands and "captive" brands are typically exercises in margin gains through cost control. They consist of either rebranded white label goods, or a vertical integration where costs are saved by retailers de-risking distribution for manufacturers.

Anko doesn't fit into either of those categories. The Anko brand is designed to appeal to Kmart consumers based on the delivery of a set of medium-term capabilities at a reasonable price — or, to put it slightly differently, it is a trusted brand (within limits). Because of that non-monopolistic (usually price-driven) approach, it is capable of expansion beyond its original domestic market, as value expressed in terms of capability is transferrable between markets. Or, again, from a different angle, Anko represents the decommodification of the lower end of the market for goods such as household appliances.

That's a different kind of growth.

Catch as a change agent

That brings us, indirectly, to Catch. From HNN's perspective, Catch represents Wesfarmers' struggle with its strong leanings towards market and category control, the untameable online market, and the need to switch from a low-growth to a high-growth mode of retail.

At its core the failure of Wesfarmers with Catch is structural. The three main retail businesses at Wesfarmers retail are major players in the broad categories where they compete. Each approaches the market from the viewpoint of categories, with the aim to provide a compelling offer in most of the categories they sell into. As Mr Schneider says, they "earn the right to be chosen" by customers.

The marketing of these retailers is simple, mostly a matter of making the public aware of the general offer. The physical retail spaces are basic. As the main attractor is low cost, spending money on fancy sales spaces and big marketing campaigns will

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only add to price or diminish margins.

It's a model that is all about finding the best ways to use size, scale and competency to produce high returns and strong future growth.

Taking over the Leibovich brothers' Catch, and transforming it into Wesfarmers' Catch, involved trying to apply a similar formula to the online-only retailer. The difficulty is that Catch and its market position bear virtually no relation whatsoever to that of the rest of Wesfarmers retail.

Catch at its inception was one of a number of Australian web retailers that were inspired by the success of US website Woot. Woot combined genuine discount value, usually on overstock goods, with the thrill of limited quantities and a time-limited purchase window.

The unique ranges sold were, for the most part, brand name items offered at a discount rate in limited size and style ranges, and limited quantities. Low price was not the result of supplychain and logistics management. It really came through the re-contextualising of unsellable, surplus stock from high-value to bargain-value, in a way that did not dilute the brand value of the manufacturer.

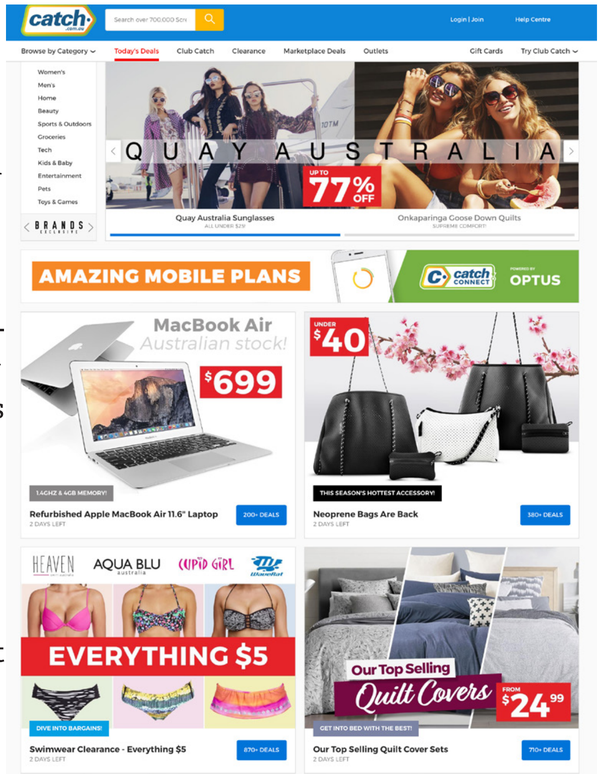
The original version (and subsequent iteration after repurchase) of Catch was very successful. That was largely because it catered directly to a narrow band of shoppers who found the new context of familiar brands appealing. The Catch founders, and the people they hired, were adept copywriters. The entire website was really a compelling narrative that promoted the products.

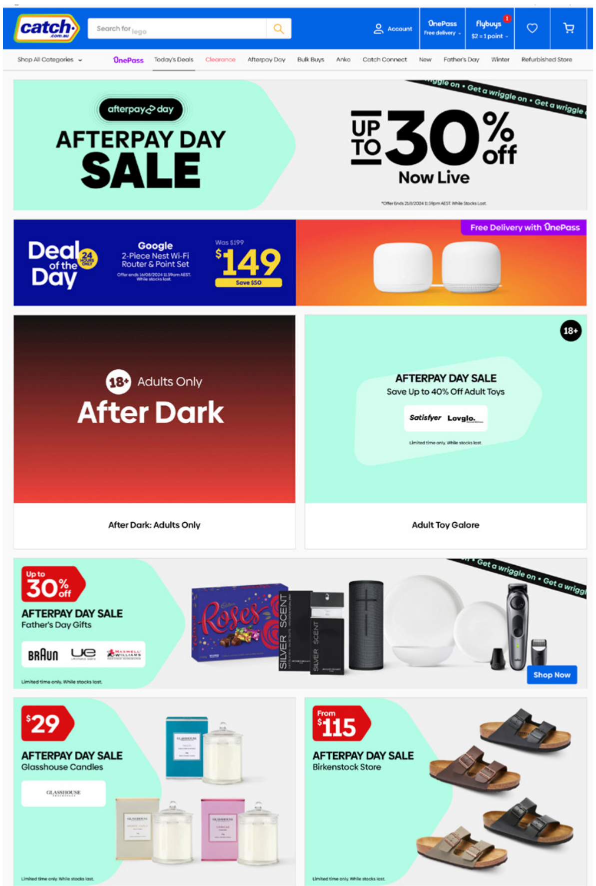
Catch under Wesfarmers ownership abandoned many of those advantages, likely because they did not really scale. Instead, the planned attraction for Catch was a Venn diagram overlap: it's one of the very few websites that combine that particular unique discount range, along with the implicit customer guarantee that comes with being part of Wesfarmers.

What ensued, however, was an attempt to follow the Wesfarmers model, and find some kind of category it could dominate. The ad hoc nature of the supplychain makes finding real efficiencies difficult and hence limits control of categories, so the only possible targets were consumer categories. But this ignores the major strength of Catch — which was also, sadly, not highlighted enough in the presentation to analysts on the Strategy Day.

What Wesfarmers has built with Catch is a platform — which is a considerable strength. Platforms

The Catch.com.au website. Top, pre-Wesfarmers, 2018. Bottom, post-Wesfarmers, 2024. The "adults only" After Dark link only appears after 9:30pm.





occupy a specific place in the digital world. At their core, they connect different groups together via mutually beneficial transactions. One obvious part of the platform for Catch is enabling third-party companies to sell items to Catch customers. Another interesting part of this, though, is that Catch facilitates interactions across multiple groups that are narrowly defined.

There is a definite "type" of Amazon customer, a "type" of eBay customer and a "type" of Kogan customer. Many of the failures of Catch under Wesfarmers have originated with the company trying to come up with its own specific type.

In fact, the multiplicity of types that use Catch is a core strength. To service that strength, though, Catch needs to retain its platform status, but introduce a multiplicity of marketing-based "faces", across both differentiated markets and through differentiated channels. For example, "CatchFashion", "CatchHome", "CatchBaby", "CatchKitchen", and so forth. As well as channel specific offering, such as "CatchTikTok", "CatchYouTube" and "CatchInstagram".

