



Helping Australia Grow

Submission by Coles Group Limited to the Commonwealth's White Paper on Australia's Agricultural Competitiveness – April 2014

Introduction

Coles has strong and enduring partnerships with hundreds of farming businesses across Australia, supplying each day the essential fresh foods our customers buy.

As a leading food, liquor and convenience retailer in every Australian state and territory, Coles welcomes the opportunity to contribute to the Commonwealth's *White Paper on Australia's Agricultural Competitiveness*.

Our submission outlines key supply chains of agricultural commodities through which Coles secures fresh fruit and vegetables, dairy and meat. It explains why Coles has worked hard in recent years to improve the integrity and efficiency of these supply chains to ensure our customers throughout Australia get the best locally grown or made food at affordable prices.

The submission will set out the importance the Coles Group attaches to a vibrant, innovative and competitive agriculture sector in Australia.

A strong, secure future for the farm sector is vital to Coles' business, critical to maintaining a diverse economic base in this country, and key to ensuring Australian families continue to have assured supplies of food of the highest standards.

Already, our farmers produce twice as much food as the nation consumes, with capacity to increase exports significantly beyond that. The number of middle-class consumers in Asia is estimated to grow by over 1.2 billion by 2020 (and 1.8 billion by 2025). Demand for quality dairy, meat, cereals, fruit and vegetables is increasing exponentially.¹

Australia has a strong reputation for great quality food, with high standards of food safety. Yet Australia's food industry is currently responsible for just over 3% of food supplies into China².

Part of this can be explained by high tariffs and other barriers to commodity imports in Asian markets. Some are being reduced or removed in free trade negotiations the Commonwealth is undertaking with regional trading partners. But what other factors are holding back Australia's performance as a food exporter – compared, say, to New Zealand?

This *White Paper* provides an invaluable opportunity to assess why Australia is not as competitive as it should be in getting food to market, domestically or for export. It is a chance to examine how the sector could contribute more to trade and economic growth, and to look for the factors that might help generate greater productivity and innovation.

Poor productivity growth in recent years is inhibiting Australia's global competitiveness. US Bureau of Labour Statistics show Australia in 2002 was ranked 17th among 34 countries in international comparisons of the costs of labour – a decade later, it is the sixth highest on this same league table.

¹ OECD, January, 2010.

² Australian Food and Grocery Council, 24 March, 2014

Against New Zealand, the cost differential per hour worked has blown out from \$US7.65 to \$US22.91 in 2012.³

In the manufacturing sector, which includes food processing, output actually fell in 2010-11 – yet hours worked in the sector increased. Multifactor productivity in Australia has been negative in seven of the last nine years.⁴ That means Australian industry is paying more for less output.

In food, as elsewhere, Australia pays a price in opportunities lost by not being able to sell as competitively into global markets, or by not competing as effectively with imported product.

It is vital Australians address resolutely the risk to economic prospects inherent in high cost structures. The World Economic Forum's *Global Competitiveness Report 2013-14*, showed our industry slipping another notch to 21st. In contrast, NZ climbed five places to 18th. That report says of Australia: "The business community cites labour regulations and bureaucratic red tape as being, respectively, the first and second most problematic factor for doing business in their country."⁵

Some multinational businesses with long histories in this country (General Motors, Toyota, Alcoa, BP, Caltex) have been shutting down manufacturing operations here in part because the comparative costs of doing business are too high.

Coles welcomes the Commonwealth Government's decision to commission a study by the Productivity Commission into the *Relative Costs of Doing Business in Australia*.

On 7 April, the Government announced this would incorporate a case study of the challenges facing businesses in the Australian dairy manufacturing industry, including costs of capital, labour, intermediate inputs and regulatory compliance.⁶ The Commission is also to identify areas of cost advantage and disadvantage for Australian dairy businesses relative to international competitors.

While it is critical that Australians focus on reducing the costs of doing business, Coles is helping Australian suppliers grow: as a proudly Australian-owned business with a 100-year history, it is investing in the business and supporting local suppliers in the farm sector.

This is possible only because Coles has reinvigorated its business model to make our stores and logistics network more productive and competitive. It is a strategy predicated on driving efficiencies through the business, and returning value to customers through lower prices.

Coles has sought and achieved operational efficiencies: accelerating stock flow to reduce inventory; introducing self-scan checkouts; streamlining distribution operations by consolidating fresh produce and chilled distribution centres; streamlining store replenishment through new layouts; and reducing wastage and loss as proportion of sales by more than 40% over four years.⁷

From the consumer perspective, the most visible benefit has been to address the 35-year cycle in Australia of annual food inflation.

Since 2010, Coles has lowered prices on thousands of grocery items as part of our *Down Down* campaign.⁸ Deloitte Access Economics has assessed savings on 1200 of these items at a volume-weighted average of 8%.⁹

³ US Bureau of Labour Statistics, International Comparisons, 2012

⁴ ABS Australian System of National Accounts

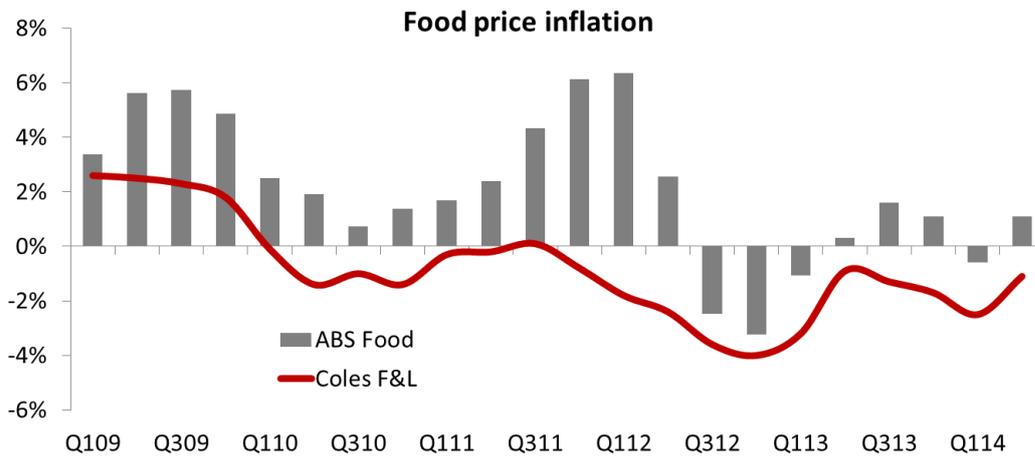
⁵ The Global Competitiveness Index 2013–2014

⁶ Productivity Commission website, 8 April

⁷ Coles Data

⁸ *All About Coles*, 2011

⁹ Deloitte Access Economics, *Analysis of the Grocery Industry*, October, 2012



From June, 2009, to June, 2013, the Consumer Price Index in Australia increased 10.7%. Over that same period, customers at Coles actually paid 4% less for food and liquor¹⁰.

