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iScan 2016

An Overview of the Australian Retail
Fuels Market





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FOREWARD

In the first of its series of annual fuel retailing reports, the Australasian Convenience and Petroleum Marketers Association (ACAPMA) is pleased to present *iScan 2016 - An Overview of the Australian Retail Fuels Market*.

This report provides a high level analysis of the Australian retail fuels market and the nature of the wholesale and retail industry that supports the operation of this market. Specifically, *iScan 2016* includes:

- » an overview of the Australian retail fuels market for the year ending 30 June 2015
- » a current snapshot of the petroleum wholesale and retail industry segments, including an assessment of the economic contribution of each industry segment to the health of the Australian economy
- » a discussion of some of the current regulatory developments affecting fuel retailers
- » some perspectives on the near term challenges for fuel retailers

This report is not intended to provide an exhaustive discussion of the retail fuels market in Australia.

Rather, this document is intended as a *quick reference guide* for the many small to medium businesses that comprise the fuel retailing market in Australia.





1. KEY RETAIL MARKET STATISTICS

Market Size

Sales of all petroleum products in Australia (including aviation fuels, lubricants, greases and ethanol blended fuels) have flat-lined at around 55,000 ML per annum over the last three years as shown in Figure 1.

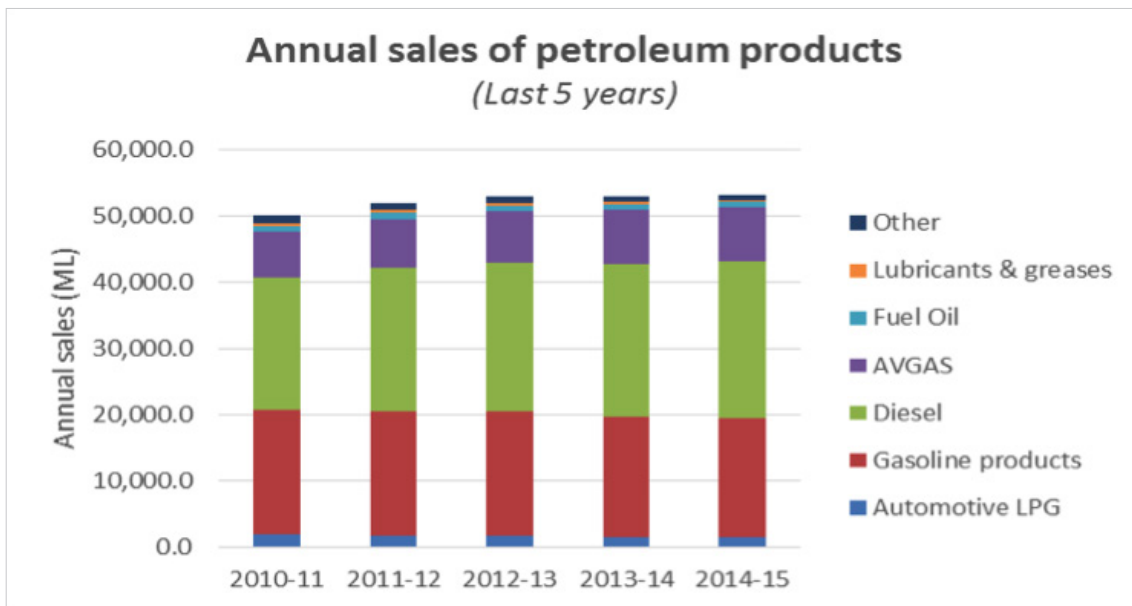


Figure 1: Annual sales of petroleum products over the last 5 years (APS 2016)

Product Sales Trends

Analysis of the recent trends in petroleum product sales for the five year period ending 30 June 2015, reveals that:

- » AutoGas sales have declined by 20% to 1,484 ML per year
- » Diesel sales (retail) have grown by 19% to 23,818 ML per year
- » Sales of ethanol blended fuel (E10) have fallen by 29% to 2,194 ML per year
- » Regular unleaded sales have fallen by 7% to 10,582 ML per year
- » Premium unleaded sales have grown by 22% to 5,204 ML per year



Sales by State and Territory Markets

An analysis of retail product sales by Australian State and Territory markets (see Figure 2) reveals that sales of regular unleaded petrol are the highest of all products sold, with the exception of NSW where sales of premium unleaded petrol are highest.

The NSW anomaly is solely attributed to the operation of the NSW biofuels mandate which has required larger fuel retailers to stock E10 on their forecourts and is considered to provide evidence of motorists' aversion to the purchase of ethanol blended fuel.