One core aspect of many of these features is that they should be driven by data analysis (and potentially behavioural forecasting) via AI. This means that one person's "CatchHome" might have the same basic framework as another's, but feature different products, or a tweaked description.

In some ways, it's a scaleable version of the original Catch, but at a much deeper level.

Beyond Catch

The reason for delving so deeply into Catch is to make a core point. This article began with the suggestion that, though they disagreed somewhat, both Wesfarmers and the investment analysts at the Strategy Day actually had considerable shared territory.

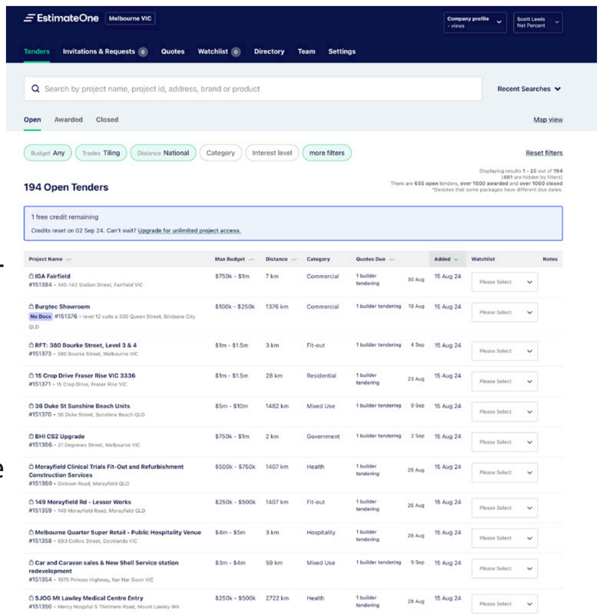
When it comes to OneDigital, there is no doubt at all that this investment by Wesfarmers is vital — and that will become clear in just another two or three years. But, at the same time, the concerns of the investment analysts as regards investment returns are also valid and relevant.

The shared territory really comes down to this. Wesfarmers has been trying to use OneDigital primarily as a means of boosting its legacy retail operations. The data processing and analysis provided by OneDigital, however, has such potential that it can only generate the needed returns if retail itself is reshaped to match its potentials.

In legacy retail, what Wesfarmers seeks is a viable market with categories it can dominate via the supplychain. The consumer data that emerges from that is helpful, but it is essentially incidental.

With the new retail, it is the dataset that makes

The EstimateOne.com website analyses tender documents, and provides a summary of jobs that involve a specific trade in a specific location radius.



the market, and that replaces — partially — both the category and the supplychain in importance.

So, for example, with OnePass, this doesn't seem like great value just yet, because it is building that datasource based on Wesfarmers conventional retail, then being judged on the basis of how it contributes to those businesses. But it's real value is developing a dataset that will enable Wesfarmers to develop new forms of retail.

Hardware and home improvement

How would you apply this kind of new retail thinking to the hardware market and Bunnings? We could start by considering the problems with the existing markets for Bunnings. For example, while the retailer has made some progress with its expansion into the trade sector, it has been relatively slow.

One reason is that it is competing with Metcash's Independent Hardware Group (IHG) and Total Tools for roughly the same market of smaller independent builders. Bunnings has also employed roughly similar strategies, for example focusing on the idea of "whole of house" — selling as much as possible into each stage of construction.

There is a real question as to whether this is the best market for Bunnings. It's a surprisingly difficult market to scale into, and more suited in many ways to the smaller, mixed independent approach of IHG.

Beyond that, is it even that good of a market? At the moment the builder market is depressed, and there is a high degree of unreliability, with something like 3000 builders becoming insolvent in FY2023/24. As is detailed in the article on Metcash in this issue, while there is a commitment to build an additional 1.2 million homes with over $30 billion in funding, how much of that work is likely to go to small builders? The most efficient way to deliver those homes is in larger multi-unit dwellings, which are beyond the capabilities of most small builders.

A better market might be subcontractors (aka "subbies"). For one thing, no matter who gets the contracts to build the 1.2 million homes, you can sure that it will be subbies building them at some stage. Numerically, it is also a larger market than small builders, and the needs of subbies tend to be broadly similar, unlike builders which tend to have highly individuated requirements.

It's also the case that the subbie marketplace hasn't really changed much in the past 20 years. In fact, the inefficiency of allocating work to subbies is one of the sources of Australia's theoretical lack of sufficient skilled construction labour.

Which brings us to companies such as EstimateOne. This is, basically, a platform for connecting commercial construction firms and subcontractors. It has been used by 50,000 organisations in Australia, New Zealand, the UK, and Ireland.

Essentially it enables subcontractors to select a region and trade/speciality, then receive notifications when there is a tender that is a match to their skills, along with extensive details about what is included.

Fully developed, this isn't just about subbies, but comes close to a predictive order flow for much of the construction industry. There are a lot of data possibilities that would come out of this. For example, it opens up the possibility of introducing this market to higher productivity practices, through the use of computer numerically controlled (CNC) machinery, 3D printing in plastic and metal, and the use of LiDAR systems for construction planning and verification.

However, this is not something that Bunnings itself would be equipped to use directly — though it would benefit from the data. In effect it would require setting up an additional entity that could facilitate this data usage, allied with Bunnings, but not a part of it.

And that, of course, is more or less what the analysts are seeking as well, a data breakout that represents this part of the corporation.

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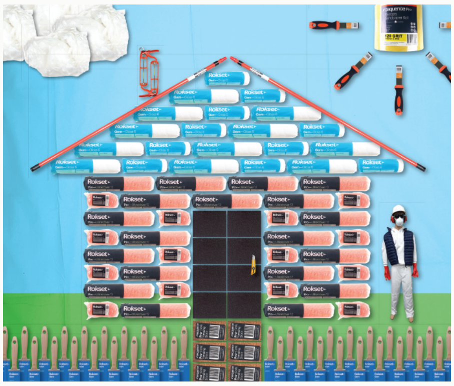

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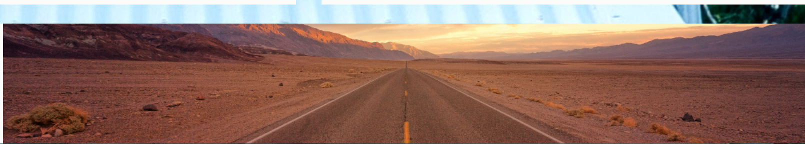

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Metcash Investor Day
Hardware Restart?

By Scott Lewis

At its most recent Investor Day, Australia wholesale/retail conglomerate Metcash unveiled the outline of a company which has changed fundamentally in terms of both operations and strategies — though this is a transformation that remains incomplete.

For example, FY2023/24 is the first year in which Metcash has found itself called to account for the structural changes it has made through adding significant retail operations to its core wholesale operations.

From its inception, Metcash sought to combine the advantages of an overarching corporate structure (such as the cost benefits of scale) with the benefits of smaller — mostly family-owned — independent businesses.

In particular, Metcash was somewhat insulated from the extremes of business cycles. Wholesale businesses have lower fixed costs. Family businesses have developed ways to get through tough times, without losing the valuable service IP brought by experienced floor staff.

Retail initially became part of the Metcash mix because most hardware store owners who joined Mitre 10 were required to offer Metcash something akin to a right of first refusal on the sale of their stores. This was intended to help prevent key Mitre 10 store sites from being taken over by major competitors, such as Bunnings.

