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Profitability of Consumer goods' manufacturers and retailers in France

Study conducted with Professor Simon Parienté covering the years 2018 and 2019, carried out on a sample of 2,880 consumer goods products' manufacturers (food & non-food, 152 billion euros turnover, i.e. 50% of national turnover), and 2,898 players large-scale distribution, "integrated" (Carrefour, Casino, Auchan, Cora) and independent (Galec/Leclerc, Intermarché, Système U) representing 124 billion euros turnover, ie 75% of national turnover. Social accounts from the Diane database. The same study has been carried out every year since 2014.

Distributors are not inherently less profitable than manufacturers; the problem does not consist in an unequal distribution of value between the two categories of actors, but in an extremely heterogeneous control of their business model by the various retailers.
In 2019, when the EGAlim law came into force, the profitability of distributors increased; that of food manufacturers continued to erode.

➲ The business models of manufacturers and retailers are fundamentally different, and comparing their profitability using a net or an operating margin indicator does not make sense.

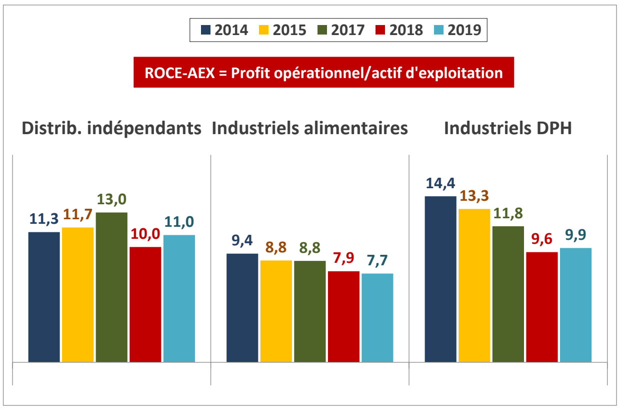
- **The net margin, like the operating margin, is expressed as a% of sales. However, the turnover achieved by a retailer has nothing to compare with that of a consumer goods producer** and this mechanically "crushes" the margin of the former when expressed as a percentage. The average annual turnover of a consumer goods manufacturer in France is € 53 million, against € 27 billion for the main players in mass retail, i.e. **a 1 to 500 ratio**.
- **Capital and investment needs**; by essence, a manufacturer must invest constantly and heavily: in factories, production equipment, or in R&D to innovate. Retailers invest mainly in warehouses and stores, which are more ad hoc investments. And the investments needed to support online sales' growth (automation, software, etc.) tend to replace traditional investments rather than add to them: **retailers mostly carry out trade-offs, for example with fewer openings of less frequent store renovations, but do not increase their total investments**.
- **Working capital requirement (WCR):** manufacturers must build up stocks, operate factories before being in a position to sell their products; they are paid at ~ 60 days by the retailers and their working capital represents on average 35% of their turnover. Retailers are paid cash by consumers, and their WCR is therefore very low or even negative, while they at the same time operate with minimal stock.

➲ The only relevant indicator for comparing such different business models is a measure of the return on capital employed, which compares the two variables of the equation to be considered: income, and the cost of capital used to generate this income

The financial results of a company must be evaluated on the basis of **all the investments made and the cost of capital employed to finance them**. This is all the more true when comparing manufacturing industry vs. retail, whose respective turnover levels are unrelated. **ROCE** (operational profit ÷ all of the company's assets) is then the most relevant indicator.

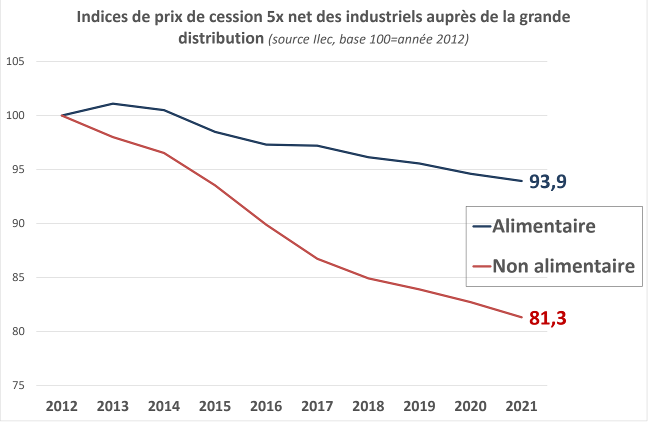
➲ Based on this ROCE indicator, the business of independent retailers (Leclerc, Intermarché, Système U) is now proving to be more profitable than that of manufacturers.

➲ The profitability gap in favor of independent retailers has even widened in recent years: their profitability has remained at a good level between 2014 and 2019 (from 11.3% in 2014 to 11.0% in 2019). That of manufacturers is weaker and has also significantly decreased over the period: -1.7 pts for food manufacturers and -4.5 pts for detergents and personal care



➲ The erosion of manufacturers' profitability since 2014, in food and even more in non-food categories, is one of the direct consequences of the price war initiated by large-scale retailers since the end of 2013, which has led to a spectacular drop in their net purchase prices from manufacturers.