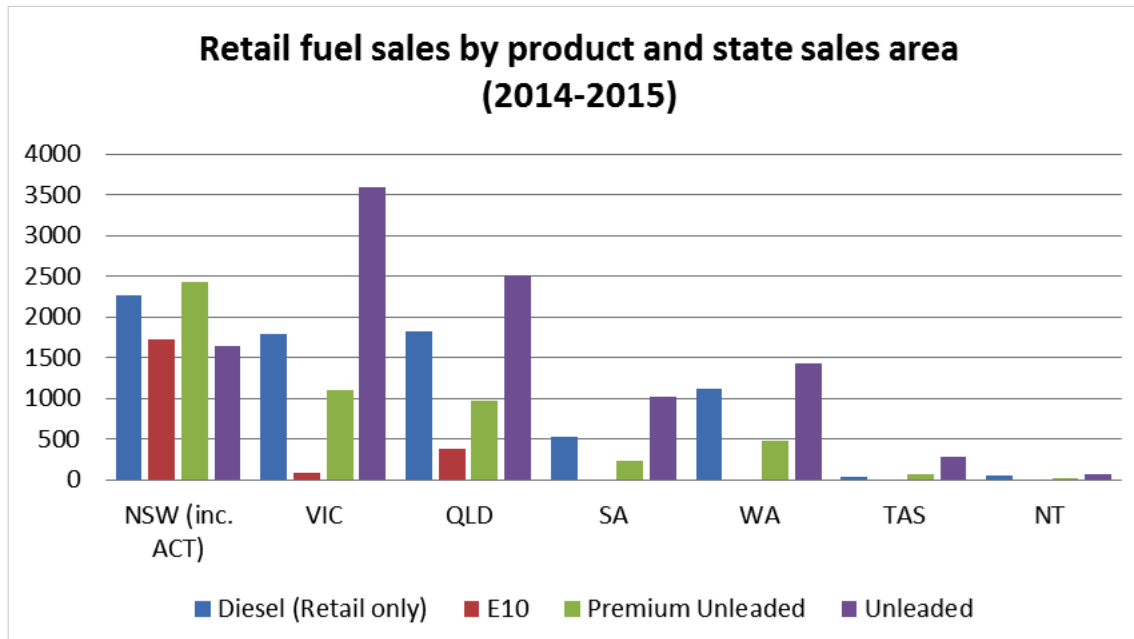


Figure 2: Breakdown of retail product sales in discrete State and Territory markets in 2014-15 (Australian Petroleum Statistics, Australian Department of Industry innovation and Science, Issue 235, February 2016)



Annual Average Retail Fuel Prices

During 2014/15, the national average retail prices for fuel were \$1.37 per litre (regular unleaded petrol) and \$142.1 per litre (diesel).

The annual average fuel prices in individual State and Territory markets varied significantly as shown in Figures 3 and 4. This variation was the subject of considerable scrutiny by the Australian Competition and Consumer Commission (ACCC) during 2015 with the Commission launching regional fuel studies in Darwin (NT), Launceston (TAS) and Armidale (NSW).

The sources of this price variation can largely be attributed to the interplay of a variety of market factors within individual State and Territory markets which include, but are not limited to, interstate variations in:

- » the intensity of retail market competition in metropolitan and regional markets
- » annual fuel sales per retail site, leading to higher capital and operating expenses per unit of fuel sold in low volume markets
- » compliance costs for fuel retailers

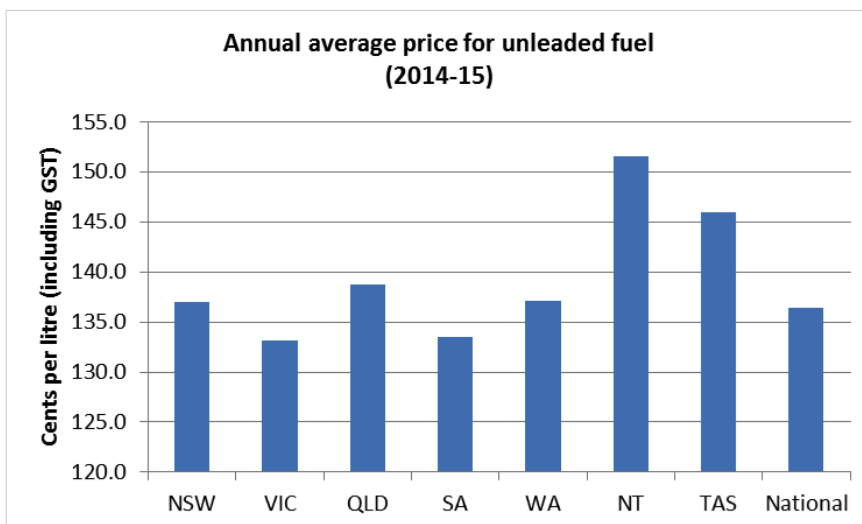


Figure 3: Average annual prices for unleaded fuel in 2014-2015 by Australian State and Territory market (AIP 2016)

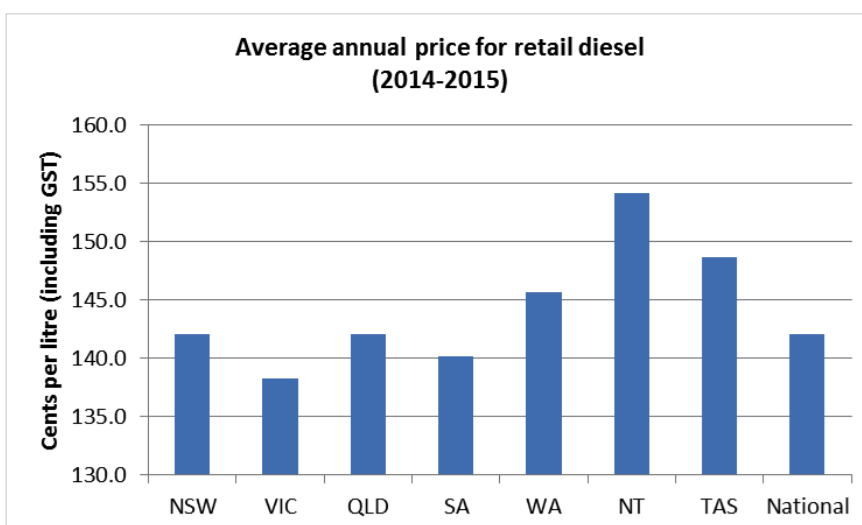


Figure 4: Average annual prices for diesel fuel in 2014-2015 by Australian State and Territory market (AIP 2016)



International Price Comparison

Australia's petrol and diesel prices compare very favourably against the prices that are levied for these fuels in comparable OECD Countries. When considered on a total price basis (i.e. including taxes), Australia was the fourth lowest of 28 OECD countries surveyed for petrol price (see Figure 5) and the fifth lowest for diesel price (see Figure 6) during the December 2015 Quarter.