As growth continued reliably in the hardware market from 2018 onwards, Metcash found that benefits from owning the total margin-stack — both wholesale and retail — were irresistible. Both full and joint ownership of Mitre 10 stores became part of its hardware strategy.

That strategy was further accelerated by the (initially partial) acquisition of Total Tools Holdings in September 2020. This entailed the development of a large number of joint venture stores.

The benefits of this strategy were considerable through the three core years of the Covid pandemic, as sales, especially at smaller local hardware stores in high margin areas such as DIY, increased sharply. As the effects of the pandemic lessened, house building also grew fast, boosting trade sales.

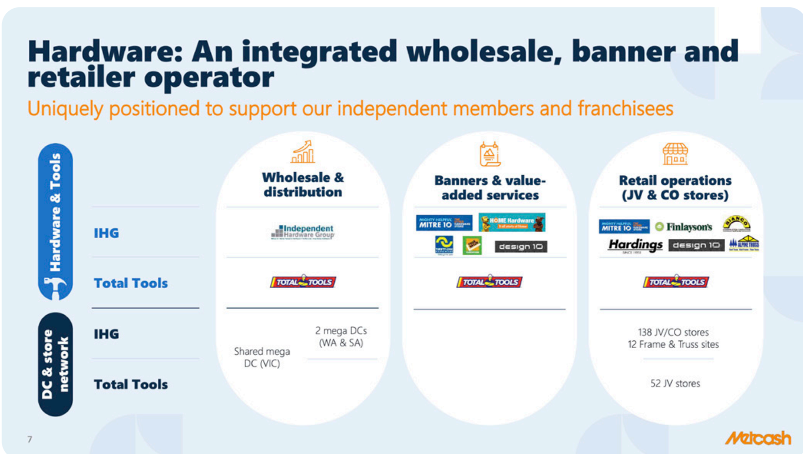
However, in the most recent financial year, the market has entered a period of decline, with rising cost of living due to inflation, high mortgage payments, and a slowdown in house building hitting hardware markets hard. The exposure to the full margin stack has reversed its benefits, and the hardware division of Metcash has seen earnings before interest and taxation (EBIT) go backwards by around 11.0% on a like-for-like basis.

Generally, the investment market reaction has been somewhat tolerant of this. This is likely due to three factors: the high level of benefit from the strategy over the prior four years; the good performance from both the food and liquor divisions of Metcash; and the likelihood of major reforms being made to the hardware division during FY2024/25. A new CEO was appointed to what is now the Total Tools Group (TTG) in March 2024. The current CEO of the Independent Hardware Group (IHG), Annette Welsh, has resigned and is moving to other tasks at Metcash.

Added to this, there is also something of an "X-factor" when it comes to the Metcash CEO, Doug Jones. He has proven so far to be a very good CEO. In particular he has demonstrated an ability to effectively both promote high-achieving staff from within Metcash, and to bring in high-performance executives from outside the company.

But it is really Mr Jones' ability to make strategic structural

Metcash Investor Day 2024 presentation; slides p10



changes to the company, developing a generalised skillset that can be applied to multiple situations, that has lifted expectations for Metcash's future.

The broader view

In this issue of HI News we've engaged with some of the more "macro" challenges facing the much larger Wesfarmers and its hardware retail division Bunnings. Outside the standard, market-driven business cycles Metcash is now coping with, there is a larger, technology-driven cycle that is also set to have its effect on the company.

You could say that Metcash and the retail operations of Wesfarmers are something of a mirror reflection of each other. Metcash is focused on the next three years, while Wesfarmers is looking six years out; Metcash is consolidating around tight financial management aligned with known processes and strategies, while Wesfarmers is opening up new territory (e.g., Kmart's Anko brand) and investing in R&D; and Metcash is chasing acquisitions with more immediate payoffs, while Wesfarmers is developing a fundamental presence in key expansion categories such as health.

Below, top: Deepa Sita, Metcash CFO.
Below, bottom: Doug Jones, Metcash CEO.

To better define what's going on we might look to Apple and the iPhone as an analog. With the iPhone version due to be released in 2024, the company has shifted from a focus on hardware — camera, displays, speakers, etc. — to software. The primary focus of the hardware is to run the AI software.

Retail is really heading in the same direction. It needs to assume certain forms that enable it to make use of software advances. That is, at the moment, mostly a process of discovery. Wesfarmers is embarked on that, and Metcash has yet to start.

Making this transition is going to be expensive both in terms of time and capital. To survive, and to remain a company with competitive growth, means achieving a certain size. Which means Metcash has to become bigger.

Whether it's specifically for this reason or not, Metcash is headed in that direction, as was clear from Mr Jones' emphatic rejection of the possibility of demerging the hardware division, in this statement at the end of his introduction on the Investor Day:

> *Having started with hardware and having spoken about hardware and Total Tools together, I know that you guys have probably all written down the D word, so I want to address that elephant in the room because I'm going to get the question. We have no current plans to demerge this part of the business. We see significant and material future value still to be extracted for our shareholders in the current construct and we believe we have the plans in place to execute that value extraction. These two divisions of hardware and food and liquor are just how we think about the business and their operating models.*

Investor Day 2024

Mr Jones outlined much of what he has helped to achieve in his introduction on the Investor Day:

> *We're in the fortunate position where our purpose is also our strategy. Championing and helping successful independents is the strategy. Independents is the market in which we operate, and I'm going to elaborate on that – as well as my colleagues.*
>
> *But beyond our strategy, it's also our operating model. What that means is that our operating model, our supply chain in particular, responds to the demands of our customers. We are not a "joined-up" retailer that pushes product out to individual stores. We are not a retailer whose store managers receive what they get on the day that the central supply chain planning team nominate. We respond to the demands and the orders of our customers.*
>
> …
>
> *The other points I'd like to make on the slide is that we are a transformed business. We are now an integrated wholesaler, banner operator, retailer, franchisor. We are larger, we are more diversified, we are better balanced, and we are more resilient than ever before.*
>
> *These are a series of high quality businesses. We have a high degree of optimism and that transformation underpins the optimism and it's been enabled not only by our strategies but by a series of unique well-defined and replicable strategies or playbooks, and you're going to hear a lot about that today. These strategies provide the framework from which we make our business stronger and more resilient and from which we grow.*
>
> …

Metcash Strategy Day 2024 presentation; slides p16

Replicating successful growth strategies across the Metcash Group

Positioned with the platform and capabilities to grow current and future businesses

		IHG	Total Tools	Food	Superior	Liquor
Leveraging platform for M&A growth and enhancing performance	Consolidate fragmented market	✓	N/A	N/A	✓	N/A
	Acquire complementary businesses	✓	☆	N/A	✓	N/A
	Enter adjacent markets	✓	☆	✓	✓	N/A
Extending through value chain for growth & resilience	Retail – company-owned	✓	✓	☆	N/A	N/A
	Retail – JVs	✓	✓	☆	☆	N/A
	New stores	☆	✓	☆	N/A	☆
Delivering unique, differentiated value ('Best store in Town')	CVP by format & market	✓	✓	✓	✓	☆
	Upgrade stores	✓	✓	✓	N/A	☆
	Improve standards & Retailer compliance	✓	✓	✓	N/A	☆
	Improved price & price perception	✓	✓	✓	✓	☆
Extending and strengthening core competitive advantages	Highly efficient distribution	✓	✓	✓	✓	✓
	Retailer tools & services	✓	✓	✓	☆	✓
	Shared & scaled supply chains	✓	☆	✓	☆	✓
	Digital B2B marketplace	☆	N/A	✓	☆	☆

16

✓ Continuing growth focus ☆ New, accelerated or potential growth focus

Metcash

Our portfolio diversity and balance between resilient, stable and defensive businesses and more cyclical and more discretionary businesses that are more exposed to the underlying cycles means that as an overall group and portfolio, we have better resilience and balance than ever before. And all of this is underpinned by disciplined and highly effective and proven capital management strategy.

