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Lodgement of Open Briefing®

Wesfarmers Limited
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Title: Open Briefing®. Wesfarmers. MD on 9% Profit Rise

Record of interview:

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Wesfarmers Limited announced a 9% increase in net profit to $618 million for the year to June 30, 2005 compared with $569 million in FY04 (excluding the profit on sale of Landmark). Earnings per share of $1.88 (before goodwill amortisation) was up 8%. Can you explain the main influences on the profit increase?

MD Richard Goyder
We had an increase in earnings of 33% from the energy division primarily due to increases in export coal prices, which impacted both Curragh and Bengalla, and a very strong performance from our LPG business due to high LPG prices. We also had record earnings from insurance after a full year contribution from the Lumley companies and a very strong underwriting performance with a Combined Operating Ratio of 85.9%. We had another strong performance from hardware with earnings up 9%, notwithstanding a weakening retail environment, and earnings from chemicals and fertilisers were up 4% making it five years in a row of increased profits from that division.

The overall profit increase was after a reduction in earnings from the Gresham Private Equity Funds which made a small contribution compared with some $51 million after tax last year.

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Directors declared a fully-franked dividend of $1.27 per share bringing the total dividend for the year to $1.80 per share, an increase of 29%. The total dividend

for the year represents 110% of net profit after tax (after goodwill amortisation). Can you clarify why dividends are up so much relative to earnings per share? With reference to franking credits, what payout ratio could we expect this year?

MD Richard Goyder

The total dividend of $1.80 per share represents 110% of net profit after tax (after goodwill amortisation), but just to clarify, it is less than 100% of our profits on a pre-goodwill basis. Earnings per share was $1.88 before goodwill amortisation.

Having said that, our dividend policy is to pay out franking credits as quickly as we can because franking credits have value to our shareholders. The final dividend of $1.27 per share reflects our strong cash flows and our franking credit position.

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In FY05, the replacement and expansion capital expenditure was $465 million and you're budgeting for $909 million in FY06 including $407 million for energy, $301 million for hardware and $134 million for chemicals and fertilisers. Can you give more detail on the main areas for budgeted capital expenditure?

MD Richard Goyder

The budgeted capital expenditure of $909 million for FY06 includes a number of items yet to be approved. It's our forecast at the moment. Within energy, the main areas of budgeted expenditure are: over $260 million at Curragh North which is mainly related to the conveyer from Curragh North to the main Curragh processing facility; an additional $40 million at Curragh; around $50 million at Premier, mainly on fleet replacement and upgrades; and around $40 million in gas and power mainly within enGen, which builds and operates remote power stations. In Hardware, we've budgeted for just over $170 million for constructing new stores and acquiring land. The 25 to 30 store upgrades should require around $50 million and about $25 million is budgeted for our new IT systems project. There's also replacement capital of around $50 million in Hardware.

If we proceed with the ammonium nitrate expansion within CSBP, around $100 million should be spent in the current financial year and the remainder the following year.

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You took over as MD in mid July 2005. Do you expect to introduce any significant changes to the corporate growth strategy? Michael Chaney commented that Wesfarmers now has a program looking to establish a business overseas. Can you give any more detail?

MD Richard Goyder

Our growth strategy has been consistent for some time. That is, to run our existing businesses as best we can with a focus on best practice and, where they are operating well, to look at growth opportunities. Our budgeted capital program for the coming year and the capital expenditure for last year reflects that. The third part of the strategy has been to manage our asset portfolio in a way that maximises total shareholder returns.

We'll continue with those generic strategies and we'll move on opportunities as they arise if they're good for our shareholders, including going offshore.

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Can you summarise the major balance sheet and profit and loss impacts you expect from adopting International Financial Reporting Standards?

MD Richard Goyder
The major balance sheet impact relates to the de-recognition of our employee share plan which will reduce share capital by around $215 million. Then there's the recognition of mine and plant rehabilitation costs which will result in the reduction of retained earnings by $56 million and the write back to retained earnings of goodwill amortisation for the past financial year of $90 million. The adoption of hedge accounting and changes to accounting for investments from 1 July 2005 will result in an increase of approximately $100 million in equity reserves.