The value provided by Coles has helped contain increases in cost-of-living for millions of households. For Coles’ customers, it has meant more than \$1 billion a year in savings¹¹. For the 28% of Salvation Army clients that struggle to buy a substantial meal once a day, affordable food is critical.¹²

Ultimately, sustained success delivers the capacity for the sector to generate more jobs and investment. As a result of the strategic turnaround since Wesfarmers bought the business in late November, 2007, Coles can now invest \$1.1 billion over the next three years on 70 new stores across Australia. This will generate more than 16,000 construction and retail jobs.¹³

Those same policies driving competitiveness help strengthen and invigorate our local supply chain.

This is especially significant for fresh produce, and the partnership with our farm suppliers.

Since FY08, Coles has sold \$1billion more a year in Australia fresh fruit and vegetables.¹⁴

Around 96% of Coles fresh fruit and vegetables are Australian grown; 100% of our fresh meat is sourced from Australian farms; as is 100% of Coles Brand fresh milk.¹⁵

This is what customers want – they prefer to buy locally-sourced produce provided it is competitive in terms of quality and affordability.

A recent survey of 1500 Australians conducted by Coles Customer Insights showed that 91% of Australians shoppers agree it is important to support Australian farmers.¹⁶

Coles believes the standards it sets for quality and value help to foster innovation and continuous improvement across the supply chain.

¹⁰ Australia Bureau of Statistics ,Food inflation; Coles quarterly sales announcements, Coles F&L inflation

¹¹ Savings based on the annual food retailing turnover per household in FY13 and cumulative Coles F&L inflation index from FY09 to FY13

¹² National Economic and Social Impact Survey, Salvation Army, May 2013

¹³ Coles media release, 5 March, 2014

¹⁴ Coles Group

¹⁵ Coles Group.

¹⁶ Coles Customer Insights Survey, February 2014

Long-term supply contracts negotiated by Coles with the dairy industry, for example, are allowing companies such as Devondale-Murray Goulburn to expand capital investment and introduce latest technologies, scaling up operations to build trade with Asia.

It is one of the important lessons from the Coles turnaround – and it raises the questions our farm sector, food processors and decision-makers more broadly will need to consider as they look to the opportunities in Asia.

Global commodity prices will forever fluctuate; the only guarantee of strong farm gate returns will be if Australia's farms can compete with the best in the world on availability, price and quality.

For Australia's farm sector to remain competitive on supermarket shelves at home and in overseas markets, there must be a constant striving for best practice through innovation.

Coles is working closely with its Australian suppliers to make sure our customers get the best available fresh produce at the best available price.

Becoming more competitive in Australia will make Australia more competitive everywhere.

The Coles story – 100 years in the city and the bush

At the dawn of the 20th century, the father of GJ Coles bought the Railway Corn Exchange, a small general store, in the rural township of St James, in northern Victoria. Barely a decade later, GJ Coles and his brothers had taken over and revolutionised the family retail business.

Having visited the United States to study latest retail trends, GJ Coles brought to Melbourne a new shopping experience. He and his brothers opened their first Coles flagship store in Smith St, Collingwood, on 9 April, 1914, promising, “Nothing over a Shilling.”

Coles started out with a staff of only six people, but with a firm understanding of looking after its customers and providing what customers wanted at affordable prices.

In the 100 years since, Coles has grown to a thriving national business: 2200 stores, including supermarkets, convenience stores and liquor outlets, and 100,000 team members. About a third are in regional Australia. Coles has done so by applying the same business principles of delivering value to the customer.

In his time, GJ Coles recognised the importance of supporting Australian jobs during challenging economic conditions, launching a buy Australian campaign during the Great Depression with the emotionally charged mantra, “Who will join me in being OPTIMISTIC?”

This focus on supporting Australian jobs is as relevant today as it was over 80 years ago.

Over the next three years, Coles is investing \$1.1 billion on 70 new stores across Australia, generating more than 16,000 construction and retail jobs.¹⁷ About a third will occur outside the capital cities.

By far the biggest investment by Coles in regional and rural Australia is through our stores, with a strong presence in communities in every corner of the country.

And customers come to our stores because they know they get value.

Since 2008, average weekly customer transactions across the Coles division have increased by 3.8 million to almost 20 million customer transactions each week.¹⁸

Cost-of-living is a vital issue for millions of Australian families

Coles’ customer survey groups repeatedly nominate cost of living as their number one concern.

The global financial crisis, and its aftermath, generated some uncertainty among Australians about job security and the economy. Increasing food prices was a key cost of living concern resulting in consumers eating out less and entertaining at home more.

According to the latest Customer Insights Survey, 80 per cent of Australians believe price reductions at supermarkets make a big difference to their cost of living.¹⁹

Five years into the Coles turnaround, we are driving prices down and keeping them down. Coles has introduced value meal solutions that can feed a family of four for \$10.

¹⁷ Coles media release, 5 March, 2014

¹⁸ Coles Group

¹⁹ Coles Customer Insights Survey, February, 2014

Importantly, Coles' brand products give customers the choice of buying the same or better quality as branded alternatives but for as much as 30% less.

The benefits of lower prices have been extended to all Coles customers, whether they live in the major capitals, regional centres or rural Australia.

The policy of state-wide, uniform pricing was introduced by Coles in January, 2010, and sought to eliminate the decades-old practice of many retailers charging country people higher prices at the checkout for household necessities than would be paid by their counterparts in the cities.²⁰

With only limited exception, Coles charges the same price across each State, regardless of distance and regardless of a suburb or region's affluence. That means paying the same for Kellogg's cornflakes in Broken Hill as you would in Balmain. It means paying the same for Vegemite in Horsham as you would in Hawthorn.