Mr Jones went on to talk specifically about the hardware division of Metcash, which includes the Independent Hardware Group (IHG) and the Total Tools Group (TTG).

The way that I think about hardware is IHG and Total Tools together. There's a natural adjacency in terms of the market.... The hardware and tools part of our business are separate pillars, but it's a good way to think about the value creating opportunities to start to think about those adjacencies and how they might support one another. The way I think about it is tactical cooperation between the two businesses but not much integration.

...

The small and medium home builder is at the heart of the market for IHG and our leading position means that we are ideally placed in a country that needs to build somewhat more than a million homes over the next few years depending on which forecast you read. And certainly we're starting to see more and more government support for that house formation at every level. And they have a growing DIY aspect to their business. That's an element of diversification in the customer base that I'm going to come back to a few times today.

In Total Tools, one way to think about it is that their core customers are tradespeople or tradies. That's a pretty exciting group of individuals to be selling to. They're flexible. They're – after the last few years – in a great financial position, they like the latest tech and they're quite literally using these tools in their trade. As I've said, this is a large and fragmented market and while the current environment might be somewhat depressed, we see fantastic upside and opportunity in our current positioning.

So across IHG and Total Tools we're lots of things. We're a buying group with almost a thousand members. We're a wholesaler and distributor, a brand owner, a banner operator, a franchisor, and of course a retailer. We've moved up the value chain into frame and truss operations, which is a key strategy to underpin the whole of house strategy.

We have extensive and very successful exclusive and private brands in Total Tools and capabilities around the development and sourcing of those, but not the manufacturer. We don't intend to enter manufacturing. And of course down the value stream into

Metcash Strategy Day 2024 presentation; slides p6

retail and you'll hear a bit about that today. All of these have been highly value accretive and successful strategies, not just to underpin the growth but to move the strategy of our businesses forward.

The cycles

At the end of talking about hardware, Mr Jones did introduce a note that would later turn out to be something of a warning about the full-year results to come:

In retail, you have retail leverage. Your EBIT grows faster than your sales when volumes are rising. That's what happens in good retail and it varies in discretionary retail as you've seen with some of the announcements. It goes the other way too. That's entirely normal and it's to be expected. It's balanced nicely in IHG and Total Tools by the fact that we don't earn all of our value from retail sales.

This is the situation that HNN has mentioned for some time: as exposure to retail (as opposed to wholesale) grows, so does exposure to increased fixed costs. Retail performs better than wholesale on up-cycles, but also worse than wholesale on down-cycles.

There is a degree of truth to the notion that as the hardware division is mixed wholesale and retail, there is some "resilience" at work there. What is also the case, however, is that businesses with more experience in retail typically have strategies in place to at least ameliorate the down-cycle effects, and/or projects in place that will produce growth in either cycle.

It may be, in fact, that there are specific reasons little of this seems to have been in place during FY2023/24. It's notable that the CEOs of the other two divisions have been replaced, with Grant Ramage taking over food in March 2023, and Kylie Wallbridge taking over liquor in March 2024. TTH as well has a new CEO, Richard Murray, as of January 2024. And in that January Metcash's new chief financial officer (CFO), Deepa Sita, assumed her duties.

As we learned in May 2024, Ms Welsh will step down as CEO of IHG in August 2024, to be replaced by Geoff Harris as interim CEO. Mr Harris has been the general manager of merchandise for IHG. Ms Welsh will move on to assume a corporate governance and strategy role at Metcash.

Ms Welsh is, of course, a respected figure in hardware. It's difficult to imagine anyone doing a better job as former IHG CEO's IC2. Both at that time and later as CEO of IHG in her own right, she was critical to the absorption of what was then Home Timber & Hardware Group (aka Danks, and now "Home Hardware") into Metcash, making, with Mitre 10, IHG.

In HNN's view — as was expressed clearly at the time — Metcash might have been more forthcoming and direct in describing to former HTH members the fate which awaited them. It was perfectly evident that, from a corporate per-

Geoff Harris, interim CEO, IHG.

Annette Welsh, who served as IC2 to former IHG CEO Mark Laidlaw, became IHG CEO in late January 2020. She has moved to another role at Metcash in August 2024.

spective, HTH would have to almost disappear as a brand, along with the small-store oriented True Value and Thrifty Link brands. Equally evident was the ongoing progress of corporate ownership — in part and whole — of formerly independent hardware stores.

That said, Ms Welsh has been regarded by many IHG store owners as something of a champion for their position as independents, even as the number of both joint venture (JV) and fully-owned stores has grown proportionately in IHG.

Ms Welsh was also responsible for developing some of what have become the foundational building blocks of IHG. That includes the "whole of house" concept, where IHG "scores" itself on how many of the five stages of each house build it engages with, something now core to its marketing. This went along with a focus on smaller builders, and helping those builders achieve better organisation. Ms Welsh was also an early, pre-Covid driver of the development of an online presence for Mitre 10, which she has continued to grow.

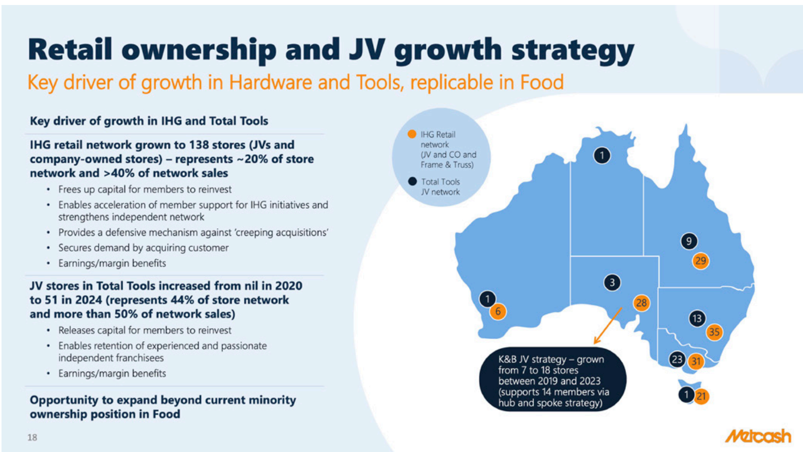
Yet there is a sense of Ms Welsh as being a somewhat successful general of past wars. She fought those wars valiantly, and if IHG did not quite "win", it didn't lose either. Instead, it achieved success in enough skirmishes to retain marketshare.

The difficulty is that most generals tend to treat new conflicts as though they were a simple repetition of past battles. That's somewhat clear from one of the statements Ms Welsh made at the Investor Day:

> *So let's talk about store network growth. Gosh, it's really a good position that we find ourselves in. As I said, five years ago we were really in a position where we were defending our network and we probably saw more stores and more independents close their stores, particularly in very small regional towns where there was no succession plan.*
>
> *We have shifted ourselves from being defensive network business to ... offensive. So we are on the offensive as opposed to being defensive and this has been backed by the fact that we've now invested in a real full and thorough assessment of the market to show us where those network gaps are.*

It is worth noting that it was not just stores closing that was the problem, it was also stores opting out of the IHG network altogether — but the core point is correct. However, it could be argued that today IHG is in neither an offensive nor a defensive position, when it comes to strategy. With the growing number of corporate and JV stores, the focus needs now to shift simply to, well, growth. But it's not network growth, it is directly revenue and earnings before income and taxation (EBIT) growth.

