Wesfarmers Limited
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NEWS

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WESFARMERS REPORTS STRONG FIRST HALF RESULT

The directors of Wesfarmers Limited today released the company's results for the half year ended 31 December 2000. On a normalised basis, net profit increased 25 per cent over the previous period to $111.8 million. The actual reported operating profit after tax increased 12 per cent from $100.1 million to $111.8 million, the lower increase reflecting the fact that the profit for the previous period included an abnormal gain of $10.3 million arising from the change in the corporate tax rate. Under new accounting standards, such abnormal items are no longer differentiated.

The most recent half year's result included profit on the sale of non-current assets of $3.3 million which compares with $13.5 million earned in the same period last year. At a divisional EBIT level, group profit rose a pleasing 35 per cent.

The result was achieved on operating revenue of nearly $2.0 billion which was 21 per cent higher than last year's $1.6 billion.

A significant factor in the growth was the inclusion, for the first time, of the result of the Curragh coal mine in Queensland acquired just prior to the commencement of the half year. As detailed below, most other business units reported first half results ahead of the comparative period last year.

The group's reported earnings per share of 42.2 cents for the half year was 13 per cent above the 37.4 cents in the corresponding six months last year. After adjusting for the abnormal gain in the previous period, underlying earnings per share rose by 26 per cent. Cash flow per share of 71.6 cents was also higher than last year's 60.0 cents.

Hardware and forest products

Operating revenue of the hardware and forest products industry segment increased by 11 per cent to $820 million in the first half. Earnings before interest and tax of $86 million were 17 per cent higher than the $73.2 million earned in the corresponding period last year.

Hardware

The Bunnings hardware merchandising business recorded another robust performance in the first half with operating revenue of $706 million, 11 per cent above the comparative six months last year. The actual increase in revenue was 17 per cent after adjusting for the change of accounting treatment of GST compared to the wholesale sales tax system.

Underlying earnings growth was slightly higher than adjusted revenue growth. This result was particularly pleasing in the light of uncertain market conditions, particularly in the building industry. Revenue and profit growth have continued at a healthy level during January 2001.

During the first half, four new Bunnings warehouse stores were opened, expanding the national chain to 43. Warehouse stores accounted for 80 per cent of total Bunnings hardware sales. This is up from 77 per cent of total sales in the full 1999/2000 financial year, reflecting the strength of the Bunnings warehouse brand and concept. The introduction of seven day trading in Queensland from 1 July 2000 was also a positive factor for the seven warehouse stores currently trading in that State.

A further five warehouse stores are expected to be opened in the second half and the business is well placed to accelerate the number of new store openings over the coming years.

Forest products

Operating revenue of the forest products business in the first half was 13 per cent below the comparative period last year as a result of the sale of the woodchipping, plantation services and plantation assets to a subsidiary of Marubeni Corporation at the beginning of October 2000.

Whilst some improvement in results was achieved from the retained timber operations, overall earnings for the period were 19 per cent lower due to the divestments.

The Australian market was affected by the slow down in housing activity following the introduction of the GST but export sales increased by more than 40 per cent. Constrained Australian housing activity will impact on results for the second half of the year.

As foreshadowed in earlier reports apparent profit growth for the hardware and forest products segment as a whole will be modest over the full year. This will result from the loss of earnings for the last eight months from the sold woodchip and plantations business and from the pull-forward of earnings in the hardware business from the September 2000 quarter to the June 2000 quarter due to the GST introduction. As discussed above, however, the hardware operations individually are expected to produce good year on year growth in earnings.

Energy

The operating revenue of the energy industry segment increased by 67 per cent to $470 million in the first half. This was mainly driven by the inclusion of Curragh coal operating revenue for the first time, but gas operating revenue was also up by 38 per cent compared to the same period last year. Earnings before interest and tax of $92.4 million were 77 per cent higher than the $52.2 million recorded last year.