People who live in rural and regional areas are no longer having to pay more for their groceries because they happen to live a long way from the cities.

Coles is a strong supporter of regional communities. We are proud to acknowledge the special contribution to national life of our farming community.

For this reason, Coles supports events like the National Farmers' Federation annual congress, and the Weekly Times *Farmer of the Year* Award.

But nowhere is our support stronger than through Coles' "Australian First" sourcing policy.²¹

²⁰ 'Coles commits to national pricing' *Australian Food News*, January 2010

²¹ Coles media release, 7 September, 2011

Locally grown, locally made – a passion for Aussie produce

Northern Queensland is one of Australia's most productive food bowls. About 20 per cent of all of Coles fruit and vegetables are grown in the region to the north of the Tropic of Capricorn, equating to some 150,000 tons a year.²²

Similarly, Coles meat processor Australian Country Choice source over 50,000 head of feeder cattle²³ and our dairy processor Lion source some 15 million litres of milk each year from the region²⁴. These purchases deliver farm gate return approaching \$400 million to the region's primary producers.²⁵

Coles' employment of 3000 north Queenslanders and purchases of goods and services in the region provide an additional economic contribution from Coles approaching \$180 million²⁶ a year.

With nearly 100 Coles Group store locations in northern Queensland, serving some 600,000 customers every week²⁷ Coles provides an important community amenity and service to a significant portion of the region's population.

The Coles' economic contribution to northern Queensland is mirrored in farming communities across the country. Around 96% of Coles fresh fruit and vegetables are Australian grown; 100% of our fresh meat is sourced from Australian farms; likewise 100% of Coles Brand fresh milk.²⁸

In Victoria, **Farm Foods** in Geelong provides hamburgers, meatloaf and sausages under the Coles Finest and Farm Foods labels -- 100,000 meals a year, employing 80 Victorians²⁹; **Farm Pride** in Bears Lagoon, central Victoria, produces 85,000 dozen cage free eggs a week; **Hopkins River Beef**, in Dunkeld and Port Fairy, western Victoria, supply beef for Coles Finest brand.³⁰

In the Goulburn Valley, Coles has supported **SPC Ardmona** and fruit growers for 70 years. In our stores, SPC dominates the canned fruit category, comprising about 80 % of all canned fruit on our shelves. Of the 83 products in this range sourced from SPC, 65 are SPC brands; 18 are Coles' brand.

In addition, Coles has recently given a commitment to SPC that we will replace two previously imported canned fruit products in our private label Smart Buy range with SPC sourced product. This will mean 100% of our private label canned pears, peaches and apricots come from SPC.³¹

Also from the Goulburn Valley, **Geoffrey Thompson Fruit Packing Pty Ltd**, supplies fresh apples and pears to Coles. This company provides 102,000 bins of fruit from local growers each year, and employs nearly 500 staff. As a retailer, Coles is proud to support that growing base.³²

Likewise, to support vegetable growers in northern Tasmania, Coles has signed a five-year contract with **Simplot** to supply all frozen vegetables for Coles' Smart Brand private label.³³

²² Coles Group (Queensland)

²³ Source: Australian Country Choice

²⁴ Coles Group (Qld)

²⁵ Coles Group, and supplier data

²⁶ Coles Group data on payroll, supplier contracts(Qld)

²⁷ Coles Group (Qld)

²⁸ Coles Group

²⁹ Case Study, *Backing Aussie Food*, Coles publication, February 2014

³⁰ Case Study, *Backing Victoria*, Coles Publication, February 2014

³¹ Coles Media Release, 30 October, 2013

³² Case Study, *Backing Victoria*, Coles publication, February 2014

³³ Coles media release, 25 January, 2014

This will benefit about 240 growers. The contract brings at least 2.7 million kilograms of additional volume each year to Australian growers previously sourced overseas from China, Thailand, New Zealand and Europe.

The agreement will assist Simplot operations in Devonport, and in Bathurst, NSW. After reporting a growth in sales revenue, managing director Terry O'Brien praised Australia's two leading supermarket chains: **"They've given us an Australian-grown leg up," Mr O'Brien said.**³⁴

In Western Australia, from Albany in the south to Nambeelup, north of Perth, **Linley Valley Pork** employs 400 people tending what the company describes as "Australia's most comfortable pigs." In 2011, Linley Valley Pork and CM Farms agreed to move to sow stall free pork supply to Coles, and won that accreditation by October, 2012.³⁵

In central Australia, **Outback Spirit** sources bush foods to produce chutneys, preserves, cooking sauces and dressings, using distinctive bush ingredients and flavours. Indigenous communities and enterprises across the Northern Territory and Top End are involved in the supply chain.

On the Adelaide plains, and at Waikerie in the Riverland, the **Mitolo family** and their 300 employees have increased consumer choice by developing a new, healthier variety of the humble potato. Selling at scale into Coles supermarkets has helped fast-track development of innovations such as the Carisma potato, with its low Glycemic Index (GI) rating, which provides a healthier option for people on diets or with Type 2 diabetes.

From NSW's Tweed Valley, north west of Byron Bay, Australia's first indigenous premium bottled water is being sold into more than 750 Coles stores across Australia. Coles has supported **Yaru Water** with advice and assistance on production, distribution and promotions, and the company is aiming ultimately for production capacity of 880,000 bottles per week.

Further to the north, from the Carnarvon Ranges and Roma in Queensland, **Australian Country Choice** supplies 110 million kilograms of no-added-hormones beef to Coles each year.³⁶

From **Rugby Farm**, located in seven regional Queensland communities including Bowen, Ayr, and the Lockyer Valley, Coles purchases fresh sweet corn, green beans, broccoli, cauliflower, lettuce, watermelon and baby corn. This helps the Hood family employ 500 staff in the winter season.³⁷

The **Wickham Farms** in Bundaberg, Warwick and the Atherton Tablelands supply 6000 tonnes of potatoes to Coles each year. This is a 40-year business relationship.³⁸

Coles is passionate about these partnerships. In fact, most Australians have the view that they would prefer to support their own industry if the price and quality is right. Consumers want that outcome.