Metcash Strategy Day 2024 presentation; slides p18



That was, indirectly, clearly pointed out in this question from the Investor Day poised by David Errington of Bank of America:

I wonder if you mind getting slide 18 up if possible. Just I think following on from Lisa's question on the DIY growth, I'm just trying to, my observations are is that Mitre 10 is could go a bit harder on the DIY and I'm a bit interested as to why you think you'll still stay at 35/65…. I just think that you could go a bit harder in DIY. Why is it … you just don't seem to be going hard at DIY, whereas you seem to be focused more on the trade side.

Ms Welsh responded:

Thank you for the feedback. We'll take that on board.

Look, I think it's a couple of things. The DIY, we are up against a giant of a DIY competitor with very substantial market share and changing a consumer's behaviour to shift … to the acronym "I'm going to the hardware store", versus "I'm going to Bunnings" on the weekend is a significant challenge …

I think we've come a long way. We have continued to grow those unique brands that are in our business that are not in our competitors. We have a range, to your point that is appropriate and is not, "Let's go and see whether or not there's 20 lawnmowers to choose from". There are five lawnmowers to choose from and there are good, better, best.

We've delivered competitive pricing. We've delivered an online solution. I think the one piece that we saw real movement on top of Covid, David, was actually our marketing activity when we relaunched the brand. And so we are finding now a lot of time and money, not a lot of money, but a lot of our time is being spent in our digital personalisation and [targeting] of the customer themselves. So we can invest dollars in marketing, but we are tiny in comparison to our competitor.

With the greatest respect, that's not a strong response, in HNN's opinion. It's also somewhat self-contradictory. Overriding everything is just that Bunnings is too big to compete with. If that is the case, why would you attempt to compete through the widely general marketing of "The Other Hardware Store" campaign?

IHG has "unique brands", it's offering five lawnmowers instead of 20. This is offered as a solution when Bunnings is all about brands, including captive brands such as Ozito. How exactly does offering fewer lawnmowers translate to a market advantage?

Above all, there is very clear evidence that none of this has really worked to expand DIY marketshare — even following a period of growth during Covid.

There are strategies which hardware retailers can undertake, and

Metcash Strategy Day 2024 presentation; hardware slides p18

these come out of the standard playbook for retail in general. That's what Mr Errington is perhaps reaching for when, in response to Ms Welsh's initial answer, prompts her:

> *Can you elaborate what targeting a further 20% growth in share, what does that mean? What does that actually mean ... and what can you be famous for other than just as an alternative if you don't want to go to Bunnings, the big guy?*

What can you be famous for, how can you differentiate the offer? And the response to that, generally, not just from Mitre 10 at IHG, but across most independent hardware retailers, is "service". Yet pretty evidently, this is not working as an advantage, because Bunnings has continued to grow marketshare in DIY, despite offering lower levels of service.

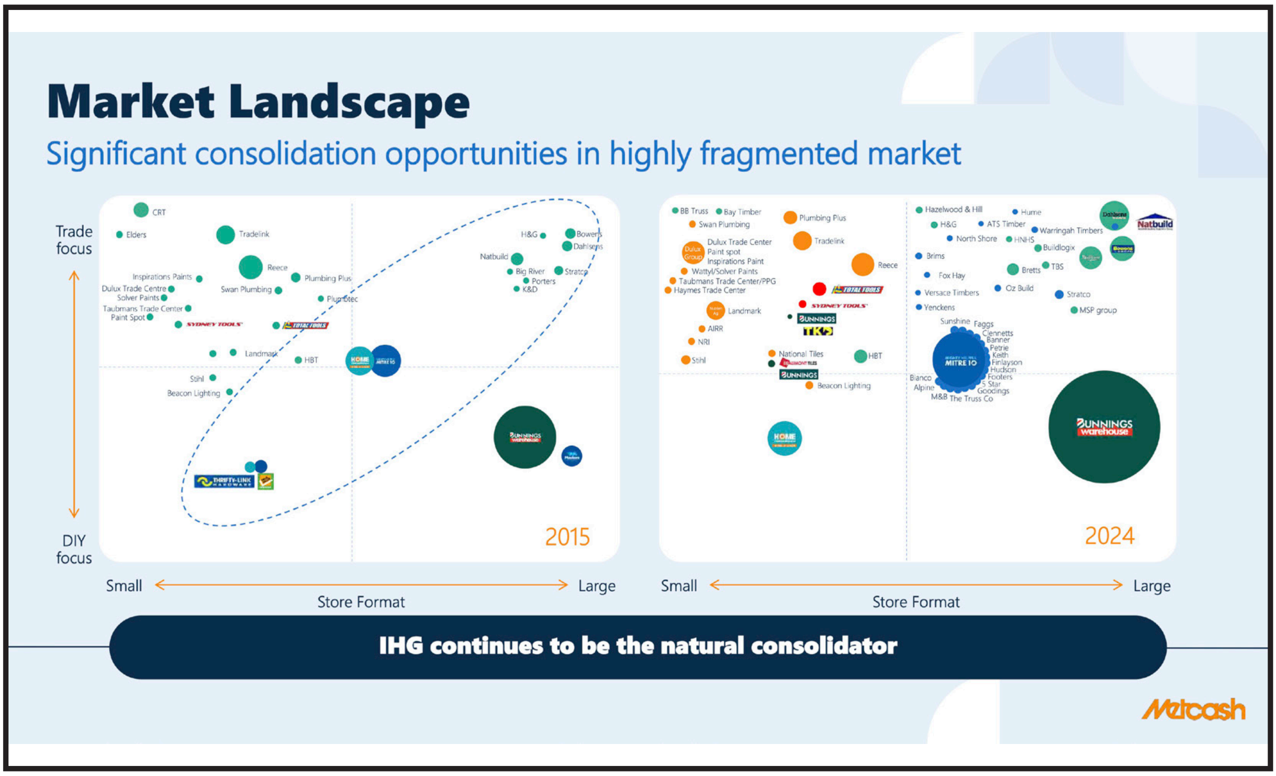
If you put that directly to many of the actual owners of independent hardware stores, the answer you will frequently get back is something along the lines that the customer, in this case, is wrong. So all those wrong customers, not knowing better, and not having apparently learned much over the past two decades, still go trooping off to Bunnings to spend most of their DIY money.

Looking deeper into this, one can see how Metcash hardware has worked its way into a particular box as regards DIY. In order to compete with Bunnings, it's necessary to adopt at-scale procurement, which means narrowing ranges as much as possible.

Those narrow ranges then mitigate against true differentiation. To develop differentiation you would need to accept higher supplier prices, train in a speciality, and market that product/service.

In the end differentiation fails at the corporate strategy level because narrow range and scale may only allow you to

Not HNN's favourite chart, but it seems important to Metcash.



eke out a small advantage, but they are reliable, where differentiation offers an unknown risk. It's also largely execution-dependent, which means it would be beyond IHG's control.

This is probably the most corrosive effect on the industry of what some regard as Bunnings' quasi-monopoly. It has resulted in a real flattening of innovation, so that hardware stores across Australia have a surprising similarity. In a sense, the whole Mitre 10 Sapphire store refurb program is an acknowledgment of this, essentially the adoption of what is basically a supermarket program.

Total Tools Group

If what we're seeing at IHG is a "reboot" of strategies that have been successful during the up-market of the Covid years, changed to better suit the more mixed future to come, then it is possible TTG is launched on a similar process, but one step ahead.