When the influence of government taxes is removed, Australia remains the fourth lowest for petrol prices and the falls to the fourth lowest for diesel price.

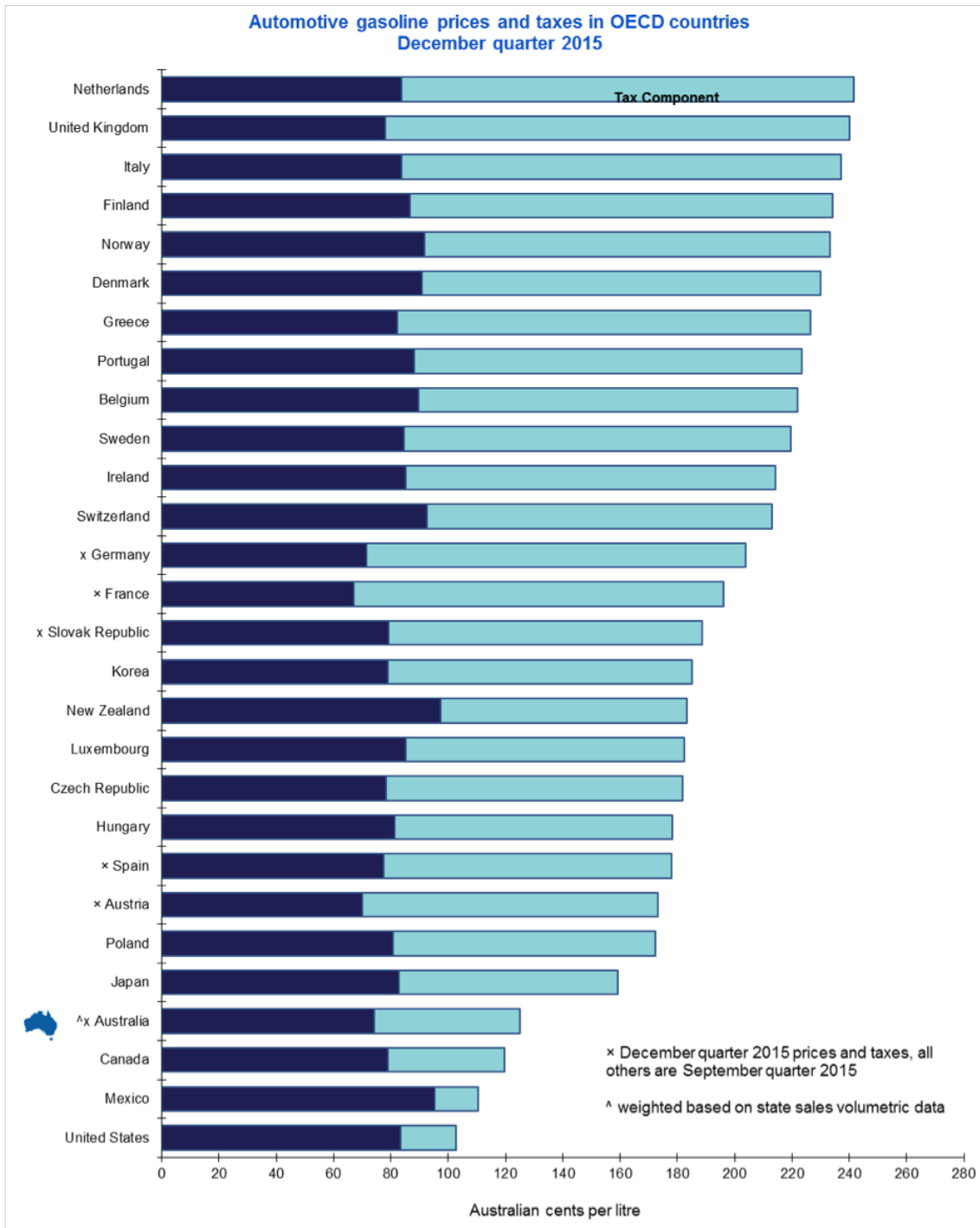


Figure 5: Australian retail petrol prices were the fourth lowest of all OECD during the December Quarter 2015 (Source: APS 2016)

