

# Low Carbon Growth Plan for Australian Retailers

## Financial implications for retail businesses

### Background

NAB has teamed up with award-winning sustainability think tank ClimateWorks to investigate the financial implications of energy efficiency opportunities for the retail sector. The ClimateWorks report makes several energy efficiency recommendations for retailers and is available at [nab.com.au/institutional](http://nab.com.au/institutional).

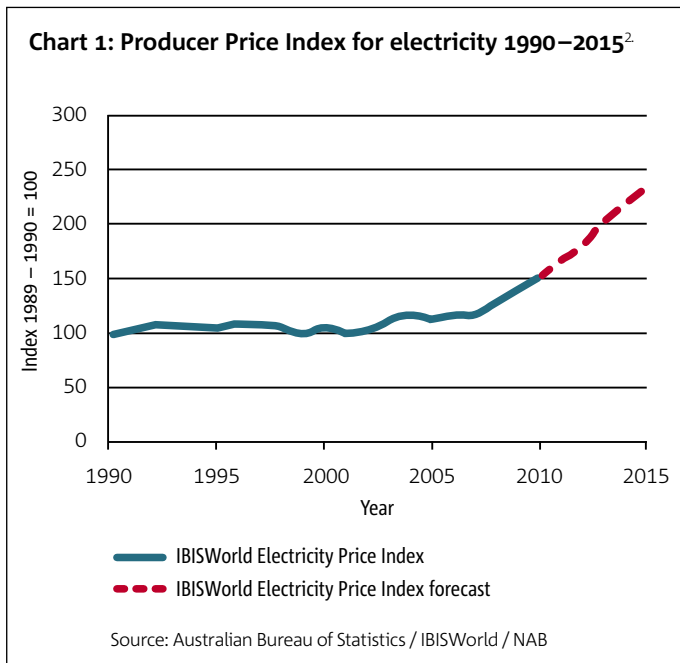
This summary takes the findings one step further and looks at the circumstances of 40 percent of the ASX 200 retail consumer sector, their most recent financial statements and analyst forecasts. It draws on this information and models the financial impact of an energy efficiency investment program on their operations.

### Key findings

- Making the energy efficiency changes in the ClimateWorks report could:
  1. **Save retailers around \$1 billion** annually by 2020.
  2. **Add 3-14 percent to EBIT** – equivalent to \$2 billion revenue growth for major retailers.
  3. Produce improved performance equivalent to revenue growth of **2.1-5.5 percent, five times** historical growth rates for the retail sector.
  4. Realise retailers' annual **return rates** of between 15 and 38 percent on energy investments.
- The value of these cost reductions will increase over time as electricity prices rise.

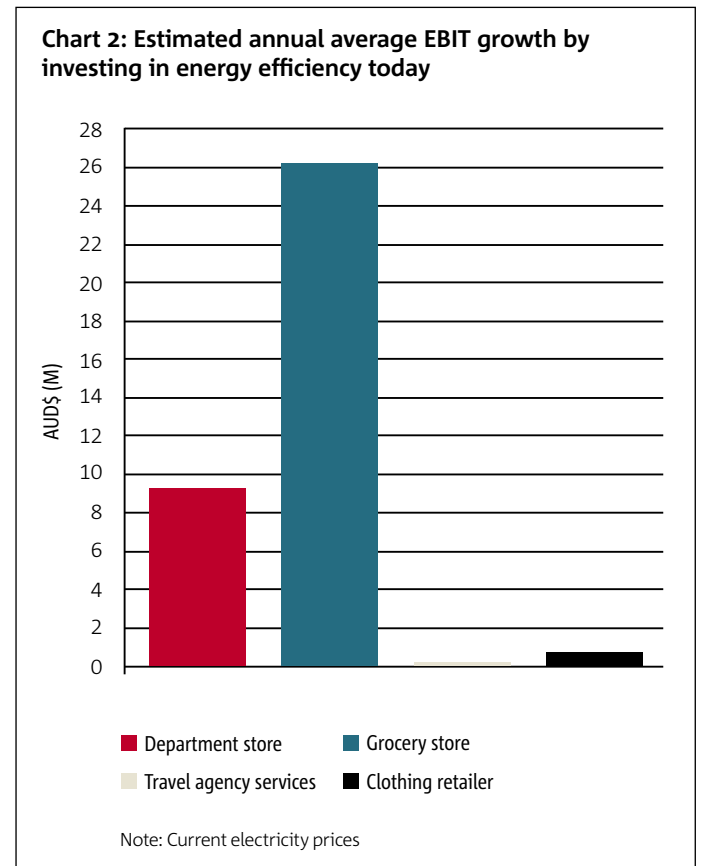
## Electricity prices

- Dramatic electricity price increases are expected, with the need for major infrastructure investment driving up electricity costs.
- **Chart 1** shows electricity prices were stable across Australia throughout the 1990s and early 2000s but over the past four years, electricity prices have increased by 30 percent, or four times the rate of inflation.<sup>1</sup>
- This trend is expected to accelerate, with commentators predicting a potential doubling or even tripling in electricity prices over the next ten years.