Certainly the new TTG CEO, Mr Murray, gave a lively presentation at the Investor Day. He showed an unusual facility — at least for Metcash executives — to relate to the assembled investment analysts. However, he was also somewhat light on details for future strategy, and betrayed a certain naivety with when it comes to the products TTG sells.

Cordless tools are nothing new to the industry — though it was interesting that Mr Murray highlighted that many tradies had readily adopted more than one battery platform. And if TTG is only now discovering the market for cordless outdoor power equipment (OPE), then it is seriously lagging the market.

This was perhaps Mr Murray's most interesting strategic comment:

> *How do we bring this all together? Well, as Annette [Welsh] talked about the whole [of house as] her strategy, we think of it as the whole of trade strategy. So it's where [tradies] work, how they work, where they live, and how they play.*
>
> *And I think I sort of touched on it probably as much in the cordless section, it's how you've got the platform, you've got these batteries. People just buy more tools on the platform, and I think we've only just scratched the surface with Insiders [loyalty program] and our digital assets, and how we bring that together online. The opportunity is we get [to] use all this data and ... the opportunity is to harness that data better and deliver better content and better personalised content to our suppliers.*

One interesting innovation that Mr Murray touched on was the introduction of electronic shelf labels (ESLs). These LCD displays of prices can be controlled by a central system, making it easy to re-adjust prices on a daily basis.

Richard Murray, CEO Total Tools

I cannot think of an IT project where I've walked around a store and every store person you walk into goes, thank you so much for these ESLs. So the challenge that the business had is if price changed a store could realistically process 400 price changes a day and that might mean one person fulltime. So most of our stores feel as though they have at least had one person over the year changing price tickets, bigger stores felt there were more.

So when you think about what this has enabled, with the rollout of ESLs, with literally the click of one button, you could change every price in every store nationally. We're a branded product retailer, prices do move. It's the reality. The other thing is also how do we test and learn? We can literally move price and play with it in a state, see what happens and then roll it out nationally.

Mr Murray also did give a hint of developments involving a greater integration with IHG in the future. In response to an analyst's question about buying opportunities in conjunction with IHG Mr Murray responded:

I think the opportunity ... for Annette [Welsh] and I, more conceptually – and this is a very high level comment – is you've got some big players like Bunnings, you've got some players like Sydney Tools, [and] we absolutely need to deliver a differentiated, go-to market strategy ... And I think the combination of IHG and Total Tools can deliver that.

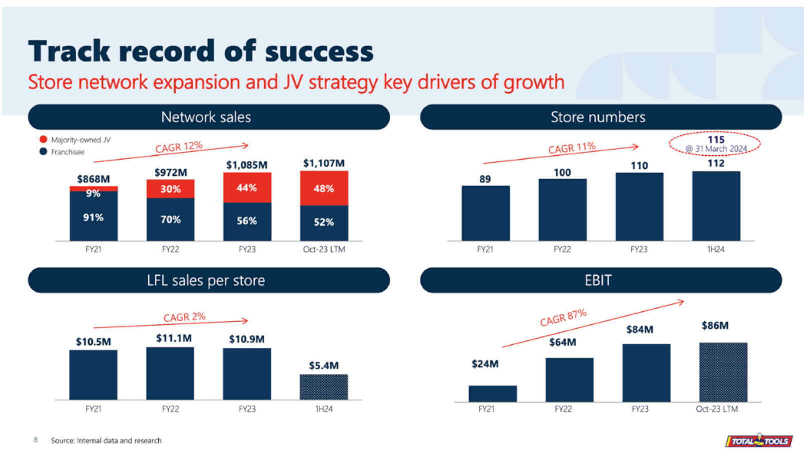
You don't necessarily get it in margin day one, but you get it in lots of different ways over time because [suppliers] want to support your business because, let's be frank, [for] many of the suppliers in the Australian market, you've got one player that is very big. And what I learned in my old time is making sure that you can balance off some of that risk with the next player is really important. So that's obviously Annette and my job to go and make sure we go and get that.

Which brings us around to a familiar part of Ms Welsh's presentation, where she spoke about the relatively small number of Mitre 10 stores that are joining forces with TTG stores.

We've collaborated with ... the Total Tools team from day one and I think last time we spoke we had shared with you that we'd created an opportunity to actually have co-location stores. We've now developed that opportunity because of its success ... and we'll see one tomorrow at Richmond. To actually take the asset of a Mitre 10, but add to it a Total Tools is therefore giving us the opportunity to increase the returns per square meter and reduce the fixed costs across those two businesses.

That's working really well, but little did we imagine it would develop into something that's more than

Metcash Strategy Day 2024 presentation; Total Tools slides 8



that. What we now have is a couple of options that have been created. One is Mitre 10 members actually becoming Total Tools franchisees. So in the same town Dubbo would be one, Orange another, we've got Mitre 10 independent member owning Dubbo, Mitre 10, but also owning Total Tools Dubbo. The third and final one, which even we didn't anticipate at the time and stay with me while I try and explain this. We have now two examples where we have a Mitre 10 independent member [and a] Total Tools franchisee coming together and creating their own joint venture to open a Total Tools store.

This seems to be, at least in part, an answer to the problem that HNN has repeatedly brought up regarding competition between Mitre 10 and TTG. If you fully own as an independent an established Mitre 10 store up in the exurbs of the Sunshine Coast, and someone plonks down a TTG store about a kilometre away, your turnover is going to fall. Not, probably, due to the sale of power tools, but more from the sale of power tool accessories, such as drill and driver bits.

Metcash FY2023/24 results

Total statutory sales revenue for Metcash (which excludes charge-through sales) was $15.91 billion, an increase of 0.7% over the previous corresponding period (pcp), which was from 1 May 2022 through to 30 April 2023. Total EBIT was $496.2 million, a decline of 0.9% on the pcp.

For the food division, EBIT came in at $210.1 million, an increase of 3.0% on the pcp. For the liquor division, EBIT was $109.2 million, up by 4.9% on the pcp.

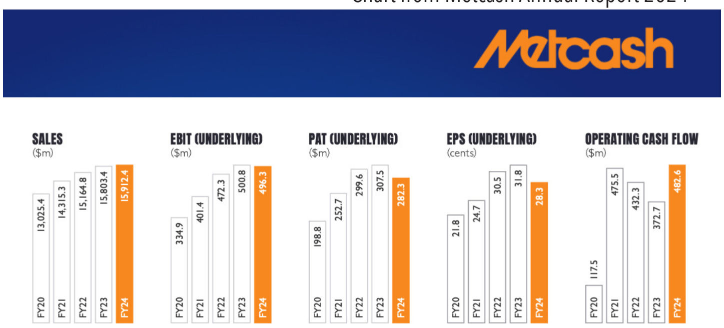
Perhaps the best testimony to how good this performance really was came from Mr Errington in this exchange during the presentation of the results:

Mr Errington: *One thing I'm really surprised with is, you've been able to get volume growth into food and liquor in particular. I mean hardware is cyclical, but food and liquor really got volume growth. Yet at the same time that you've been driving hard to get working capital improvements and cost outs … What are some of the things you're actually doing that's getting such a great result without impacting volume growth in your key two pillars, food and liquor? … [O]ne thing that really took me surprise today is just how strong the cash realisation [is]. You're able to get the cost outs … yet you're still able to get volume growth in very difficult markets. So can you bring to life, please, so that then we get an idea, is this sustainable or is it just one-off cost savings and one-off cash realisation benefits? Because that … is what surprised me the most today.*

Mr Jones: *Hey David, thanks. Before I invite Deepa [Sita] to add some detail, Kylie [Wallbridge] and Grant [Ramage] are sitting across the table from me nodding and saying, "I think he means 'well done' ". So thanks for that.*

Mr Errington: *Yes, I do. Absolutely I do.*

Chart from Metcash Annual Report 2024



Independent Hardware Group

Total sales came in at $2798 million for the reporting period, down by 1.0 on the pcp, but down 3.0% when confined to organic growth. In retail scan sales, DIY sales were up 2.7% overall, but down 0.5% in organic terms. Trade sales fell by 1.0%, but slid by 3.8% in organic terms. EBIT came in at $129 million, down by 4.9%, and down 10.7% when limited to organic growth.