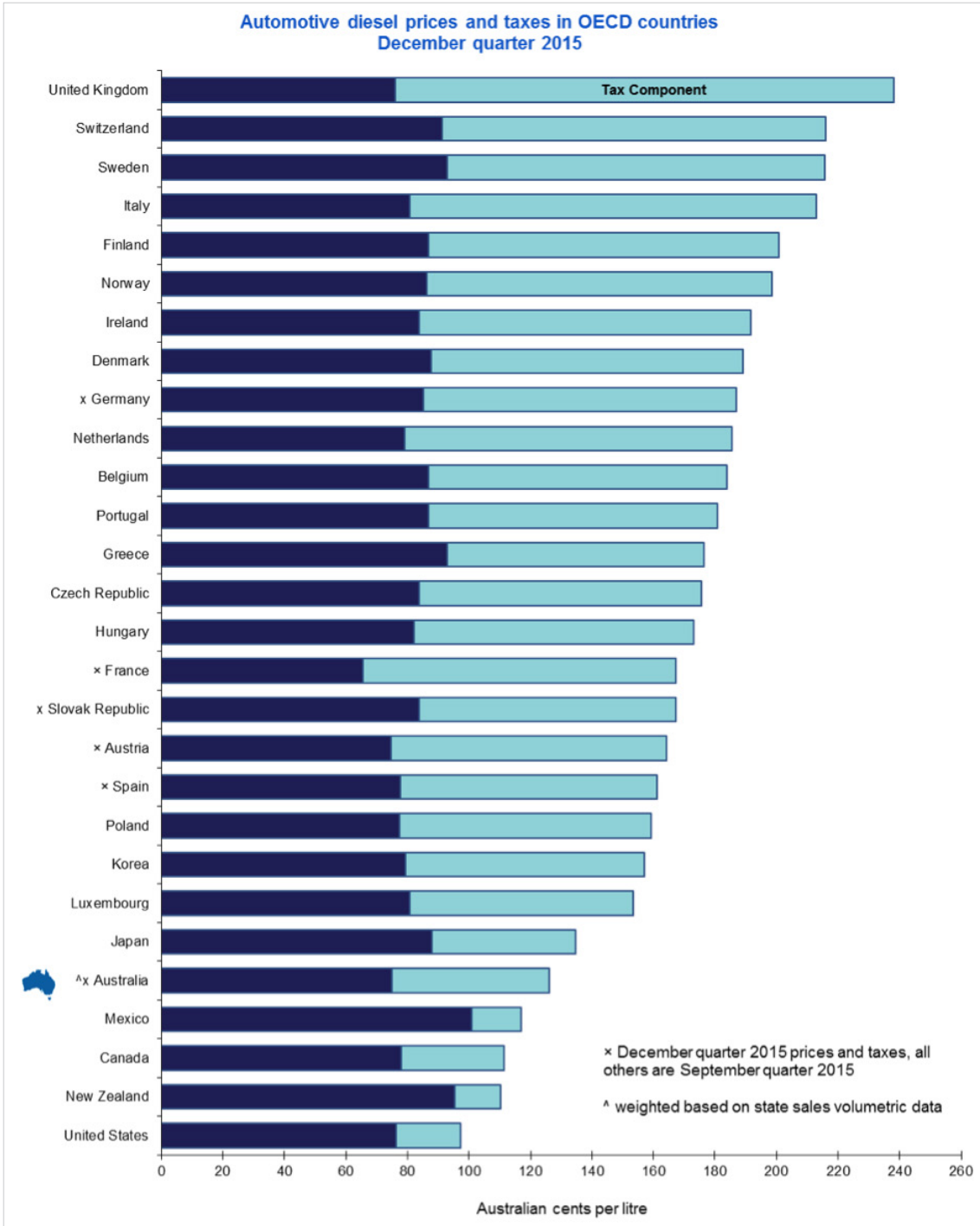


Figure 6: Australian retail diesel prices were the fifth lowest of all OECD economies during the December 2015 quarter (APS 2016)





2. PETROLEUM WHOLESALING

Australian Fuel Industry in 2014-15 - Petroleum Wholesale Industry sub-segment	
No. of businesses in operation	792
Total number of employees	12,650
Annual revenue generated	\$41.2 Billion
Annual profit	\$824 Million
Industry value-add to Australian Economy	\$2.2 Billion
Market shares	As with the refining segment of the industry, the four Australian Oil Majors (i.e. Caltex, BP, Exxon Mobil and Viva Energy) accounted for 93.6% of all revenue generated from this industry segment

Source: IBIS World 2015, *Petroleum refining and petroleum manufacturing in Australia: Market Research Report, October 2015*)

The Australian wholesale fuel industry has been the subject of considerable consolidation over the past decade, with the total number of petroleum wholesale businesses declining by 22% since 2006 (IBIS World 2015).

Despite these changes, revenue earned by petroleum wholesalers has been relatively flat, with average growth of a mere 0.8% year on year over the past 10 years.

The Australian Competition and Consumer Commission (ACCC December 2014) estimates that fuel wholesalers have averaged a gross profit (i.e. EBITDA basis) of just 1.2% per year over the past 10 years, demonstrating the fundamental *small-margin high-volume* nature of the Australian wholesale fuels market.





3. PETROLEUM RETAILING

Australian Fuel Industry in 2014-15 - Petroleum Retail Industry sub-segment	
No. of businesses in operation	3,790
Total number of employees	43,278
Annual revenue generated	\$37.0 Billion
Annual profit	\$924.5 Million
Industry value-add to Australian Economy	\$2.6 Billion
Market shares	The Australian retail fuel market is dominated by the two supermarket chains - Coles and Woolworths - who account for just over 50% of all retail fuel sales in Australia. Three of the four oil majors (i.e. Caltex, BP and Viva) account for a further 20% of retail sales with the remaining 30% split between mid-cap retailers (e.g. Puma Energy, 7-Eleven, United Petroleum) and small fuel retailing businesses.

