WOW OR WES? AND THE AWARD FOR MOST UNDERPAID EMPLOYEES GOES TO…

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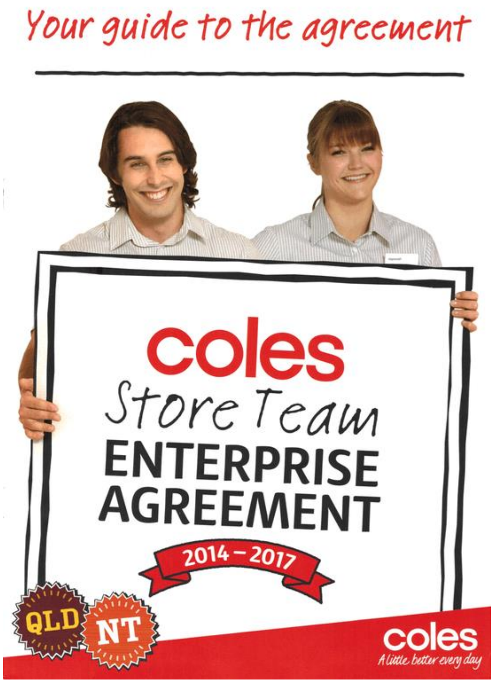
It was just over a year ago that we heard Coles admit to the Fair Work Commission that as much as 60 percent of its workforce would be better off under the award – the minimum employee wage and benefits mandated by the state. The source of underpayment was the company's cosy Enterprise Bargaining Agreement (EBA) struck with the Shop, Distributive & Allied Employees Association (SDA), Australia's largest union for workers in retail.

Under the SDA deal, Coles employees were eligible to an hourly wage rate that exceeded the minimum award rate – sounds great so far – but at the cost of severely slashing, or even completely removing, penalty rates – not so good. **In aggregate, this arrangement cost Coles employees over $50 million a year in wages!** The agreement clearly failed the "Better Off Overall Test", a measure to ensure that any EBA offers a combination of pay and benefits that is better than the award.



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But the buck didn't stop here; an investigation by Fairfax Media revealed that the SDA had struck similar deals with the likes of KFC, Hungry Jacks, and Australia's two largest employers, Woolworths and McDonald's. **Across these five industry leaders, over 250,000 Australian employees were receiving worse payment than the minimum award.** To make matters worse for these culprits, the Fair Work Commission has also implemented a 3.5% national wage increase starting from July 1st 2018.

Coles has since inked a new deal with its employees that was accepted this February. The new agreement, which entitles employees to penalty rates, shift rates, free uniforms and pay rises, could add as much as $100 million in incremental cost to an already rapidly growing employee benefits expense line. Coles flagged the new agreement in their FY18 outlook, framing it as a 'deliberate decision to invest in team members for the long term'.

For Australia's biggest employer, Woolworths, the penny is yet to drop. **According to the Retail and Fast Food Workers Union (RAFFWU), the union that exposed the unfair Coles-SDA deal, Woolworths employees are being paid even less than their Coles counterparts were under the old deal.** Woolworths last renegotiated its enterprise bargaining agreement more than two years ago, with a new agreement currently in negotiation. Given the level of scrutiny placed on Coles by the Fair Work Commission, you can expect a severe increase in wage and benefits for the alleged 2/3 of Woolworths employees who are being

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underpaid. With penalties and other benefits reinstated, and a 3.5% increase to those employees on minimum wage, we estimate a step in employee benefits for Woolworths of well north of $180 million, or a c.7.7% hit to EBIT all else being equal.

Wage increases aren't unusual in the course of business and there are generally two ways to offset their impact on margins; improving productivity and increasing prices. **Using CODB/Sales as a proxy for productivity, and you can see that Woolworths productivity has been in decline in recent years; CODB/Sales has increased from 20.9% in FY14 to 24.5% in FY17, a 17% decrease in productivity.** On the pricing front it seems as though Woolworths is shifting away from the price war mentality of the past, instead focusing on quality of service and product. But given the ever-increasing competition in the sector, only time will tell whether this move will be enough to save margins.

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