Total Tools Group

Total sales for TTG were $679 million, an increase of 16.4%; on a like-for-like basis, however, growth was negative by 1.3%. Total network sales were $1112 million, up 2,6%, but down 2.3% on a like-for-like basis. EBIT was $82 million, down 1.9%, but down 11.5% in like-for-like terms.

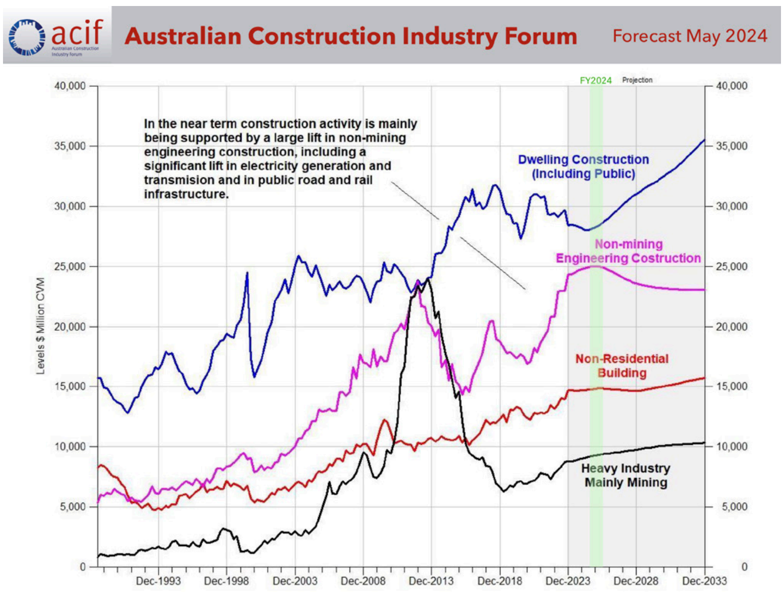
IHG and cyclical variation

We note that there are repeated references throughout the presentation insisting that IHG has somehow outperformed the general market. Given that, according to Australian Bureau of Statistics (ABS) stats, growth in hardware retail sales for the reporting period as contrasted with the pcp was largely flat (down -0.04% when applying a rough weighting based on the number of Mitre 10 stores in each state), it's difficult to see what this optimism is based on. Though there are, of course, a lot of factors at work, including rises and declines in the supply cost of various building supplies, which had yet to fully stabilise post-Covid.

The news of a steep decline in like-for-like EBIT has been delivered via three carefully managed events, which are, in order: the Investor Day, moved from the October date of the previous event in 2022 to March 2024; the resignation of Ms Welsh as CEO of IHG, announced in May 2024; and the full-year results announcement in June 2024. And all that is set against the background of Metcash's claims regarding the increase in size of the hardware division since FY2019/20, highlighted in a box every slide of the stack for the full-year presentation. Hardware sales are up 68%, IHG sales are up 35%, and TTG retail network sales are up circa 100% from 2019.

This has been a skilful presentation, in the best possible light, of a very good narrative about corporate transformation that Mr Jones and Metcash has to tell. It's just that this transformation seems, as far an HNN can tell, not to have really fully extended into its hardware division.

Australian Construction Industry Forum (ACIF) forecast from May 2024. Full ACIF forecasts may be purchased from the ACIF website: https://www.acif.com.au/forecasts/purchase-forecasts



Yet from an investment analyst perspective, given the past success of hardware under Ms Welsh, and her immanent departure from the CEO role, perhaps it would seem almost churlish to take Metcash to task for a problem it has, in a sense, already taken care of.

It is interesting to consider how a similar decline in the Wesfarmers-owned Bunnings might be regarded.

From a pure industry perspective, of course, it looks a little different. The hardware market contraction at IHG indicated by the fall in like-for-like sales is especially meaningful when inflation is running at around 4.0%. The question is, where did that revenue go to? And the answer is likely to turn out to be: mostly to Bunnings. Which means we could be watching the industry trend which saw independent retailers benefit at least as much as Bunnings from Covid-era spending coming to an end — and even possibly reversing.

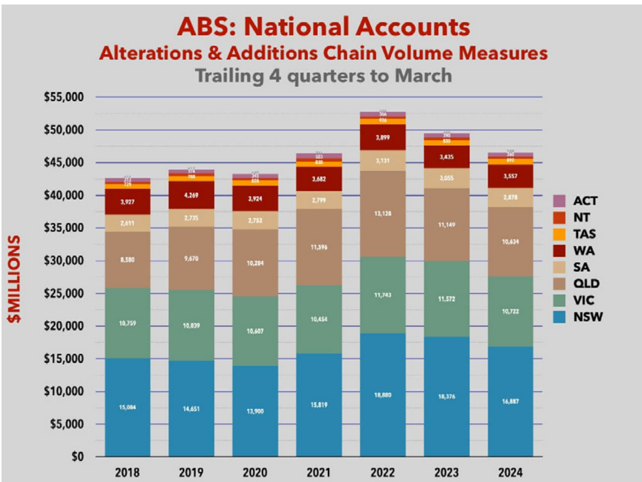
For the industry, what needs to be considered is how much of future growth at Metcash will be taken from Bunnings, and how much the target might well be fellow independent stores in other networks.

The housing accord

It's also useful to just delve a little deeper into this deference to industry cycles. For example, one of the elements Metcash relied on in forecasting a better future — as have others in the hardware industry — is the 1.2 millions homes that the federal and state governments have committed to building between July 2024 and Jun 2029 (along with an additional 10,000 "accessible" homes for lower-income prospective homeowners). Those are goals with funding, specifically $32 billion in new housing initiatives delivered through the federal government's Homes for Australia plan.

As Ms Welsh stated at the Investor Day:

> *Let's talk a little bit about the market. There probably isn't a day when the building sector and the numbers are not on the front page of one of the papers and what's happening in the industry. We are really proud of our growth. As you can see, the compound average growth rate of 18.7% versus the housing start growth of minus 1.2 and renovations of plus 2.4.*
>
> *The future, the next three years, the HIA forecasts indicate that there are below average starts, but the government continue to talk about that opportunity of 1.2 million homes to be built over the next five years and that gives us really good confidence in medium to long-term growth. When we come out of it we are absolutely well placed to take advantage of anything the government delivers as we were during the Covid years.*
>
> *Whether it's our heritage, whether it's our high service proposition or our whole of house approach and our scale, it gives us real confidence that we are retaining every builder and that is our*



focus. Whilst we are also increasing the number of builders we have a relationship with, we are converting them from our competitors.