The major impacts on the profit and loss statement are that we will cease to amortise goodwill which was around $90 million in FY05 and we'll also be recognising expenses relating to the company's employee share scheme. In FY06, because there's a vesting of shares, we estimate the expense from the share scheme will be $5 million, $12 million in the following year and $20 million in the year after. They are all pre-tax numbers.

Hardware

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Earnings before interest, tax and goodwill amortisation (EBITA) from the Bunnings hardware business increased by 9% to $418 million. Can you describe conditions in your major markets over the year? What progress are you making in improving your business in New South Wales and Victoria?

MD Richard Goyder
On the retail side, overall trading performance was strongest in New Zealand, Queensland and Western Australia. In the trade sector, all markets except New Zealand and Western Australia were difficult.

In New South Wales a significant focus for us has been on building the team within the store network and in upgrading stores through our refurbishment program. Next week we'll open our Vermont South store in Victoria which we think is the largest warehouse in the southern hemisphere. We have developed a number of product and service initiatives in that store which will be progressively introduced into our network of stores.

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For FY05, underlying store-on-store cash sales growth was 5.6%, but you stated that there were more subdued retail hardware conditions across Australia in the second half and that trend has continued into July. Can you outline the ongoing initiatives to improve operating efficiencies across the business?

MD Richard Goyder
Cash sales growth from the first half of the year was 6.6% but that slowed to 4.4% for the second half. Our focus is firmly on driving sales growth. To do that, we're enhancing and expanding the product range and services offered and we're continuing to set market-leading prices for our customers. We'll also continue to support the lowest price position by improving the efficiency of our business processing systems and our supply chain.

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New warehouse development is forecast to continue at between 10 to 14 stores per year (10 in FY05) and you expect to refurbish or upgrade between 25 and 30 stores in FY06 (16 in FY05). What are the most common sizes of new warehouse stores and in which states do you expect the most growth in new stores and refurbishments?

MD Richard Goyder
It's important to note that the roll out program in any period can fluctuate because of the uncertain nature of sourcing new sites and planning approvals. That said, in the coming financial year we plan to open three or four of the smaller 3000 series stores and at least four of the 8000 and 9000 series size stores. Planned new store openings will be spread across the network. The largest numbers of refurbishments are planned for our NSW/ACT network.

Energy

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EBITA from Wesfarmers' energy business increased by 33% to $319 million. For FY05, coal sales were 4.6mt of coking and 2.5mt of steaming at Curragh, 2.2mt of steaming at Bengalla (40% interest) and 3.3mt of steaming at Premier. What coal production and sales across your three operations do you expect in FY06? Can the mining, rail and port infrastructure at Curragh comfortably support that target?

MD Richard Goyder
We haven't disclosed our forecast production or sales volumes other than the export coking coal sales target of 7 million tonnes from Curragh. We have contracted capacity with both Queensland Rail and the Central Queensland Port Authority to handle 7 million tonnes at Curragh this year. Achieving that target will require consistent high levels of performance at the mine, rail and port facilities.

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Earnings at Bengalla were up 178.5% on slightly lower sales volumes while earnings at Curragh were up 51% on slightly higher sales volume. Can you explain the large increase in earnings at Bengalla, particularly relative to Curragh?

MD Richard Goyder
Bengalla's earnings benefited from increases in export volumes and export prices and it sold more of the higher priced export coal and less of the lower priced domestic coal. Curragh export sales volumes were similar to last year and the earnings increase came from the higher export prices in the last quarter.

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From 1 July 2005, producers of gas into the DBNGP will no longer be required to ensure a minimum LPG content. In FY05, export sales volumes from the Wesfarmers LPG extraction facility at Kwinana fell by 10% to 199,000 tonnes. When do you expect to have a reasonable understanding of LPG content and therefore production for this year? Can you outline progress on the alternative arrangements that you're pursuing to lift future LPG production?

MD Richard Goyder
It'll probably take some months to fully assess the LPG content. However, early indications are that the LPG content will be significantly below last year's average because year to date levels are around half the average of last year. We will continue to pursue additional arrangements for supply consistent with our objective of maximising production.