Source: IBIS World 2016, *Fuel Retailing in Australia: Market Research Report, February 2016*

The Australian retail fuels industry has undergone significant transformation over the past decade as a result of new competition from two of Australia's largest food and grocery enterprises - Coles and Woolworths. Despite these changes, the number of retail fuel sites has been relatively stable hovering between 6,300 and 6,500 since 2005.

Nonetheless, with an estimated 6,400 sites in operation as at January 2016, the total number of sites has declined from the heady days of the late 1970's when the number of service station sites peaked at just over 21,000.

The smaller number of sites, however, has seen growth in annual volumes per site. Today, the average non-supermarket site averages around 2.9 ML per year (ACCC 2014) and the nation's 1,600 'supermarket sites' average 5.4 ML per year.

The real story of the changes that have occurred in the retail end of the Australian fuel market, however, are the change in business structures that have occurred.

Whereas the oil majors previously owned the vast majority of service stations in the past, strategic decisions to divest the retail assets has seen the emergence of a range of different retail fuel business models in Australia in recent years.



The Australian fuel retail industry currently utilises five different business models for the retail of transport fuels to consumers, namely:

- » Company owned and company operated (COCO)
- » Dealer owned and dealer operated (DODO)
- » Independent fuel retailers
- » Franchisees
- » Commission agents

ACAPMA estimates that approximately 33% of the nation's fuel retail outlets were COCO's and 20% were DODO's and the full breakdown of retail business models used in the national retail market is provided in Figure 7 below.

Each of these retail models vary significantly in terms of cost structures, profit margins and the nature of operational control (including price) exercised by the fuel supplier.

In fact, and despite having their brand displayed at more than 52% of the Nation's 6,400 service stations, Australia's four major oil companies have direct control of less than 9% of all sites in Australia.

Retail Business Models

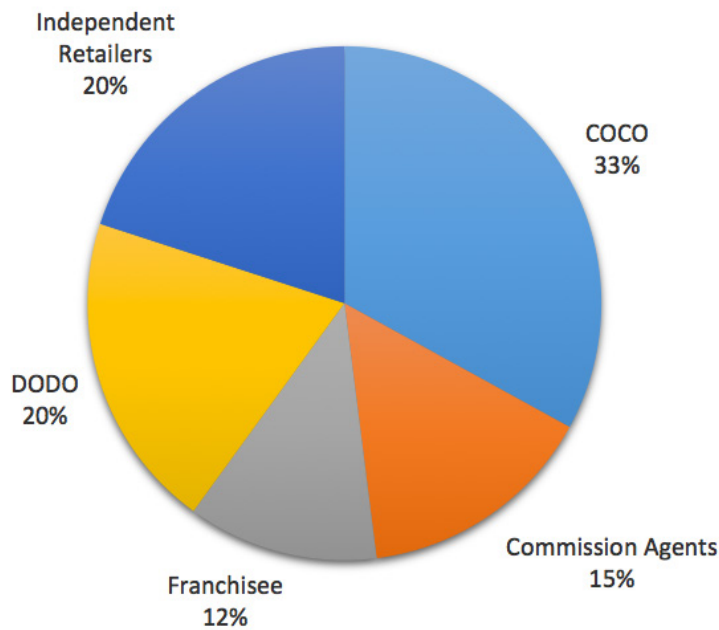


Figure 7: Estimated breakdown of service station sites by retail business model (ACCC, 2014)



Company Owned and Company Operated (COCO)

Company-owned, company-operated service stations, are retail fuel businesses which are wholly owned and operated by the business which is branded on the forecourt. As a result the company has full control of all aspects relating to the operation of the fuel retail business - from setting fuel prices to the operation of the convenience store and employment of all staff.

This business model is largely utilised by the two major supermarket brands in Australia, who account for 73% of the estimated 2,080 COCO retail sites in Australia (refer Figure 8).

COCO Sites

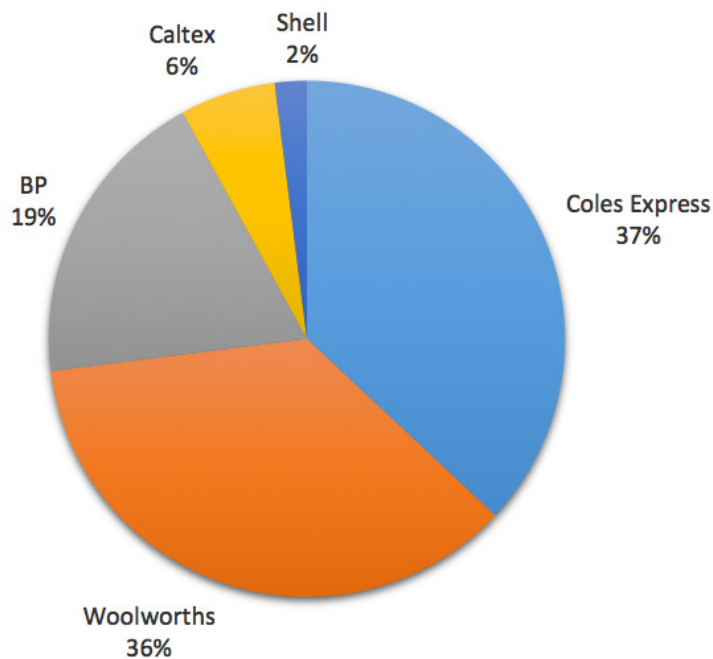


Figure 8: Summary of COCO sites by retail brand in Australia (ACCC, 2014)

Under this business model the company, or major brand, has complete control over the site operations which includes the cost of running the business, all business decisions (e.g. employment, store design, stock lists), and setting the fuel price.