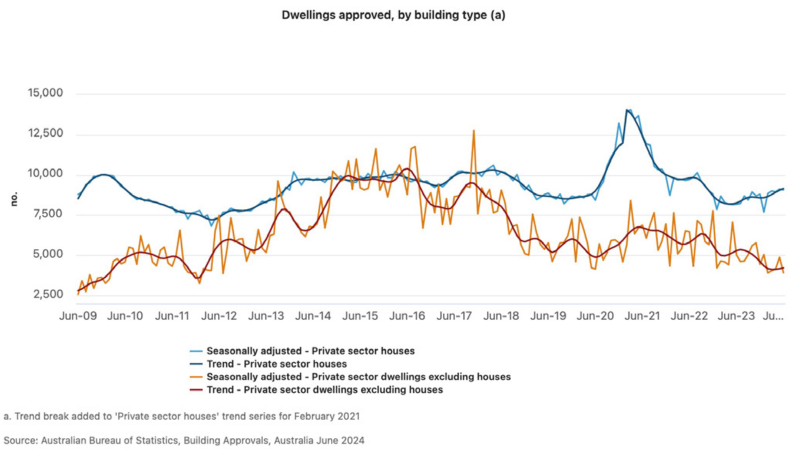
The National Housing Accord was agreed by National Cabinet in August 2023. From the federal level there are 11 key points:

- Provide a one-off $2 billion payment to states and territories through the Social Housing Accelerator payment to deliver a permanent increase in the stock of social housing. This was provided in June 2023, and requires state reporting every six months, starting in February 2024, with dwellings completed by June 2028.
- The New Homes Bonus will provide $3 billion for performance-funding states and territories that exceed their targets in building the additional 1.2 million homes.
- The Housing Support Program will spend $500 million on a competitive basis to local and state governments to aid in connecting essential services, adding amenities, or building planning.
- Funding of $350 million from 2024 to 2029 to support the construction of 10,000 affordable homes.
- Facilitation of funding of social and affordable housing, utilising superannuation and institutional funding, through the Housing Australia Future Fund.
- Concessional loans and grants through Housing Australia. Housing Australia had its liability cap increased by $2 billion as of July 2023. The goal is the support of the construction of 7000 new social and affordable dwellings.
- Grants for Community Housing Providers to further develop their financial and management capabilities.
- Identify surplus Commonwealth land to support social and affordable housing goals.
- Support construction of build-to-rent development by reducing the managed investment trust withholding tax rate for new construction from 30% to 15%, as well as increasing the capital tax deduction rate to 4.0% from 2.5%. These changes are project to increase construction of new rental dwellings by 150,000 over 10 years.
- Boosts to first home buyers by further extending the Home Guarantee Scheme to reduce mortgage requirements.
- A shared equity scheme, where the federal government will contribute up to 40% equity for new homes and 30% for existing homes. The scheme runs for four years with 10,000 places a year.

There has been an assumption about the 1.2 million "homes", and the other social and affordable construction boosts outlined above made explicitly by many and somewhat implicitly by Metcash, which is that these government programs will boost construction of detached houses and smaller multi-unit dwellings.

That really does not seem likely, or at least not to the extent supposed and implied. If you really are

Australian Bureau of Statistics (ABS) dwellings approved by building type.



going to build 1.2 million homes, alongside accessible dwellings, it is going to be a lot easier with large multi-unit dwellings, such as eight-plus storey apartment blocks, with 50+ dwellings each.

More to the point, however, is that since the start of Covid, Australia overall has developed deficit in multi-unit dwellings. If we put aside FY2019/20 as a "mixed" year, we can contrast the number of "pre-Covid" building approvals for multi-unit dwellings in the private sector for FY2015/16 to FY2018/19 with the post-Covid ones from FY2020/21 to FY2023/24. Respectively, that is 403,679 and 271,147.

That's a deficit of 132,532, representing a decline of 33%. Simply to get back to even, it would be necessary over the next four years (to FY2028) to build 536,000 multi-unit dwellings, or 134,000 each financial year. (For FY2023/24, approvals for 56,150 dwellings in multi-unit buildings were issued.)

This is an important influence for the narrow marketing at Metcash towards smaller builders. These larger scale projects will require greater skills both in construction and project management than those builders possess. They are also going to require more complex capital structures. If multi-unit building displaces detached houses, it's quite possible that this market will continue to be depressed over the next five years or so.

Analysis

It's notable that the last time we heard so much about transformation at Metcash, it was from former CEO Ian Morrice, and it involved a one-year plan (which took over three years) and included reductions in the dividend payout.

This time, with Mr Jones, it involves a plan mostly executed, with evidently good results in a down market (with the exception of the hardware division).

Yet, because of the times we live in, it really is necessary to ask if all this will really be enough, looking at the next five years or so. That's a tough question to ask, of course, and it's necessary to give it some context.

As was mentioned at the start of this article, there is something of a strategic gap between Metcash and companies such as Wesfarmers. That gap relates to understanding that future high growth is most likely found in software- and information-related opportunities. So let's look at a current activity of Metcash, and what those new opportunities might look like.

It has been widely reported that there were something like 3000 small- and medium-sized builder insolvencies during FY2023/24.

Metcash Strategy Day 2024 presentation; Total Tools slides 17

The cause of this, paradoxically, has been the sharp increase in the size of the house building market over the Covid period.

While these failures have been blamed on extraneous factors such as increased supply prices, a shortage of skilled labour and supplychain interruptions, the real reason for failure isn't external.

It's really all about the cashflow. Cashflow seems deceptively simple. It's just the money coming in minus the money going out at any particular point of time. But, as the word suggests, it's really about flow of that relationship, and being able to predict that flow over time.

Any sensible approach to managing a construction company starts with cashflow. Builders need to understand that they are effectively lending money to their clients at certain stages of a project. To survive, the builder must have capital reserves equal to what we could term the point of maximum client debt.

It's not too hard to work out that number for one building project. Most builders cannot cope with working out that point across even just three or four projects, as it involves layering all the data from each together.

As a result builders instead opt for an ad hoc approach to "managing" cashflow: they just keep bidding on new projects, so as to obtain the initial deposit to meet immediate cashflow needs. It's like a self-inflicted pyramid scheme. The cashflow problem eventually overwhelms the builder, and the business goes insolvent.

The opportunity that's embedded in this problem is very large. Looking at it from Metcash's frame of reference, it's all about the de-fragmentation they have a proven ability to manage. Only its not a de-fragmentation of the supply-side of a relationship, it's all about the de-fragmentation of the demand-side instead.

To be fair, IHG under Ms Welsh has been progressing in this direction since 2018 at least. As she said on the Investor Day:

> *Let's just talk specifically about the build trade strategy. Gosh, builders and traders, well guys, they live very busy lives and our job is to ensure that ... we actually make their job as simple and easy as possible. Organising the disorganised builder. That is what we're here to do. Our partnership with that builder is focused on delivering connections that are more than just supplying them with product and price. This is what you see here in the whole of house build trade strategy.*

You could say that what's being discussed with this opportunity is moving somewhat from a "whole of house" strategy, to a "whole of builder" strategy.

One other point on this, is that it also plays into a blind spot in the Wesfarmers retail strategy. The core strategy at

Wesfarmers is using size allied with extreme scale to generate profits. One key to that scale is keeping operations as simple as possible; when you add complexity to commodified processes, you automatically de-scale them.

But this kind of strategy actually relies on scaling through complexity. That makes it difficult to manage, but it benefits from actually being relatively limited in size — it is certainly below 40,000 users.

So when we say about these notable advances at Metcash "Is it enough?", what we mean is, can the company think in these terms now, at this size, about this kind of pathway to higher growth?

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