Case Study 1: Coles Dairy supply chain – a focus on regional Australia

A series of landmark initiatives by Coles to source dairy products from Australian dairy businesses and farmer-owned co-operatives provide better deals for farmers across the country.

*Coles has signed a 10-year contract for **Devondale -Murray Goulburn**, the dairy co-operative representing 2460 farmers in Victoria and southern NSW, to supply Coles directly with more than 100 million litres a year of fresh pasteurised milk.³⁹ This long-term commitment is enabling a \$120 million investment by Devondale-Murray Goulburn in new processing facilities.*

³⁴ Massive cost cuts boost Simplot profit, *Australian Financial Review*, 3 April, 2014

³⁵ Case Study, *Backing Aussie Food*, Coles publication, February 2014

³⁶ Case Study, *Backing Queensland*, Coles publication, March 2014

³⁷ *ibid.*

³⁸ *ibid.*

³⁹ Coles media release, 10 April, 2013

In Lismore, NSW, and Labrador, in southern Queensland, Coles has agreed a five-year contract with the **Norco** co-operative of 160 dairy farmers to supply 60 million litres a year of Coles fresh milk into supermarkets in northern NSW and Queensland.⁴⁰

Other key examples of the success of this program can be found in the attached **Backing Aussie Dairy** booklet which features a broad range of dairy enterprises investing in processing and new innovations across many dairy regions in Australia with the purpose of:

- deepening direct relationship with Australian owned processors
- replacing imported cheese with Australian cheese for Coles brand
- creating new demand for specialty regional dairy products and
- providing 5-10 year contracts to farmer co-operatives.

In Far North Queensland, Coles continues to source its own brand and **Dairy Farmers brand**, from Lion's Malanda facility in the Atherton Tablelands.

In an historic first for the Australian dairy industry, Coles has also announced an exclusive agreement to sell the South Australian Dairyfarmers' Association's own brand of milk — **SADA Fresh** — in Coles' South Australian stores and deliver 20 cents a litre back to a farmers' fund.⁴¹

Also in South Australia, through our relationships with small family-owned dairy companies, **Moo Premium Foods** and **B.-d Farm** Paris Creek, we are also encouraging innovation in the dairy industry and fostering growth in these boutique brands.⁴²

Similar family-owned and operated dairy farms— **Bannister Downs** at Northcliffe in Western Australia which is becoming a household name following continual innovation and Maffra Cheese Company, a Victorian family business from Gippsland, whose focus on quality has resulted in prestigious awards in Australia and overseas.

These agreements build on landmark deals with **Bega Cheese**, to replace 9 million tonnes of imported product with Australian-made cheese resulting in additional regional NSW and Victorian dairy farmers' milk and dairy processing jobs, reflecting higher demand for Australian dairy products.⁴³

Coles' exclusive partnership with **Warrnambool Cheese and Butter Factory (WCB)** for the Great Ocean Road brand is now into its third year and has been a significant retail brand boost demand for WCB dairy products. An additional 50 million litres of milk are being sourced by WCB annually from Victoria's south west region for the **Great Ocean Road** brand.⁴⁴

Looking ahead

Coles is working with the dairy industry on delivering greater certainty. For example, Coles has funded programs to develop export markets via the **Global Foundation**. More importantly, for domestic drinking milk, Coles has established long-term commercial supply arrangements with dairy farming cooperatives like Devondale Murray Goulburn & Norco.

These long term milk volume and product commitments enable processors to plan and invest for the future for their business and their dairy farmer supply base.

⁴⁰ Coles media release, 10 April, 2013

⁴¹ Coles media release, 25 October, 2013

⁴² Case Study, *Backing Aussie Dairy*, Coles publication, March, 2014

⁴³ Coles media release, 7 September, 2011

⁴⁴ Coles media release, 19 January, 2012

Case Study 2: Meat Supply Chain – paddock to plate

Beef:

The beef supply chain has undergone enormous changes over the last 20 years. A fluctuating Australian dollar impacted farmer returns and domestic supply. Meanwhile, BSE scares in Europe and America significantly affected consumer confidence in buying beef and forced graziers and meat processors to improve traceability⁴⁵.

These factors led to changes in the way Coles purchased beef from the late 1990s. Until this time much of Coles retail beef was purchased as boxed primal cuts from a broad range of meat processors. Today, Coles seeks greater line-of-sight over supply of 10,000 head of cattle a week, negotiating forward contracts through dedicated supply chains of graziers and processors.

These “paddock to the plate” arrangements provide greater certainty and assurance for graziers and processors selling beef through to Coles and improves the traceability and quality for Coles, our customers and industry regulators.

Australia is the third largest exporter of beef in the world and annually slaughters around 9 million head of cattle. This excludes live exports which are approaching one million head per annum.⁴⁶

The value of this beef export trade to Australia is over \$5 billion annually with over 1 million kilotons sold as fresh, chilled or frozen meat⁴⁷. Coles beef volumes by comparison are relatively small representing less than 6% of annual production.

*With close to 70% of Australia’s beef being produced for export⁴⁸, it remains vital for Coles to have a dedicated supply chain to ensure security and a continuous supply of quality beef. Coles long-term supply commitments enables and encourages graziers and processors to invest in beef supply chains. Over 90 per cent of the meat Coles purchases is sourced from these dedicated supply chains. This ensures security of supply, traceability and consistent quality to MSA standards and grading. The following case study highlights one of Coles key meat suppliers, **Australian Country Choice**.*

With traceability control right along the supply chain — from the paddock to the retail shelves — Australian Country Choice (ACC) is Coles’ largest fresh beef supplier. And with one of the world’s most significant vertically-integrated supply chains, the Queensland-based company continues to deliver 100 per cent Australian beef, with no added hormones.

ACC Chief Executive Officer David Foote says Coles’ move to HGP-free beef in 2011 was a game changer for his company and in fact the whole of the Australian beef industry.

“While there is absolutely no question about the safety to consumers of eating beef from cattle treated with hormones, there is clear consumer sentiment toward products with fewer additives, which come from sustainable production systems and have identifiable origins,” David Foote ACC CEO⁴⁹

ACC’s beef supply chain incorporates 26 grazing properties covering 680,000ha, two feedlots and a central processing, boning, packaging and distribution facility in Brisbane processing some 265,000 cattle annually. Over 110 million kilograms of processed beef was sold through Coles in 2012.