While prices at individual sites operated by the company may vary in response to variations in the level of competition in local markets, the company retains all profit earned from the sale of fuel and convenience store items.

In 2015, approximately 33% of all fuel retail sites in Australia were COCO's (ACCC, 2014)

9 10

diesel
BP Ultimate unleaded 91
autogas

\$ 10
Litres
This pump is fitted with Vapor Recovery
cents per litre
CALIBRO PUMP-ROOF





Dealer Owned and Dealer Operated (DODO)

Dealer-owned, dealer-operated service stations are retail sites that are owned by a fuel dealer but operated under a branding arrangement with a major oil company or an independent fuel wholesaler.

Under these agreements, the dealer purchases fuel from the company brand that is displayed at their sites and enters into a strict branding agreement designed to emulate the look and feel of a COCO - typically including the operation of the convenience store.

This model is typically used by the major oil companies in Australia as shown in Figure 11.

DODO Sites

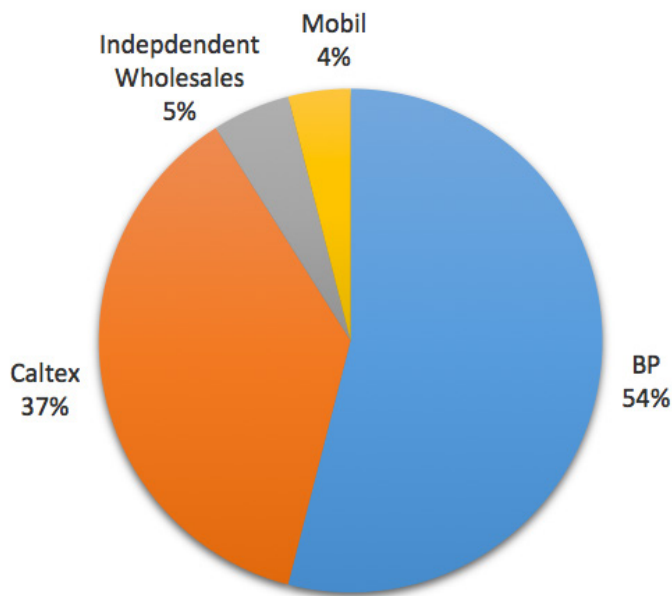


Figure 11: Summary of DODO sites by retail brand in Australia (ACCC, 2014)

While these sites typically have the same look and feel as a COCO site, the dealer business operates independently of the fuel supplier and controls all aspects of the business - including the setting of retail fuel prices.

In 2015, approximately 20% (or 1,280) of Australia's 6,400 retail sites were DODO's (ACCC, 2014).



Independent Retailers

Similar to DODO's independent fuel retailers are fuel retail businesses that are wholly independent of the fuel supplier.

These businesses typically enter into supply arrangements with a fuel supplier but the agreement does not always include a branding agreement.

Where a branding agreement is included, the agreement tends to be more 'light touch' than that used for a DODO and typically provides the dealer with considerable freedom in respect of the operation of their convenience store.

This business model is typically utilised by the major oil companies (i.e. BP, Shell and Caltex) as well as the independent wholesalers (e.g. Metro Petroleum) and specialist fuel retailers (e.g. 7-Eleven and United Petroleum) as shown in Figure 12.

Independent Retailers

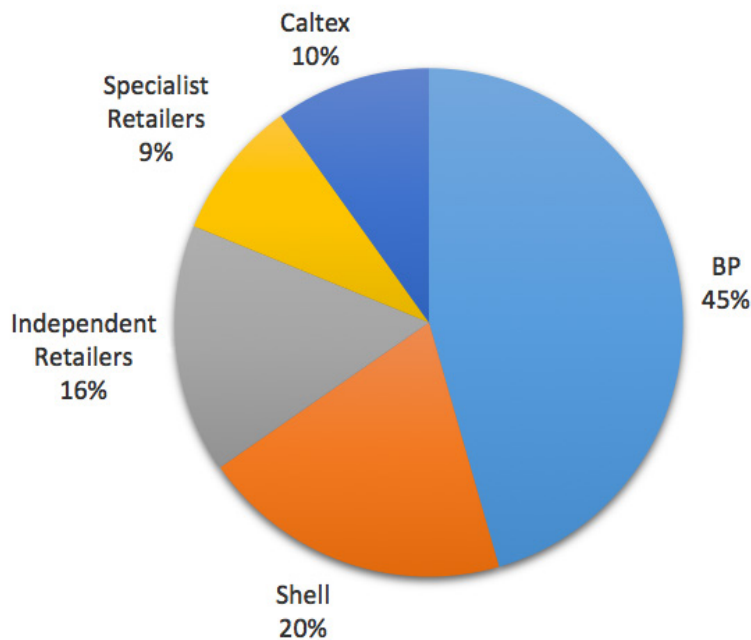


Figure 12: Proportion of Independent Fuel Retailers by Retail Brand in Australia (ACCC, 2014)

Independent fuel retailers are service stations which are wholly owned, and operated, by independent businesses and therefore are not controlled by the fuel supplier.

These businesses are responsible for all costs associated with the retail operation and, as such, retain full control over the setting of retail fuel prices.