## The financial impact of energy efficiency

- Energy efficiency opportunities can make a material contribution to the EBIT growth of retail companies. In fact, a reallocation of capital towards energy efficiency technology could deliver annual savings that may be more significant for a business's overall performance than hitting forecast growth numbers.
- The best opportunities are in grocery and department stores, largely due to their significant floor area and low margins.
- **The EBIT growth opportunity**
  - ClimateWorks' analysis has uncovered potential gross annual energy savings (excluding upfront costs) ranging from \$75 million for grocery and department stores to \$2.4 million for clothing and travel businesses. On a net basis<sup>3</sup>, this translates to energy savings in a range from \$56 million to \$0.4 million.
  - NAB's analysis shows that given current electricity prices there is a solid business case to pursue these headline opportunities. At current electricity prices<sup>4</sup> the energy savings achieved could produce EBIT growth of between \$0.2 and \$26 million for the companies examined (see **Chart 2**).



1. Energy market outlook – Presentation to Multi-Party Climate Change Committee, November 2010.

2. IBISWorld – Electricity service price in Australia, 7 October 2010. NB: the Producer Price Index is based on prices received by electricity suppliers into the manufacturing sector.

3. A similar dataset is not available for the retail sector; however, our work with retail companies suggests that the PPI is representative of the broad trend they have been exposed to.

4. Assuming a cost of capital of 11 percent and depreciation over the life of the relevant asset.

5. Assuming the average retailer's cost of electricity is \$80 per MWh.

• **Potential for upside as prices rise**

- If electricity prices are to double as forecast by 2015, investments in energy efficiency will be even more compelling: those that have already started down this path will have a powerful advantage over their counterparts. And in a market of ever shrinking margins and intense competition, this advantage will become increasingly apparent.
- The significant benefits of energy efficiency opportunities are particularly acute in department stores, where these opportunities could deliver the equivalent of revenue growth five times greater than forecast for 2011–2016. **Chart 3** shows the increased revenue growth required<sup>5</sup> to produce equivalent EBIT uplift from energy efficiency.
- A reallocation of capital towards energy efficiency technology could deliver annual savings that may be more significant for businesses’ overall performance than hitting forecast growth numbers.

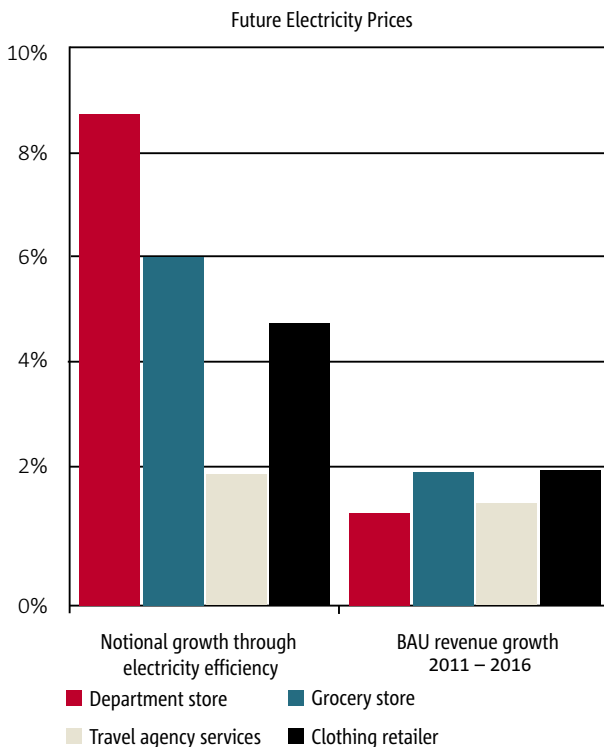
**Capturing the EBIT growth potential will require a boost to CAPEX or shift in spending priorities**

Securing the EBIT growth potential will require significant investment.