*While ACC and other processors in Victoria and Western Australia source the larger volumes Coles requires, there are also a number of branded beef suppliers, such as **King Island** and **Hervey Beef**, and small producers like **Hopkins River Beef** in Victoria and **Kylagh Cattle Co** in Western Australia.*

⁴⁵ ABS 1301.0 - Year Book Australia, 2005

⁴⁶ ABARES Agricultural Commodities March 2014 p.76

⁴⁷ ABARES Agricultural Commodities March 2014 p.77

⁴⁸ ABARES Agricultural Commodities March 2014 p.76

⁴⁹ Case Study, *Backing Aussie Food*, Coles publication, February 2014

Hopkins River Beef turn out 10-15,000 head of prime beef cattle a year for **Coles Finest** and Hopkins River brand. David Maconochie, Manager of Hopkins River says:

“To supply a branded product 52 weeks a year, you’ve got to be consistent. We know Coles are doing everything they can to ensure the quality of our product from the time it leaves the property; it’s up to us to do everything right here.”⁵⁰

Coles Finest Brand sources 2600 pure Angus steers from Kylagh Cattle Co. Owner Ivan Rodgers says:

“We don’t have a huge product mix, but rather focus on continual improvement in an operational, nutritional, environmental and animal welfare context. With Coles, we welcome the opportunity to prove our products integrity and our point of difference.”⁵¹

Lamb:

Coles’ lamb supply is increasingly vertically integrated with some 70 per cent purchased directly from graziers and processors, mainly in Australia’s south east and WA’s south west. Some 35,000 lambs per week are sourced by Coles from these regions.

According to ABARES, there has been a trend in Australia towards lower lamb consumption, although this demand is influenced by alternative meats, like chicken, and will rise when market prices for lamb fall. For example, in 2012/13 retail lamb prices fell by 12 per cent due to an increase in lamb supply and discounting by major supermarkets to sell through this supply. The result saw domestic per capita consumption to rise to 9.6kg per capita in 2012/13⁵²

Lamb exports now represent more than half of Australia’s output (excluding mutton and live exports) to a record 200,000 tonnes in 2012/13⁵³. Australia and New Zealand are the two dominant suppliers of lamb to the world market. While New Zealand is a larger lamb exporter than Australia, Australia is the largest mutton exporter.⁵⁴ Live exports of sheep are expected to remain at just under 2 million head per annum, mainly to Middle East markets⁵⁵.

Pork:

Coles fresh pork meat supply chain, like beef and lamb is 100 per cent Australian sourced and is vertically integrated. East coast supply is sourced from a number of individual farmers and groups such as Top Pork and processed by Primo Group in South Australia. In WA Coles sources most of its pork from Craig Moyston Group and their **Linley Valley Pork**. Coles source over 400,000 pigs a year representing about 8.5 per cent of annual pig slaughtering.

Plantagenet Pork, north of Albany WA, operate a number of AQIP approved Free Range farms. Sows have access to wallows in summer and straw in winter and are protected from potential predators to avoid losses of piglets. With only nine sows per paddock, each sow has its own hut from a week before farrowing. Piglets remain in the huts for 14 days before being able to move freely in their paddocks. Paddocks are rotated every two years.

⁵⁰Case Study, *Backing Aussie Food*, Coles publication, February, 2014

⁵¹Case Study, *Backing the West*, Coles Publication, March, 2014

⁵² Beef consumption per capita is expected to reduce to 27.5kg by 2018 compared to 32.2kg in 2013/14. Lamb per capita consumption is expected to decrease to 9kg per capita from 12kg in 2000 – ABARES Agricultural Commodities March 2014 p.83 and 89

⁵³ ABARES Agricultural Commodities March 2014 p.90

⁵⁴ ABARES Agricultural Commodities March 2014 p.101

⁵⁵ ibid. p.103

David Plant from Plantagenet says:

“The long term contract we have with Coles to supply Free Range pork has allowed us to increase the number of local farmers we work with. These new pig enterprises have added an additional revenue stream to many traditional cropping farms”

Primo Smallgoods process over 680,000 pigs a year at their Port Wakefield facility in SA, representing 25 million kilograms of meat. Primo have been supplying Coles for over 10 years. Over half of Port Wakefield’s population is employed at Primo, which sources its pigs from 45 pig farming families across South Australia and western Victoria.

Chicken

Chicken meat production in Australia is largely for domestic consumption. Exports represent 5 per cent of production. Chicken meat production has grown consistently over the past decade to reach over 1 million tonnes (2012/13) and now makes up one quarter of meat production in Australia, compared to 18 per cent a decade ago⁵⁶.

Australians are among the highest consumers of chicken meat in the world consuming nearly 45kg per capita. The growth in chicken consumption reflects the competitive pricing of chicken relative to beef, lamb and pork.⁵⁷ This is a long term trend driven by a vertically integrated supply chains dominated by large processors who produce 70 per cent of meat chicken⁵⁸. Other medium sized processors and smaller specialty processors make up the other 30%.

Coles sell approximately 60 million chickens annually, representing about 8% of the annual 700 million birds processed each year. On January 3, 2014, Coles became the only national supermarket to have 100% of its fresh chicken RSPCA approved, including BBQ chicken from the deli.⁵⁹

Cordina Farms are second and third generation growers allied with the Summertime Chicken Group. Based in the Sydney basin and Central Coast areas of NSW, Cordina employ 500 staff and contractors and are supplied by 60 farms. In 2011, Cordina launched its Freedom Farms RSPCA approved chicken, an indoor higher welfare model. In 2013 Coles launched its Coles Brand Made Easy range of premium fresh value added chicken product in partnership with Cordina.

John Cordina says consumer research confirmed to them that consumers want more focus by suppliers on animal welfare, tied in with high quality standards.

It’s very much a partnership. We have to produce something that meets consumer demand and provide consumers with value and, by working with Coles, that’s what we have done.”

John Cordina CEO Cordina⁶⁰

Case Study 3: Fresh fruit and vegetables – Australia’s Finest

Coles direct relationships and partnerships with over 350 fresh produce suppliers means we can now consistently supply Australian-grown fresh, quality fruit and vegetables to our stores each day.