Gas

Domestic sales volumes of LP gas for the half year were 10 per cent above the comparative period last year. This strong sales performance reflects the improved business focus arising from the reorganisation of the Kleenheat Gas national distribution chain in late 1999.

The growth in sales volumes was largely offset by reduced margins flowing from significantly higher international benchmark prices and weak Australian currency. Kleenheat’s profit result was significantly below budget and only marginally above that of the previous corresponding period.

Conversely, earnings from export sales to Japan benefited from the same international price and currency factors. Export volumes were 31 per cent higher than last year, due to an additional shipment during the period.

The overall first half profit contribution from the group's gas activities was significantly above the comparative period last year and full year earnings are expected to reflect this robust first half performance.

Growth highlights included the LP gas plant expansion at Kwinana that was commissioned in December 2000 on time and on budget; successful integration of the recently acquired Shoal gas business in New South Wales; continued success with ProPlus diesel substitution; securing the LP gas supply to Woolworths' service stations nationally; and progress of the market entry project in Bangladesh. The Western Australian Government initiative to subsidise autogas conversions and the introduction of LP gas vehicles by Ford should deliver strong growth in this sector.

Coal

The coal interests of Wesfarmers Energy comprise open-cut operations at Collie in Western Australia's south-west, the recently acquired Curragh mine in Queensland's Bowen Basin and a 40 per cent interest in the Bengalla mine in the Hunter Valley in New South Wales.

The volume of first half coal deliveries from the Collie mine was seven per cent below the corresponding period last year due mainly to reductions in offtake from Western Power. Overburden removal was 14 per cent above last year and the profit contribution from the Collie operation for the period was eight per cent above the corresponding period last year.

Integration of the Curragh mine into Wesfarmers progressed smoothly, with all key staff retained and operational performance ahead of expectations. Earnings were significantly ahead of budget as a result of increased export volumes, prices and favourable exchange rates. Initial indications are that annual price renegotiations will reflect improved global supply/demand conditions and result in price increases that should underpin a strong full year result.

Bengalla sales volumes were ahead of budget and last year as the mine continues to ramp up to full production. Higher sales proceeds due to strengthening international prices for thermal coal combined with exchange rate benefits on export volumes to produce above budget earnings, which are expected to be sustained for the full year.

Development highlights include continued progress on quality and productivity improvements at Collie; granting of the Curragh East mining lease in November with commencement of mining in this area scheduled for September this year; and completion of the raw coal bypass facility at Bengalla together with commencement of engineering works for stage two of the main coal processing plant.

Fertilisers and chemicals

Operating revenue of $160 million of the group's fertilisers and chemicals business for the six months was 28 per cent higher than for the comparative period last year and earnings of $7.5 million compared to last year's $4.1 million. The low absolute level of these figures reflects the fact that 70 per cent of fertiliser sales occur in the second half of the financial year.

Total fertiliser despatches were 21 per cent above the corresponding trading period last year, mainly due to a carryover of demand to the first two months of the trading period and strong sales in November ahead of price increases which became effective late in that month. Demand for the remaining months was similar to last year.

Cropping and mixed farming enterprises continued to apply more nitrogen and potassium while the demand for superphosphate remained subdued. Firming international fertiliser prices, coupled with a significantly weaker Australian dollar throughout the critical procurement period led to higher domestic prices, which became effective from late November. Whilst most agricultural areas face challenging financial circumstances in light of reduced harvest outcomes, the recent improvement in commodity prices, particularly wool and beef, will provide some offset to potentially lower levels of overall demand in the coming six months.

Wesfarmers CSBP currently estimates that it will sell around 970,000 tonnes of fertiliser in the full year, which is about 120,000 tonnes below last year and 160,000 tonnes below the original budget for 2000/2001.

Overall sales volumes of the company's chemical products were some 43 per cent higher than in the corresponding period last year, mainly due to the commencement of contractual deliveries of ammonia.