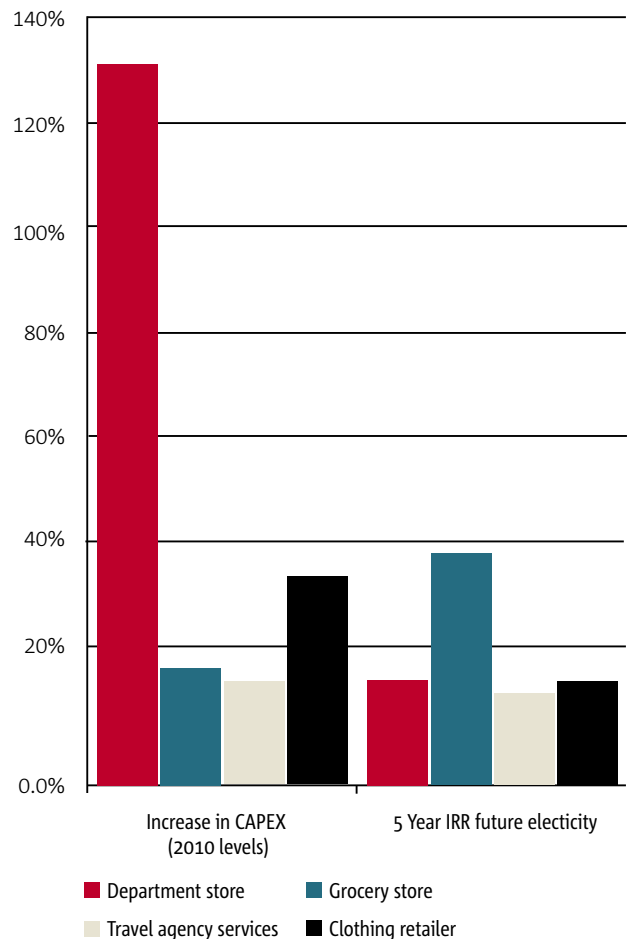
Findings highlight that the capital expenditure required to secure the energy efficiency savings varies significantly between the industries examined relative to current capital expenditure levels.

These investments will generate a 12 percent to 38 percent rate of return over five years (**Chart 4**). In payback terms, the investment is recovered within as little as three years at electricity prices of \$157/MWh.

**Chart 3: Notional growth from energy efficiency vs projected growth under BAU (Future electricity prices) from 2011–2016**



**Chart 4: Increase in current CAPEX required to realise energy savings and 5 year IRR on CAPEX investment with a future electricity price of \$157 per MWh**



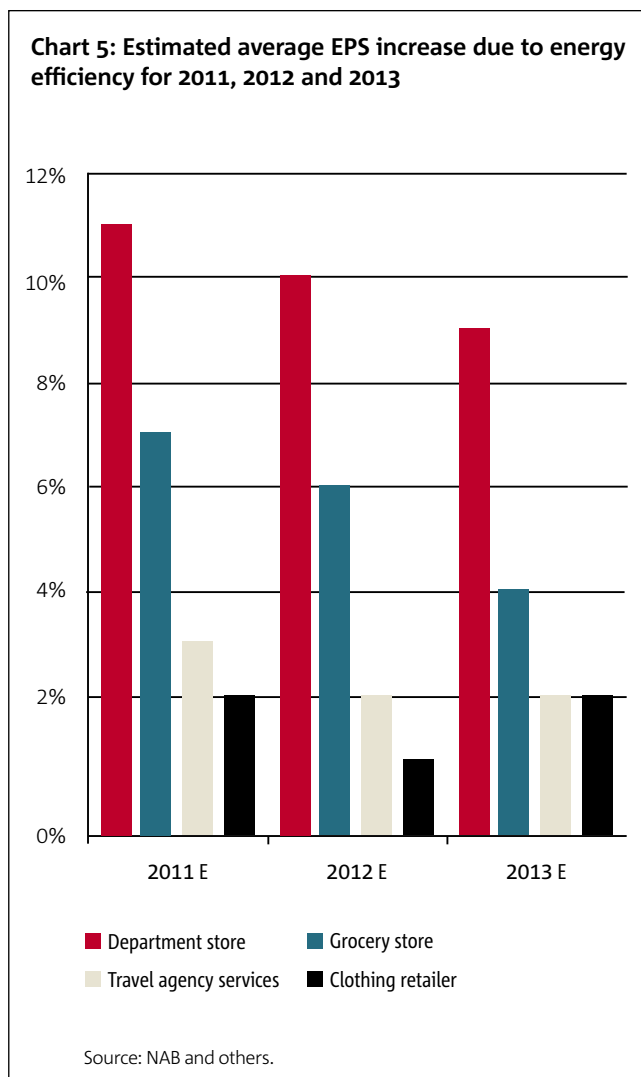
5. Electricity price of \$157 per MWh per ClimateWorks.

## The best opportunities are in grocery and department stores

Within the retail sector, the best opportunities are in grocery and department stores.

The combination of low margins, large floor space and modest revenue growth potential in these two subsectors makes cost savings particularly attractive.

Energy efficiency savings could translate into strong improvements in earnings per share between 2011 and 2013,<sup>6</sup> as **Chart 5** shows.



## Financing options available

NAB is committed to supporting retailers that wish to facilitate opportunities to decrease energy consumption to realise cost reductions, and has a range of general funding options available.

Specialist asset finance is also available to help fund energy-efficiency equipment to lower energy costs and reduce upfront capital expenditure.

It's also important for retailers with properties in the Melbourne CBD and New South Wales to note local councils are changing regulations to allow property owners to fund upgrades through the Council rating system.

## Contact

To learn more about how your organisation can benefit from energy efficiencies, please speak with:

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6. The EPS growth figures were determined by applying the annual energy savings to each business's income statement and determining the change in EPS via the forecasted data from equity research reports for 2011, 2012 and 2013.