Coles has also successfully been able to close the gap on imports by working with Australian growers on new initiatives to extend their growing season and in recent years we have replaced imported garlic, avocados, red and white onions and capsicums with Australian-grown produce.

⁵⁶ ABARES Agricultural Commodities March 2014 p.101

⁵⁷ ABARES Agricultural Commodities p.102.

⁵⁸ ibid. p.103

⁵⁹ Coles media release, 3 January, 2014

⁶⁰ Case Study, *Backing New South Wales*, Coles publication, July 2013

The response from customers demonstrates their strong support. Working through direct relationships with fruit and vegetable growers, Coles' and its suppliers across Australia are expanding sales volumes through investment in continuous improvement and innovation, providing our customers with high-quality fruit and vegetables.

Examples include:

- A third-generation tomato, capsicum, cucumber and zucchini business at Virginia, South Australia, which has increased yields dramatically by transforming traditional glasshouses into hydroponic systems.*
- A Victorian grower from Werribee who is the first in Australia to introduce symphony lettuce — where three varieties of lettuces are grown together as one bunch.*
- A Sheffield potato grower who is pioneering bio-fumigation in Tasmania and exploring new varieties with the support of Coles.*
- A family business at Manjimup in Western Australia, which was among the first to grow Pink Lady apples commercially and now has the state's largest organic apple orchard.*
- Citrus growers in New South Wales, who credit Coles with providing the business with greater stability through price and volume commitments.*
- Fruit and vegetable growers at Gumlu in North Queensland, who have invested in a \$2 million packing shed on the back of a direct relationship with Coles.*
- Mango growers in Katherine in the Northern Territory, who stood to lose millions of dollars in the 2013 season if Coles hadn't helped out with transport logistics.*

Farm gate returns

In 2012, Coles commissioned independent analysis from FreshLogic of the share of retail sale prices available to primary producers, processors and the retailer on products sourced and sold by Coles.

In most fresh produce categories sold by Coles, the analysis found that the primary producer received between 42% and 66% of the retail selling price in 2012.⁶¹

This analysis of pricing through the value chain was based on average retail selling prices over time. FreshLogic's THRUChain analysis model examined Coles internal retail sales and category costings.

It incorporated industry information and data on yields from cattle and sugar production, as well as product conversion relationships that apply to dairy products. Finally, it included information from wholesalers and producers on the costs incurred in the early stages of fresh produce supply chains. The analysis noted the impact of significant price fluctuation in many fresh produce categories which flow from the farm gate through to consumer pricing as part of regular seasonal cycles.

In processed products, the farm gate share was lower (20% to the cane grower for sugar; 21% to the wheat grower for bread). This is attributable to the additional processing and supply chain costs between the farm and the consumer.

These include the costs of transport from farm to market, packing, packaging materials, storage and any ripening. They also include any margin deducted by a processor, wholesaler or broker.

Dairy Pricing

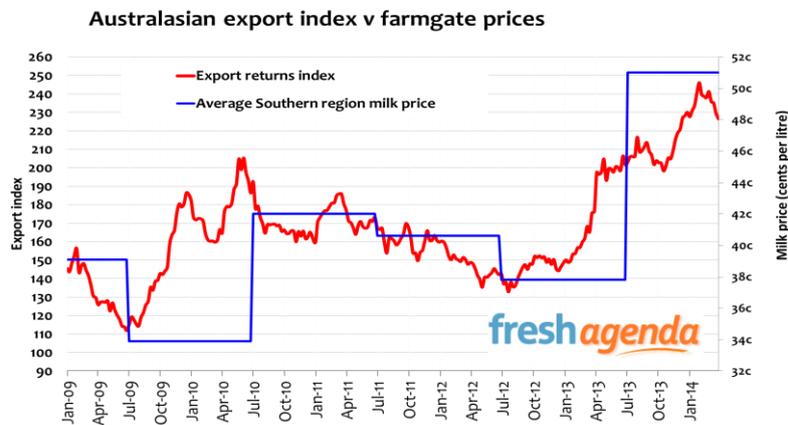
According to dairy supply chain specialists **Fresh Agenda**: "Average farm gate prices in Victoria are likely to reach record levels in 2013/14, having rebounded from the 2012 and 2013 years when there was a weaker global dairy market and a stronger value of the \$A."⁶²

⁶¹ Fresh Logic, Analysis of Food Products, July 2012

⁶² Fresh Agenda, Milk Facts March, 2014

According to the *Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES)* the southern dairy regions produce over 70 per cent of Australia’s milk. This is the region where farm gate milk prices closely follow global dairy commodity prices (refer to Chart D1 below). With about 40 per cent of the milk output exported in 2012/13 and a further 30 per cent of milk used in non-drinking milk products like cheese and butterfat (packed milk represents less than 30%) about three quarters of Australia’s output is therefore largely exposed to global dairy prices.

Chart D1

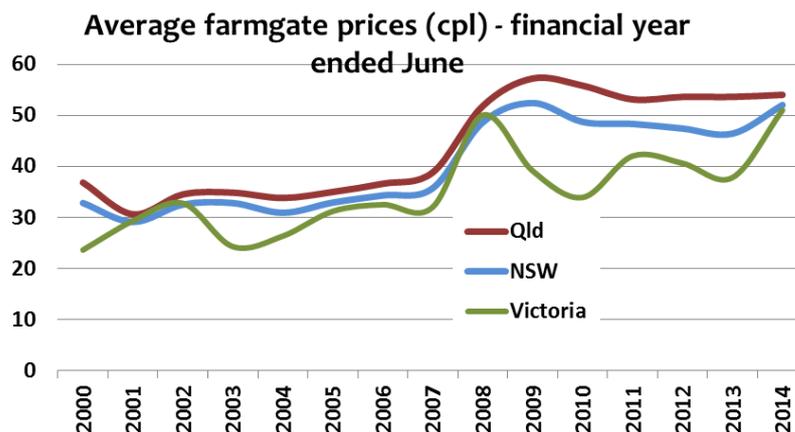


Source: Fresh Agenda March 2014

According to Fresh Agenda, farm gate milk prices in the northern regions of NSW and Queensland, largely used for drinking milk, are influenced by southern prices yet remain relatively high compared to southern farm gate prices.⁶³

Northern prices have remained higher than southern prices since 2009, due to the influences of higher cost of production, and the logistics cost of sourcing milk from southern supply regions. Fresh Agenda’s Chart D2 below illustrates southern region prices getting closer to higher northern prices.