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You've stated that the key areas of focus for the energy division in FY06 will be on improving existing operations. What are some of the strategies to do that?

MD Richard Goyder
The major focus for the year will be on achieving the targeted 7 million tonnes of export sales from Curragh. In addition, we want to optimise our operational performance, productivity and unit costs, improve our sales mix and enter new sales markets.

Insurance

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EBITA from Wesfarmers Insurance Division was $139 million which you described as a result way ahead of expectations. Can you maintain that performance? How are market conditions changing and what impact is that having on your business?

MD Richard Goyder
Wesfarmers Federation Insurance and Lumley have historically been at the upper end of the market in terms of financial performance and at the lower end of market in terms of Combined Operating Ratio. Those businesses have consistently made underwriting profits and that will continue to be their focus.

Market conditions in the insurance industry are certainly more difficult than they were 12 months ago with evidence of greater competition and some competitors chasing market share. Against this background, growth should be more difficult to achieve and we will concentrate on maintaining and servicing the profitable segments of our business.

corporatefile.com.au
June is usually a busy period for insurance companies because a lot of policies are renewed. How has WID fared with client retention? What impact has competition had on margins?

MD Richard Goyder
We retained a high percentage of our June renewals although, in many cases, we had to reduce our premiums. Reductions were in the order of 10% although some individual accounts recorded greater reductions. Margins will therefore be affected, but will be partly offset by efficiency gains in other parts of the business.

Industrial & Safety

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EBITA from the industrial and safety businesses decreased by 2% to $110 million. Can you report on any findings of the external review of the industrial and safety business? Is an improvement in margins realistic?

MD Richard Goyder
The review conducted by Port Jackson Partners concluded that the general business model is sound. However, there is scope for improvement including expanding our import program and making changes to our logistics model. These improvements will take some time to flow through.

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The performance of the Protector Alsafe business in Australia and the Blackwoods Paykels business in New Zealand were lower than expected. Why do you expect these businesses to improve?

MD Richard Goyder
We've stabilised Protector Alsafe and it is now performing better. We expect further improvements as we hopefully win back business that we lost a year or so ago when it comes up for renewal. We feel that we'll be in a better position to win some of that back.

Blackwoods Paykels has been through a significant integration program including transferring to new IT systems, but that is pretty much behind us and we're looking forward to a focus on building the revenue base of the business again.

Chemicals & fertilisers

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EBITA from the fertiliser and chemicals business segment increased by 4% to $89 million. Revenue from chemicals was up 10% and revenue from fertilisers was up 16%. Given the boom mining conditions and an improvement in seasonal conditions for fertilisers, did you regard the earnings result as disappointing?

MD Richard Goyder
We're actually very pleased with the performance of chemicals and fertilisers. It was CSBP's fifth consecutive year of improved earnings. The majority of production from CSBP's chemicals business is sold under long term contracts so the opportunity to achieve increased prices is limited and the plants have been performing at capacity for the last two years which also limits the potential for volume increases.

In fertilisers, sales volumes increased by 5% over the previous year. The rain in June impacted sales in what is traditionally our highest volume sales month.

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The Oslo-based explosives manufacturer Dyno Nobel is being sold. Wesfarmers has some long term off-take contracts and a joint venture with Dyno in Queensland Nitrates. What are the implications for Wesfarmers from the sale of Dyno?

MD Richard Goyder
Our off-take contracts will not be affected by the potential sale of Dyno Nobel and the sale process really has no impact on the operations of the QNP joint venture or the potential capacity increases of that facility.

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What's the status of the possible expansions of your ammonia nitrate plants at Kwinana and the Queensland Nitrates Project JV? Does it look like you'll secure adequate off-take contracts for the additional capacity?

MD Richard Goyder
We're nearing completion of the feasibility study for the expansion at Kwinana. There are a few commercial details to be finalised which would then satisfy us in terms of having adequate off-take contracts. Subject to finalising those agreements and getting board approval, we're anticipating construction to commence later this year with plant commissioning in mid 2007.

At QNP we're in the pre-feasibility stage and we're talking to our customers about potential off-take arrangements. We'll make a decision whether to proceed to a full feasibility study in the first half of this financial year.

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Thank you Richard.

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