In 2015, approximately 20% (or 1,280) of Australia's 6,400 service station sites were considered to be 'independent retailers'.



Franchisees

Franchisees are service stations where the retail site is owned by a company but the operation of the site and the convenience store is franchised out to a third party business.

Franchise businesses for fuel retail operate in a similar fashion to any conventional franchise business.

These models are predominantly utilised by the major brands (e.g. BP and Caltex) as well as independent wholesalers (e.g. Metro Petroleum) and 'specialist retailers' (e.g. 7-Eleven and United Petroleum) as shown in Figure 9.

Franchise agreements vary from business to business, however a majority leave operational control of the service station to the franchisee. This includes the operation of the business and all associated costs of running that business.

A franchise agreement may also include some form of support for the franchisee in the form of concessional pricing for goods and/or the provision of financial support.

Under this type of agreement the franchisee collects the profits from the sale of fuel and pays the franchisor a set value for each litre of fuel sold. This means that the fuel company has a degree of control over the retail fuel price by means of the franchise charge per litre of fuel sold by effectively setting a 'floor' in the retail price of fuel.

Franchisees

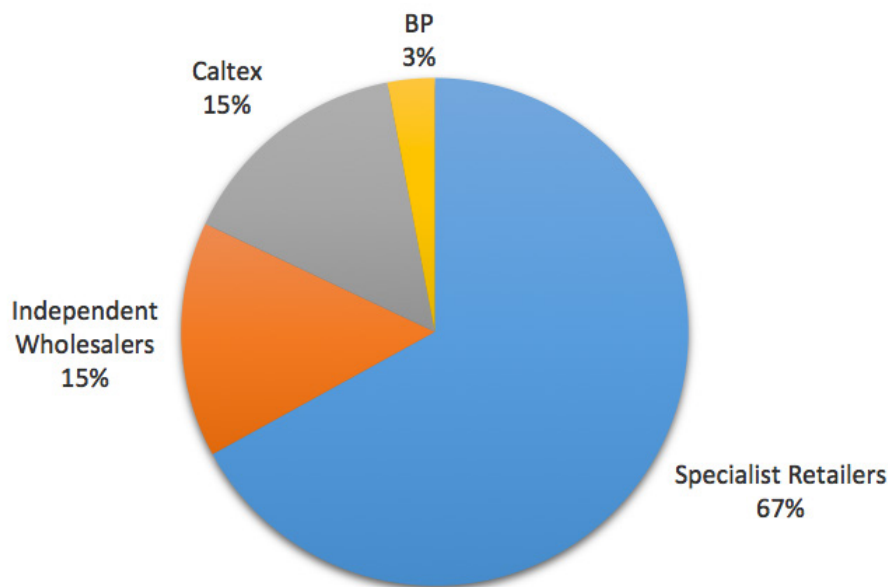


Figure 9: Use of franchise models for fuel retail in Australia by retail brand (ACCC, 2014)

Franchise businesses accounted for just under 12% (or 768) of the nation's 6,400 service station sites in 2015 (ACCC, 2014).

24 Hours

premium
unleaded

per litre

109.9

diesel

per litre

119.9

Wash Centre



Commission Agents

A Commission Agent is a hybrid version of a franchise agreement that is made legal in Australia as a result of the operation of the *Australian OilCode Regulation (2006)*. Administered by the ACCC, the OilCode regulates the conduct of fuel wholesalers and fuel retailers.

The *Commission Agent* model is extensively used by Caltex and independent fuel wholesalers such as Metro Fuels (Refer Figure 10)

Commission Agents

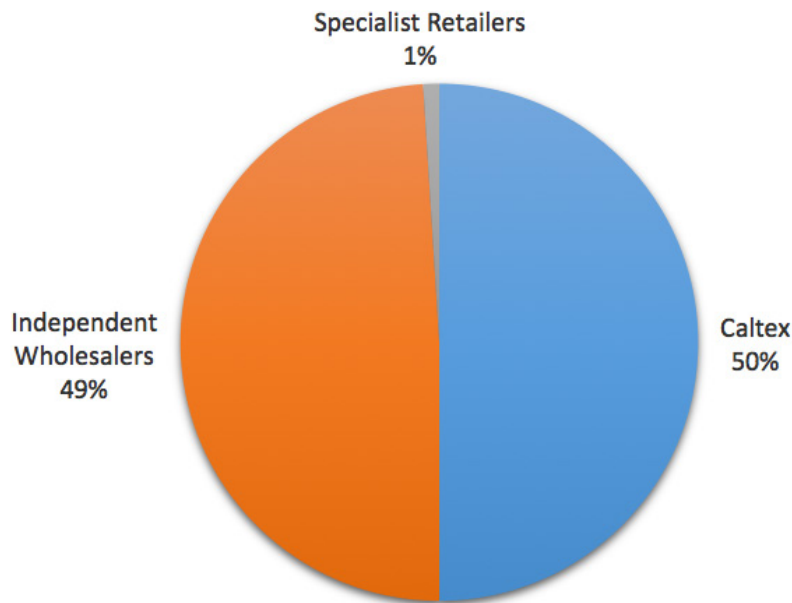


Figure 10: Use of Commission Agent models for retail fuel sales in Australia by retail brand (ACCC, 2014)

The principal difference between a franchise site and a Commission Agent is that the Commission Agent is not required to purchase the fuel. Rather, the fuel supplier delivers the fuel and the Commission Agent is paid a commission for each litre of fuel sold.