Chart D2



Source: Fresh Agenda March 2014

⁶³Fresh Agenda, Milk Facts March, 2014

Livestock and Meat Pricing

Coles sources its meat from thousands of graziers across Australia mostly via integrated supply chains which include farmers, feedlots and processors.⁶⁴

Coles today buys more livestock from more graziers than ever before.

Importantly, depending on which species and region, Coles has forward contracts to secure supply and offers a purchase prices (on a per kilo price) 30-90 days out from delivery to the processor. This enables farmers to calculate Coles price relative to the market price and additional costs they may incur in feed. In poor seasonal conditions this is an important benefit to farmers and also provides certainty before additional costs are incurred.

There are some common misunderstandings around per kilo pricing of retail meat relative to the livestock or saleyard prices farmers receive. Coles buys very small volumes of livestock at saleyards (zero for pigs, 3 per cent of its cattle and less than 30 per cent of lambs). The vast majority of the meat Coles buys is what the industry call "*Hot Standard Carcass Weight*" or HSCW). The difference is important to understand in relation farm gate and retail pricing.

A 500 kg live weight steer at a saleyard for example sells for around \$2 a kilo and valued at around a \$1000 a head. The HSCW of this steer is just over half of this weight (a 54% meat yield) double the per kilo price for carcass meat to \$4 a kilo.

The primal meat cuts and trim are derived from this carcass, reducing weight to less than 200kg. This means the saleable meat costs \$5 a kilo before processing, refrigeration and distribution costs. This per kilo cost, plus the costs incurred by the processors, is what Coles pays for the meat before taking into account its own costs such as store distribution, wages and other overhead costs.

Consumers understand that there are many different cuts of meat from a carcass; from fillet tenderloins to legs, to mince. These prices change seasonally and vary by cuts from \$5 a kilo to \$40 a kilo for premium cuts of meat.

Meat from the same carcass is priced differently to reflect consumer demand and availability of each cut of meat. For example, primal cuts like tenderloins represent less than 2 per cent of a carcass⁶⁵. As a premium meat prized by restaurants and our customers, the only way to optimise the use of the whole carcass and meet consumer demand is to price each cut differently.

⁶⁴ Coles data

⁶⁵ Aus-Meat Ltd. Handbook of Australian Meat 7th Edition International Red Meat manual 2005

Engaging with Suppliers: A Coles Priority

Since August, 2012, Coles has held a series of road shows across Australia to identify new and innovative producers to supply food into Coles supermarkets. This was to meet growing demand from customers for even more locally sourced fresh produce.

Australian consumers are among the most passionate in the world when it comes to supporting local producers, with almost 70 per cent placing a 'high' or 'very high' level of importance on choosing products made in their own country.⁶⁶

'Meet the Buyer' events have since become a centrepiece of Coles' procurement strategy.

Coles' team of buyers – representing all categories from grocery to fresh produce, bakery, dairy, delicatessen, meat and frozen food - travel to each event to meet one-to-one with local producers of all sizes. The buyers spend time with each supplier providing advice and feedback on their product range as well as opportunities that may exist within Coles.

Turnout by potential suppliers has been impressive, with as many as 120 local producers attending each of the events, held in venues across capital cities and in Cairns. As a result, Coles has signed on more than 130 new local products not previously on the shelves of a major supermarket.

In February, 2014, chef Curtis Stone led a "Meet the Grower" roadshow that travelled from the Lockyer Valley in Queensland, through NSW, South Australia and across to the Goulburn Valley in Victoria to visit 100 growers supplying into Coles.

This formed part of centenary celebrations with communities that have led double digit growth in sales of fresh produce at Coles every year, for the last five years – this and other Coles initiatives have led to the sale of an additional 200,000 tonnes of fresh fruit and vegetables.⁶⁷

Fair Dealings

Coles cares about its suppliers. We always challenge to get the best deal for our customers, but we work hard to collaborate with our suppliers to ensure fairness.

If we make a mistake we will try and act fast to fix it, and endeavor not to repeat it. We have worked hard behind the scenes to build better, stronger relationships.

Coles has joined with Woolworths, and members of the Australian Food and Grocery Council, to develop and sign on to the Food and Grocery Industry Voluntary Code of Conduct.

The Code seeks to secure across the sector the benefits of robust competition, better value for consumers and fair and transparent dealings between retailers and suppliers.

The Code, announced in November, 2013, enshrines a transparent set of principles for standards of conduct across the food industry supply chain, and provides for dispute settling procedures if disagreements arise, including through formal sessions of the Retailer and Supplier Roundtable.

The Roundtable is a broader ongoing initiative to promote discussion and collaboration across the supply chain, including on the impact of extensive government regulation on the costs of doing business in the food industry.

⁶⁶ Datamonitor: Value of Australian Made 2011

⁶⁷ Wesfarmers Annual Report 2013

Both the Roundtable and the Code mark recognition of the importance of building and sustaining trust and co-operation across the food and grocery industry supply chain. It aims to ensure transparency and certainty in commercial transactions for businesses, large and small.

Under the Code, all transactions must be governed by a Grocery Supply Agreement, which will specify the contractual obligations of both parties, including detailing the limited circumstances in which the retailer can either reject goods supplied or withhold or delay payment.

The conditions of the Grocery Supply Agreement cannot be varied retrospectively, unless a specific change of circumstances in which variation might occur have been set out clearly and unambiguously in the agreement. Delisting of products can only occur in accordance with the terms of the agreement and for genuine commercial reasons.

Fresh produce can only be rejected by the retailer if the supplier has failed to meet the agreed fresh produce standards and quality specifications. This can only occur within 24 hours of the time of delivery, and the retailer must provide to the supplier written reasons for a rejection.

Under the Code, retailers when developing own brand products are obliged to respect the intellectual property rights of their suppliers. Nothing in the code precludes a supplier from raising any complaint or dispute with the Australian Competition and Consumer Commission.

