

## Appendix E: Margins methodology

- E.1 This appendix sets out our methodology for calculating gross profit margins for:
- (a) manufacturers; and
  - (b) retailers.

### Methodology for calculating manufacturers' profit margins

E.2 We requested data necessary for the calculation of gross profit margins from manufacturers of the following types of formula milks in the UK:<sup>1</sup>

- (a) Infant formula
- (b) Follow-on formula
- (c) Growing-up milk; and
- (d) Special milks.

E.3 The data was provided on a monthly basis for the period January 2019 through to May 2024.

#### Revenue data

E.4 We requested 'product-specific' revenue data from each manufacturer.<sup>2</sup>

E.5 One manufacturer told us that our definition of revenue could exclude some transactions which have been recorded as trade support<sup>3</sup> but are closely connected to product sales. This is because rebates and trade support are not recognised accounting metrics in their own right. These metrics (and hence 'product-specific revenue') may be defined differently within and/or between different manufacturers' revenue data.

E.6 By contrast, another manufacturer told us that its accounting systems do not yet apply trade support by stock keeping unit. Therefore, its apportioning of trade support is 'fairly arbitrary from a systems point of view'.

E.7 One manufacturer recommended that we view its data over a lower frequency than monthly in order to deduce trends. This is because its monthly data could

---

<sup>1</sup> We requested data from the five largest manufacturers: Danone, Kendal, Nestle, HiPP, and a contract manufacturer [redacted].

<sup>2</sup> 'Product-specific revenue' means revenue entitled to be received in exchange for each unit of product (including any refunds, discounts, volume-based rebates, price concessions, credits, incentives or similar items, provided that they are directly attributable to the exchange of a particular unit of product).

<sup>3</sup> For example, payments by manufacturers to retailers to support them drive consumer purchases through staff training, better product placement or marketing activities.

include accruals and subsequent reconciliations based on its actual sales volumes and spending.

### *Our approach*

- E.8 We take into account that it may not always be clear cut whether some transactions meet our definition of 'product-specific revenue'. However, because the definition is narrow<sup>4</sup> and these transactions are likely to be manual and infrequent in nature,<sup>5</sup> we do not consider that they will materially affect our calculations.
- E.9 We note that there is a possibility that some manufacturers' product-specific revenue includes some transactions which, by their nature, do not follow the 'matching principle'.<sup>6</sup> We have mitigated the potential impact of these transactions on our calculations by calculating gross margins on an annual basis (see paragraphs E.15 to E.17 below).

### **Cost of goods data**

- E.10 We requested variable cost of goods data<sup>7</sup> and a breakdown of the following variable components:
- (i) Raw material costs;
  - (ii) Labour costs; and
  - (iii) Packaging costs.
- E.11 One manufacturer told us that there was not a simple approach to providing a breakdown of its standard cost price. In particular, instead of providing its variable labour costs, it could only provide a broader category of 'industrial costs', which includes plant and machinery, quality assurance, and labour costs allocated to products on the basis of volume produced for its UK customer business unit'.

---

<sup>4</sup> For example, the definition of 'product-specific revenue' excludes transactions relating to brand building activities which aim to increase a manufacturers' market presence, such as in-store displays.

<sup>5</sup> By 'manual', we mean negotiated and recorded on an individual basis rather than through an automated sales process.

<sup>6</sup> The 'matching principle' is an accounting concept that involves matching costs with corresponding revenues in the same accounting period.

<sup>7</sup> Variable cost of goods data means costs which relate to the exchange of each unit of product.

### *Our approach*

- E.12 We note that manufacturers' variable cost of goods data could include some costs which are non-variable in nature<sup>8</sup> and/or costs which have been allocated to specific products using a degree of judgement.<sup>9</sup>
- E.13 In addition, we observe that several manufacturers have international operations and record transactions in foreign currencies which have been converted into pounds sterling.
- E.14 We have therefore placed less weight on comparisons between the level of manufacturers' gross margins than we have on how manufacturers' gross margin trends over time and their spreads.

### **Calculation of manufacturers' gross margins**

- E.15 The annual gross margins generated, in aggregate across all manufacturers weighted by revenue, across the markets for the supply of infant formula and follow-on formula, have been calculated as:
- The sum of annual product-specific revenues generated by all of the manufacturers in the relevant market after deduction of the manufacturers' corresponding annual variable cost of goods, divided by the sum of annual product-specific revenues generated by all of the manufacturers in the relevant market.
- E.16 The annual gross margins generated by each brand, weighted by revenue, across the markets for the supply of infant formula and follow-on formula, have been calculated as:
- The sum of annual product-specific revenues generated by a particular brand in the relevant market after deduction of the brand's corresponding annual variable cost of goods, divided by the sum of annual product-specific revenues generated by the brand in the relevant market.
- E.17 The annual gross margins generated by each brand's most popular (by revenue) 800g or 900g powder products across the markets for the supply of infant formula and follow-on formula, have been calculated as:
- The sum of annual product-specific revenues generated by each brand from the supply of the 800g or 900g powder in the relevant market after deduction of the brand's corresponding annual variable cost of goods, divided by the

---

<sup>8</sup> For example, supervisors' salaries.

<sup>9</sup> For example, costs may be allocated evenly across a range of products rather than on the basis of volume sales, or they may be recorded at a single point in time rather than being matched against particular sales.

sum of annual product-specific revenues generated by each brand from the supply of the 800g or 900g powder in the relevant market.

## **Methodology for calculating retailers' profit margins**

E.18 We requested data necessary for the calculation of gross profit margins from retailers in the UK<sup>10</sup> for the following types of formula:

- (a) Infant formula;
- (b) Follow-on formula;
- (c) Growing-up milk; and
- (d) Special milks

E.19 The data was provided on a monthly basis for the period from January 2019 through to May 2024.

### **Revenue and cost of goods data**

E.20 We requested details of retail sales revenue and variable cost of goods data.<sup>11</sup>

E.21 We calculated retailers' gross margins using the variable cost of the finished goods after deduction of any offsetting amounts (ie discounts, rebates and other similar items).

### **Calculation of retailers' gross margins**

E.22 The annual gross margins generated, in aggregate across all retailers weighted by revenue, across the markets for the supply of infant formula and follow-on formula, have been calculated as:

- The sum of annual retail sales revenues generated by all of the retailers in the relevant market after deduction of the retailers' corresponding annual variable cost of goods, divided by the sum of annual retail sales revenues generated by all of the manufacturers in the relevant market.

E.23 The annual gross margins generated by each retailer, weighted by revenue, across the markets for the supply of infant formula and follow-on formula, have been calculated as:

- The sum of annual retail sales revenues generated by a particular retailer in the relevant market after deduction of the retailer's corresponding annual

---

<sup>10</sup> We analysed data from [X] retailers: [X].

<sup>11</sup> 'Variable cost of goods data' means costs which relate to the exchange of each unit of product.

variable cost of goods divided by the sum of annual retail sales revenues generated by the retailer in the relevant market.