As a result, the Commission Agent model provides the fuel supplier with control over the setting of the retail price of transport fuels.

In 2015, approximately 14% (or 896) of the service stations in Australia were operating as Commission Agents.



4. LEGISLATIVE & REGULATORY DEVELOPMENTS

New Biofuel Mandates (NSW & QLD)

Over the past 12 months, the NSW and QLD governments have passed new legislation mandating the sale of ethanol-blended petrol by fuel retailers.

At the time of writing this report, the detail of the new Regulations - including the criteria for providing individual businesses with exemption from the mandate - were still being developed and therefore the likely impact on fuel retailing businesses in both states is still subject to a degree of uncertainty.

Nonetheless, both State Governments propose to introduce the new laws from 1 January 2017 and fuel retailers in these States should be investigating the scope and cost of the works required to make their retail sites compatible with the storage and sale of ethanol blended fuel - with a view to either financing these improvements or seeking exemption from the new laws.

ACAPMA has prepared a guide on how to prepare for the introduction of these new laws and these guides can be found at: http://www.acapma.com.au/wp-content/uploads/2016/04/ACA094_how_to_guide_NSW.pdf (for NSW Retailers), and: http://www.acapma.com.au/wp-content/uploads/2016/04/ACA094_how_to_guide_QLD.pdf (for QLD Retailers)

Fuel Check Regulation (NSW)

In March 2016, the NSW State Government passed a new law that will require all fuel retailers to advise the NSW State Government every time they make a change to retail fuel prices on their forecourt.

This new law is expected to come into operation in July 2016 and all NSW fuel retailers are required to provide basic business and contact information to NSW Fair Trading by 30 June 2016.

Further information on the operation of this law and details of the information requirements can be found at: http://www.fairtrading.nsw.gov.au/ftw/Businesses/Specific_industries_and_businesses/Biofuels_industry/Service_station_data_collection.page

Fuel Price Boards (QLD, TAS & VIC)

The Victorian Government recently announced its intention to introduce new laws governing the operation of fuel price boards for all fuel retailers in that State. The new laws are consistent with those operating in South Australia and, while not requiring installation of a fuel price board at all sites, will prohibit the display of discounted fuel prices.

The detail of the Victorian laws are current being developed and are scheduled to come into operation in November 2016 and further information can be found at: <http://acapmag.com.au/home/2016/02/new-price-board-regulations-for-victoria-2/>

Shortly after the Victorian Government decision, the Tasmanian and Queensland State Governments announced that they would also be investigating the merits of passing similar laws in their own states - but these investigations have not yet been completed.



Fuel Price Disclosure (NT)

In February 2016, the Northern Territory (NT) Government announced plans to introduce new fuel price disclosure laws for all fuel retailers operating in the Territory.

The proposed laws will require all fuel retailers to regularly report revenues and profits from fuel sales to the Government, with fines of up to \$60,000 for retailers who fail to comply.

The laws have not yet been passed by the NT Parliament and it is unclear if and when the new laws will come into operation.

Regional Fuel Price Studies (NSW, QLD & TAS)

The Australian Competition and Consumer Commission (ACCC) published the first of its Regional Petrol Market Studies in November 2015. This study of petrol price in Darwin was the first of five 'deep dive' petrol market studies announced by the ACCC in March 2015.

It is understood that Regional Market Studies for Launceston (TAS) and Armidale (NSW) will be published in July and August 2016.

The ACCC has announced that the fourth study will examine the petrol market in Cairns while details of the fifth and final study have not been announced.

Vapour Recovery - Stage 2 (NSW)

All fuel retail sites in Greater Sydney (i.e. Sydney, Illawarra, Lower Hunter and Central Coast) selling more than 0.5 ML of petrol per year were required to comply with Vapour Recovery Stage 1 (VR1) regulations by 1 January 2015.

Businesses operation retail fuel sites in Sydney that sell more than 3.5 ML of petrol per year will be required to be compliant with Vapour Recovery Stage 2 (VR2) requirements by 1 January 2017.



5. NEAR-TERM BUSINESS CHALLENGES FOR FUEL RETAILERS

Funding of New Compliance Costs

During the 2016/17 financial year, new regulations in the east coast states (i.e. QLD, NSW and VIC) will be required to make new capital investments to comply with new biofuels laws (QLD and NSW), new fuel price boards (VIC) and VR2 equipment (NSW).

The introduction of these new laws will place significant demands on the capital reserves of many fuel retail businesses - and/or require new business borrowings - unless these businesses are able to secure exemptions.

The short time frame afforded for implementation of these regulations - particularly the biofuels regulations in NSW and QLD - effectively concentrates the demand for capital investment, at a time when most businesses are seeking to rebuild their capital reserves following more than a decade of intense retail market competition.

As a consequence, fuel retailers in NSW and QLD are likely to come under significant pressure over the next 12 months.

Increasing Competition in the Convenience Segment

Industry feedback suggests that competition in the convenience segment of the retail fuel market has intensified over the past six months, with many retailers and buying groups adapting their business strategies in an attempt to counter the significant buying power of the supermarket chains.

This competition is expected to continue into the 2016/17 financial year, placing increased pressure on revenues and profits from convenience store sales.

FURTHER INFORMATION

Further information about this publication can be obtained by contacting the ACAPMA Secretariat on 1300 160 270 or emailing your inquiry to communications@acapma.com.au.

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