The adoption of this voluntary code in Commonwealth law would limit the need to tie up resources of retailers, suppliers and the taxpayer in expensive litigation, as well as limit the cost to the economy of unnecessary regulation and bureaucratic over-reach.

The National Farmers' Federation was consulted during the drafting of the Code, and has been invited to join the Retailer and Supplier Roundtable. Costco and Aldi, as major global entrants into the market, have also been approached to become signatories.

The supermarket and food processing industries are high volume, low margin businesses operating in high cost environments.

Coles holds strongly to the view that the only sensible way forward for the industry is to continue delivering value to the customer through a quality offering at affordable prices.

Future Priorities

Coles is celebrating 100 years as an Australian-owned retail business focused on quality, service and value. These three principles are what the company was built upon and will remain at the heart of everything Coles strives to do.

Since 2008, we have turned food inflation into food deflation at Coles.

Coles' investment in lower prices since 2008 has not only reduced the cost of shopping for customers but has also increased competition, driven more sales for Australian farmers and food manufacturers, created new and more secure jobs and put millions of dollars back into communities.

A firm generating economies of scale to deliver lower prices to the customer is fundamentally pro-competitive.

It is good for family budgets; it is good for the wider economy because it frees up household savings for other spending purposes; and it is good because it encourages the sector as a whole to be more agile and productive, more innovative and more customer-focused.

Those same policies help to strengthen and invigorate Coles local supply chains. This is especially significant for fresh produce, and the relationship with our farm suppliers.

Under the Coles model, consumers decide what we sell and in turn what farmers grow.

From 2009 to 2013, Coles' lower prices saved Australian families an average of \$450 off their yearly grocery bill.⁶⁸ The turnaround has secured jobs for 100,000 Coles team members and supported a further 120,000 jobs throughout the broader economy, including tens of thousands of jobs in regional and rural Australia.⁶⁹

Success has meant the company has nearly tripled its income tax payment to the Commonwealth since 2008, allowing greater spending on health, education and welfare.⁷⁰

Coles is also putting more than \$38 million back into local communities each year through support for charities such as Redkite, SecondBite food rescue, and Foodbank.⁷¹

On 9 April, Coles was proud to announce a \$5 million fund-raising effort for a special fund to care for servicemen and women and their families who have suffered through death, injury or illness, particularly as a result of war service in Afghanistan.⁷²

Coles understands the importance of social licence to operate – and it provides this community support in the country as well as the cities.

Farming is a notoriously tough business; Australia is good at it; but crops are variable and weather patterns alternate between bountiful and unkind.

In the spring of 2011, when there was a bumper lettuce crop, oversupply in the market meant farmers were being forced to plough the lettuce back into the ground.⁷³

⁶⁸ *Coles Cost of Living Report*, Spring 2013.

⁶⁹ Deloitte Access Economics, *Analysis of the Grocery Industry*, October, 2012

⁷⁰ Coles Group data. Paid in income tax by Coles Division of Wesfarmers in 2012-13

⁷¹ Wesfarmers Annual Report, 2013

⁷² Coles Media Release with ADF Assistance Trust, 9 April, 2014

⁷³ Coles data and growers: Fresh Select October 2011

Coles, recognising the impact on growers, placed lettuce on super special nationally to encourage more sales. The response of Coles' customers was such that growers experienced volumes uplift of greater than 50 percent.

This increased sales and profits to farmers. It was a win for both our suppliers and customers

As another example, Coles' customers want fresh strawberries all year round. To address that deficiency, we funded protective tunnels for a local strawberry grower in Victoria's Yarra Valley.

A healthy food manufacturing industry thrives on innovation which leads to export opportunity and growth beyond our shores.

We have worked with numerous Australian small companies to bring innovative products to the market as well as quality products under the Coles brand. In exceptional cases, we have provided loans to small suppliers where investment was badly needed but funds were unavailable.

We do this to allow the production of higher quality products or to help get better value products to our customers. We also do it because it is important to encourage Australian farmers to be competitive in this market – and, by extension, more competitive globally.

Australians are increasingly concerned about how their food is produced. Animal welfare and ethical sourcing are issues that will also be important in determining how successful Australian farmers can be in building new or expanded markets overseas.

Coles has made a decision to lead on these issues.

For example, all Coles Brand eggs are 100% cage free; all Coles Brand fresh pork is 100% sow stall free and Australian grown, a standard recently endorsed by the Industry⁷⁴.

In May, 2013, Coles announced a major new partnership with AusVeg, adopting their industry standard on sustainability as our best practice approach to ensure clean and green fruit and vegetables for our customers.⁷⁵

In June, 2013, a new quality assurance program and logo that guarantees the safety and welfare of Australian eggs was launched by the Victorian Farmers Federation, with Coles as the lead retailer⁷⁶. Under HenCare, consumers can have confidence that animal welfare, biosecurity and environmental requirements are being met.

On January 3, 2014, Coles became the only national supermarket to have 100% of its fresh chicken RSPCA approved, including BBQ chicken from the deli.⁷⁷

In its supply chain, Coles has stopped the injection of young cattle with growth hormones and ensured the salmon it sells is sustainably sourced.⁷⁸

Coles believes it is imperative to do the right thing by our customers, to do the right thing by our suppliers, and to do the right thing by the communities to which we belong.

⁷⁴ Australian Pork Limited Media Statement March 2014 (speech to the Australian Bureau of Agricultural and Resource Economics and Sciences Outlook Conference)

⁷⁵ Coles Media release, 31 May, 2013

⁷⁶ Victoria Farmers Federation Media Statement June 2013

⁷⁷ Coles website; Curtis Stone; Hope Bertram, RSPCA

⁷⁸ <https://www.coles.com.au/helping-australia-grow/responsible-sourcing-and-sustainability/responsibly-sourced-meat-and-seafood>

We have a single minded vision: to become Australia's best supermarket.

- The best supermarket for customers;
- the best supermarket for team members,
- the best supermarket for Australian suppliers,
- and the best supermarket for the everyday Australians who invest their hard-earned savings in our company.

Coles will continue to do the right thing by our customers, suppliers, investors and communities, by delivering safe, affordable, high-quality food to Australian families... and helping Australia grow.