The new ammonia plant at Kwinana has been operating with increasing reliability. After an extended shutdown in the September/October period to repair equipment, the plant has regularly achieved its nameplate capacity. That shutdown, however, necessitated an import cargo, supplied to customers at very low margins, with the result that EBIT from ammonia sales was about $5 million below budget for the period.

Sales of ammonium nitrate, including a small tonnage sold in liquid fertilisers, were stronger than in the previous corresponding period. Offtake of sodium cyanide increased by 14 per cent, despite the lack of development activity in the gold sector.

Joint venture operations at Queensland Nitrates were disappointing over the period. Whilst the facilities have proven themselves capable of running at capacity, achieving continuous production over prolonged periods remains a challenge.

The outlook for chemicals in the second half is mixed – with improvements expected in ammonia, offset by higher raw material costs in sodium cyanide.

Rural services and insurance

First half operating revenue of the group's rural services and insurance business of $425 million was 14 per cent above the comparative figure of $374 million last year. Earnings of $26.0 million were 77 per cent above last year's $14.7 million.

Merchandise and fertiliser sales rose by 18 per cent despite a dry season in Western Australia, floods in northern New South Wales and a generally flat market. Gross profit from livestock marketing rose by 18 per cent, largely as a result of buoyant cattle prices. Higher wool prices generated improved revenue from wool marketing activity.

Many parts of eastern Australia are enjoying an excellent season which will support livestock activity and crop prospects. Producers in Western Australia will be looking for a good autumn break to allow widespread seeding operations to commence.

Wesfarmers Federation Insurance has produced significantly improved results in the first half. Premium income growth resulted from higher new business levels and retention of existing business at above-budget levels. Crop claims were below budget. Subject to normal conditions in the second half, this business will produce higher earnings than last year.

Transport

In the context of a markedly higher operating cost environment the group's transport, logistics and express freight operations performed satisfactorily during the first half. In particular, Wesfarmers Transport's general freight operations performed above budget expectations and it is anticipated will show an improved result over last year.

The group's operations that provide services to primary producers in remote areas suffered as a result of inclement weather and poor growing seasons in some regions during the first half and this is expected to impact on Wesfarmers Transport results for the full year.

A small contribution was achieved during the half from the 50 per cent owned Australian Railroad Group, which comprises South Australian and Western Australian rail freight businesses. Wesfarmers settled its investment in Australian Railroad Group on 17 December 2000.

Finance

The group's ratio of net debt to equity as at 31 December 2000 was 84.3 per cent, up from 52.3 per cent at 31 December 1999 as a result of new investments and higher working capital usage. Group gearing is traditionally higher at this time of year due to the seasonal build-up of fertiliser inventories. The rolling 12 month cash interest cover was 11.3 times, well above the group's minimum requirement of four times.

Interim dividend

The directors have declared a fully franked interim dividend of 27 cents per share (last year 25 cents per share) payable to shareholders on 20 April 2001 and expect the company to maintain its dividend policy of paying out 100 per cent of profits for the full year.

New shares issued under the company's dividend investment plan in respect of the interim dividend will be at a discount of 2.5 per cent to market.

Outlook

The directors are pleased with the reported result and remain confident about the prospects for the group and the immediate outlook for the second half of the financial year.

The key businesses of the Wesfarmers group continue to perform well and the full year result will also be positively affected by the acquisition of the Australian Railroad Group business.

The directors foreshadowed a few years ago the eventual resumption of company contributions to the Wesfarmers Staff Retirement Fund as the surplus in the fund was eliminated. The surplus has allowed the company to take a contribution holiday for over 10 years. The directors' current expectation is that contributions will recommence in the 2000/2001 year at a level of $5 million, increasing by $5 million per annum, with a full contribution of around $25 million from 2004/2005.

The directors remain confident that the full year 2000/2001 result will exceed that recorded last year by a reasonable margin. In the directors' view, the prospect of increased profits at a time when the economy is slowing reflect the value of the company's diversified portfolio of investments.

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