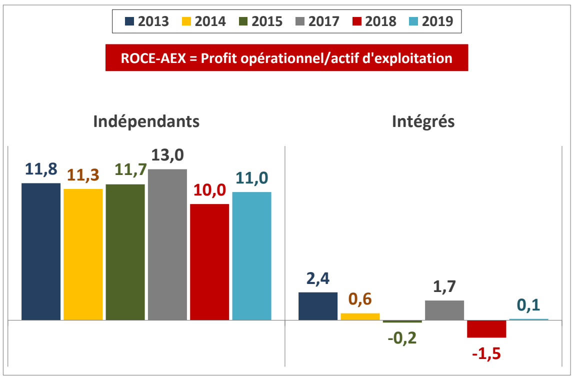
- **The drop in food manufacturers' profitability** over the past few years has been notable in a majority of categories, in particular groceries and basic products (meat, cold meats, canned goods, etc.), which were already the most fragile. **The trend continued in 2019**: overall, the entry into force of the EGAlim law did not improve the profitability of food manufacturers
- **The deterioration in the trend for non-food products (detergents and personal care products) between 2014 and 2019 was impressive** and affected more particularly large companies (turnover> € 250m). They have been the main targets of the price war since 2013, which has led to a sharp drop in their net sale prices to hyper and supermarkets. The very slight upturn in non-food manufacturers' profitability observed between 2018 and 2019 cannot be explained by an improvement in operating income, since it continued to deteriorate (-0.3 pts). It is rather due to a drop in capital employed, which might be an illustration of a reduced capacity to invest and innovate.



➲ The two main determinants of manufacturers' profitability are, on the one hand, the line of business and the ability to create value via the brand, and on the other hand, the weight of exports, which emphasizes the dilutive effect of the activity carried out in France

- **Line of business: for food manufacturers, profitability varies from one to five** between basic products and beverages (alcoholic and non-alcoholic).
- **Exports: companies which generate more than half of their turnover from exports generate twice the profitability** of those which do not export, via higher margins.

➲ The retail universe is far from being homogeneous; it is on the contrary bipolarized: facing independents who enjoy an enviable position, integrated retailers find themselves in a more difficult situation

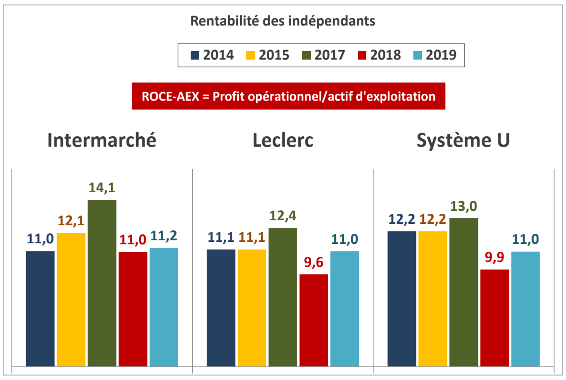


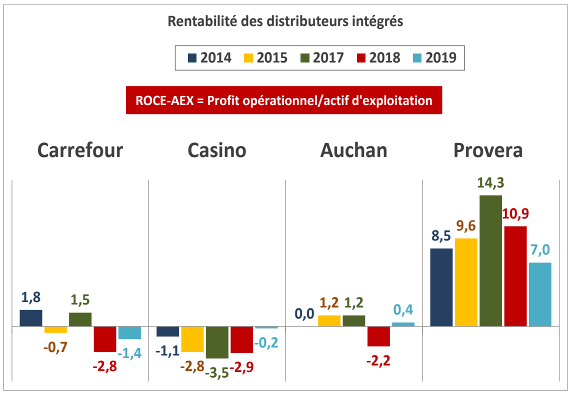
➲ The significantly higher profitability of independent retailers (Galec/ Leclerc, Intermarché, Système U) compared to integrated ones (Carrefour, Casino, Auchan, Cora-Match) cannot be explained by better purchase prices but by three main factors:

- **A network of medium-sized store formats (small hyper, large supermarkets), better suited to the current needs** of consumers, less affected by the erosion of sales of non-food products to the benefit of retailers and specialized stores, and thereby maximizing turnover per square meter.
- **Better controlled costs**: the amount of personnel costs and consumption of services represents a quarter of integrated hypermarkets' turnover, against only 16.4% for independent retailers.
- **Recourse to debt** (supposed to bring in more than it costs) and its leverage effect: the independent retailers are mainly financed by debt, while the integrated ones are financed at more than 60% on equity, with shareholders to remunerate.

➲ The three groups of independent retailers enjoy very comparable levels of profitability; among the integrated ones, Carrefour, Casino and Auchan are in a tense situation; Cora-Match is an exception, with profitability close to that of the independents

In 2019, except for Provera, all retailers recorded an increase in their profitability compared to the previous year. Provera's better profitability, compared to other integrated retailers, can be explained, among other things, by its very regional presence, in the East of France, where the independent retailers are less present, and the price war less intense. Cora is thus the hypermarkets with the highest consumer price index, even though the group has benefited since the end of 2014 from its purchasing alliance with Carrefour, which grants it better conditions than before.





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