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Wesfarmers

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Title: Open Briefing®. Wesfarmers. MD Goyder on 36% Profit Rise

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Wesfarmers Limited announced a 36% increase in profit after tax to $447.5 million for the half year ended 31 December 2005. Included in that was a profit before tax of $1.1 million (pcp $3.4m) on the sale of non-current assets and the full cost of shares issued to employees under the employee share plan of $27.1 million before tax. Allowing for market conditions, how did you think each of the Wesfarmers' businesses performed?

MD Richard Goyder
Clearly energy made a significant contribution to the increased earnings, largely due to higher export coal prices and volume increases. The gas business has been impacted by record international energy prices, but overall the division's performance was very pleasing. We think Bunnings performed well in a difficult trading environment with underlying earnings increasing by over 6% and same store sales growth improving in the second quarter.

The insurance division performance was satisfactory in an environment where we have seen the impact of increased competition and a reversion to long-term claims ratios. The industrial and safety division performance was flat, but a significant amount of work is in progress to improve the business. CSBP was affected by plant issues and ammonium nitrate imports at QNP and by gas flow issues at Kwinana which reduced ammonia production, but notwithstanding, it was a strong result.

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What main profit influences do you expect in the second half?

MD Richard Goyder
The domestic environment in Australia and New Zealand will affect Bunnings and the industrial and safety distribution business. World commodity prices will continue to impact the coal business and gas earnings. We are currently renegotiating export coal supply contracts which come into effect on 1 April 2006.

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Can you explain the magnitude of the cost of shares issued to employees under the employee share plan? What ongoing costs do you expect from the program?

MD Richard Goyder
For the half year we expensed $27.1 million before tax in relation to our employee share plan which will be the full expense for FY06. The cost of the program in future years is likely to rise broadly in line with increases in the number of our employees or through further enhancements to the plan. This plan is an important factor in attracting and retaining quality employees and we believe overall, has a very positive impact.

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Capital expenditure for the half was $303 million and forecast expenditure for the year is now expected to be around $775 million, compared with the original budget of around $900 million. Can you explain the adjustment to the original full year budget? Can you give a guide for FY07?

MD Richard Goyder
The current estimates of capital expenditure for FY06 have reduced against our budget primarily because of timing delays on projects in energy, hardware and CSBP.

It's too early to provide guidance on capital expenditure for FY07, but we'd expect a strong program moving forward as we continue to rollout new warehouses and continue with the store refurbishment program at Bunnings. We expect some ongoing capital expenditure in our coal business to try to capture productivity improvements and there is also potentially major capital expenditure on the ammonium nitrate expansion at QNP.

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Wesfarmers and its joint venture partner have entered into an agreement to sell the Australian Railroad Group. Wesfarmers' share of sale proceeds after payment of debt will be approximately $425 million. Can you sum up the success of this investment against your usual investment criteria after taking into account capital injected?

MD Richard Goyder
We'll book a pre-tax profit on the sale of our 50% interest in ARG of around $235 million which will give us an internal rate of return before tax on our equity investment of around 25%.

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As at 31 December 2005, Net Debt to Equity was 74.1% and the ARG sale will free up additional capital. You had previously undertaken a review of your lending arrangements with your banks including determining the most appropriate gearing range. Can you update progress? What will you do with the funds from the sale of ARG?

MD Richard Goyder
The adoption of A-IFRS increased our gearing by around seven percentage points and we're considering that impact and other factors in reviewing whether our preferred gearing range is appropriate, particularly given our strong cash interest cover ratio.

We'll initially use the ARG proceeds to pay down debt, bearing in mind that the transaction is not expected to be completed for a couple of months. If there's an opportunity to make an investment that meets our hurdle rate then obviously we'll do that, but if we can't find one and our gearing moves to an inefficient level, we'd also look at the most efficient way of returning funds to shareholders.

Energy

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Earnings before interest and tax (EBIT) from Wesfarmers' Energy business increased by 177% over the corresponding period last year to $343.2 million. For the half year, what was the profit and loss and cash flow impact under the Stanwell rebate accounting treatment?

MD Richard Goyder
Energy's reported EBIT for the half included approximately $20 million in amortisation charges relating to the Stawell rebate with an additional $6.7 million in discounting charges included in Group finance costs.

The cash flow impact over FY06 will be broadly in line with the amount expensed. In line with our guidance at our November 2005 Briefing Day and subject to negotiated price outcomes for metallurgical coal, we expect an amortisation charge of around $80 million for FY06.

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For the half year, coal production was 3.0 million tonnes of metallurgical coal and 1.4mt of steaming coal from Curragh, 1.9mt of steaming coal from Premier and 1.3mt of steaming coal from Bengalla (WES 40%). What are your production forecasts for the year across all three coal operations?

MD Richard Goyder
We haven't disclosed our forecast production volumes other than for export metallurgical coal from Curragh which we expect to be in the range of 6.4 million to 6.8 million tonnes for FY06, subject to ongoing satisfactory mine, port and rail performance.

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You've stated that industry reports point to a decline in export coal prices, that Curragh has settled for 37% of its contracted volumes for FY07 and that you will provide further pricing detail when the majority of contract volumes has been settled. Can you talk then about the unit cost performance at the coal operations over the half? Can you talk about some of the cost initiatives you're pursuing across the energy division at a time of great cost pressure?

MD Richard Goyder
I can't provide specific details regarding unit cost performance for the half. However, picking up on the guidance that we provided to the market in November 2005, the total cash costs year on year at Curragh in December 2005 were slightly above the 24% year on year increases presented back then, reflecting the continued ramp up in volumes.

Cost initiatives across all business units focus on reducing the usage of critical inputs such as fuel and tyres balanced against operational reliability and production targets.

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Can you summarise the success of the expansion at Curragh? What sustainable, long term production profile do you expect?

MD Richard Goyder
Obviously we consider the expansion a success as indicated by the lift in energy earnings and the increase in production. We expect sustainable long term export sales of 7 million tonnes per annum.

Hardware

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EBIT from the Bunnings hardware merchandising business decreased by 2% to $220.9 million. However, allowing for costs associated with the employee share plan and some refurbishment expenses, the comparative growth in EBIT was 6.3%. Cash sales growth was 4.7% and store on store cash sales growth was 2.7%. Can you summarise the trading conditions across each state and the outlook for Bunnings?

MD Richard Goyder
Our best trading performances in the first half came from our stores in Queensland, Western Australia and New South Wales. In New Zealand, Bunnings continues to achieve impressive growth although consumer sentiment in that market appears to be under pressure at the moment.

Against a background of tighter discretionary consumer spending across Australia we were encouraged by Bunnings' trading performance in the December quarter and this has carried through into 2006.

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Trade sales were 0.2% lower, but you stated that you've made good progress in addressing that sector. Can you give more detail on that? Do you expect it to lead to financial improvements in that sector?

MD Richard Goyder
We're developing separate facilities to service large builder customers and particularly for those we deliver goods to site because our existing stores are not designed to service these customers effectively. As we establish a facility within a region to service large builders we're then able to refocus our merchandising within the surrounding store network to service the rest of the building trade sector. Both aspects of this strategy are achieving pleasing results, particularly when you consider the downturns in housing markets in NSW and Queensland.

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How successful can the Bunnings business be in the future compared to its growth achievements over the last three or four years? Where can you improve it?

MD Richard Goyder
We think Bunnings continues to have strong growth opportunities, firstly through the ongoing store rollout program where we expect to continue to open 10 to 14 new stores per annum for the foreseeable future. Secondly, we're looking to strengthen our performance in those product categories where our market share is quite low relative to other categories and drive sales growth within the existing network of stores. Another opportunity is to expand our product range and services in stores and beyond the store. An example of the latter is our special orders offer that started in Victoria in October 2005. Bunnings will be widening the range of products offered and expanding the offer across our network in 2006. Finally, the work I referred to on the trade side of the business also opens up growth opportunities.

Insurance

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EBIT for the insurance division fell 4.1% to $63.5 million. WES noted at the November 2005 Investor Briefing that all business units were experiencing increased competition. Can you explain which insurance areas were most affected?

MD Richard Goyder
We're seeing the insurance market as very competitive across all commercial classes of business. All players are seeking growth which has led to discounting of various lines of business which puts pressure on margins, including in our rural portfolio.

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What impact have local or world events such as the US hurricanes had on the Wesfarmers' insurance business?

MD Richard Goyder
We've renewed only the Wesfarmers Federation Insurance reinsurance program since the US hurricanes. We experienced a slight rise in our underlying costs while prior to the hurricanes we would have expected a slight reduction, but it has been a fairly minimal impact. We're due to renew our Lumley reinsurance program in the middle of the year so it's hard to predict what impact there will be at this stage.

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What long term targets would be acceptable for key performance indicators in the business such as the combined operating ratio (88.8% for the half) and the insurance margin (14.4%)?

MD Richard Goyder
Our long term combined operating ratios have been in the low 90s and insurance margins have been around 11% to 12%. At these levels ROC is above the Group's targets.

Industrial and safety

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EBIT for the industrial and safety business fell 10.7% to $46.0 million. Can you explain how it fell by that much on fairly steady revenue of $588 million?

MD Richard Goyder
An impact of $3.4 million associated with the employee share plan and continued difficulties experienced by Blackwoods Paykels in New Zealand were the two main factors influencing earnings in that business. Both the Australian businesses, Blackwoods and Protector Alsafe, produced improved results.

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Can you explain the objectives you've set for the business in the second half?

MD Richard Goyder
We've appointed Terry Bowen as Managing Director of the industrial and safety division and he commenced in late October. His first major task was a review of strategies to lift performance of the business. Previous to that, we had the Port Jackson Partners' review of the business. Last week Terry announced a restructure of the business around trading streams and some significant changes to the leadership team. They are also reviewing product range and the offer to the market, as well as opportunities for efficiency gains and improvements in working capital management.

Chemicals & Fertilisers

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EBIT for CSBP, your chemicals and fertilisers business, fell 8.2% to $26.7 million. What is the timetable to commissioning the new ammonium nitrate plant at Kwinana? Can you comment on pricing? What ammonium nitrate capacity will CSBP have after the new plant is commissioned?

MD Richard Goyder
The ammonium nitrate plant at Kwinana remains on track to be commissioned in the second half of 2007. Total capacity following commission will be around 470,000 tonnes per annum. We can't comment on pricing, but we currently anticipate that around 120,000 tonnes will be used in the fertiliser business to manufacture CSBP's liquid fertiliser Flexi-N.

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When do you expect the evaluation for the plant expansion at QNP to be completed? What will be the most important considerations for it to go ahead?

MD Richard Goyder
We're in the final stages of that feasibility study and we would expect it to be completed within three months. The most important factors in determining the go ahead are the capital costs of construction and the extent to which firm off-take commitments can be secured.

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Wesfarmers stated at the November 2005 Investor Briefing that chemicals contributes around 60% of EBITA generated by the chemicals and fertilisers division. With regard to fertilisers, how is the 2005 harvest shaping and what will be the major business influences going forward?

MD Richard Goyder
The 2005 harvest was affected by frost although total grain production in Western Australia was very strong. Major influences in 2006 will be the commodity price outlook, input prices and the timing of the seasonal break across the agricultural regions of Western Australia.

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Thank you Richard.

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