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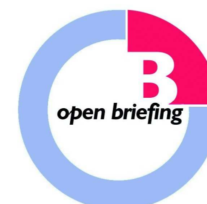

Wesfarmers Limited
Wesfarmers House
40 The Esplanade
Perth Western Australia 6000

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The content of this Open Briefing® reflects edited analyst and management discussion at the Wesfarmers Full Year Results Briefing held in Melbourne on Thursday August 16, 2007.

Home Improvement

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Obviously there's good momentum for Bunnings going into 2008 and one would presume that would continue. What are the key risks to maintaining the underlying store-on-store cash sales growth of 10.4% achieved in FY07?

John Gillam Managing Director, Home Improvement
The leading indicator we watch most carefully is residential housing data for both value and churn. Value doesn't have to be going up as long as churn is good. If value is declining and churn is slowing then that would lead to tougher conditions for us. We also keep an eye out for any concurrence of adverse trends in other factors such as interest rates and energy prices. Rates have moved and higher rates are a risk, but energy prices have been relatively high for quite a while, so there would have to be a spike to a new level for it to affect our trading conditions.

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It was a terrific result from Bunnings, but I'm a bit surprised that - with Revenue up 15.5% and with underlying cash store-on-store sales growth up by 10.4% - that Trading EBIT wasn't up by more than 16.1%. How do you explain that? Is it because you are reinvesting profits into the business or is the business not as strongly leveraged as some analysts think?

John Gillam
We have a very strong ongoing program aimed at lifting our offer in areas where we have low relative market share such as kitchens, lighting, flooring, plumbing and landscaping. Although we talk about having done 31 store

refurbishments, we actually did some work at nearly every store in terms of lifting the product offer and some of that work was quite significant. We're now very restricted in our ability to capitalise any of that expenditure. We are also now running with a 7 year reinvestment cycle for our stores and our store development team is very busy with lots of projects on. In addition, we continue to reinvest in price to provide better value for customers as we have previously outlined.

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What amount of your sales numbers are derived from the general industry environment and how much are derived from the refurbishment plan?

John Gillam
That's hard to say because it's difficult to separately track the sales lift from refurbishments for any length of time. We are consciously driving more sales growth from the large network that we have already in place and this is supported by refurbishing our older stores. The growth we are generating from product areas where we have relatively lower market positions occurs across the whole network and refurbishment work is also aimed at supporting this opportunity.

We are continuing to lift our focus on delivering better service, which doesn't have much to do directly with refurbishment, but does leverage off the quality of our store environment. Looking forward, we see the existing network being a much stronger contributor to our growth profile rather than just growing via new store rollouts.

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How important have the new product initiatives, such as bathrooms and kitchens, been to revenue in the last 12 months?

John Gillam
Over the last 12 months these initiatives have been good additions to top line growth. As was noted in the release, all our merchandising categories delivered growth over the last 12 months. We expect the areas of product focus we outlined to contribute even more in FY08 and then there are several new categories we are currently developing.

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Can you provide an update on the carpet trial business? And are there plans to roll that out more extensively?

John Gillam
Yes, as I mentioned in May, to deliver the widest range in flooring, we've had to work through how to add carpet into the product mix which in turn means developing a good measure, quote and installation service to meet customer expectations. The one store trial at Box Hill in Victoria has gone well and is now in over 18 stores throughout Victoria with that whole region to have coverage in the near term. We expect to really push the flooring area, with carpet, over the next year.

Coal

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What are the key hurdles in the feasibility studies for the expansions of Curragh and Bengalla to go ahead?

Stewart Butel Managing Director, Wesfarmers Coal
The Bengalla feasibility study is very close to being completed. The decision to expand is predominantly dependent on infrastructure issues such as rail and port capacity.

We've just recently started the Curragh feasibility study. The study involves a number of key components. The first is relocating Blackwater Creek which is between Curragh and Curragh East. This area has around 40 million tonnes of good quality coking coal. The feasibility study also involves an upgrade to the coal preparation plant to increase capacity to around 2,000 tonnes per hour, and additional mining equipment. We expect to be in a position to make a decision on the expansion by around the middle of next year, with additional volume ramping up from the second half of 2009.

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If you get in the range of your volume expectations for the expansion at Curragh, what's your expectation for cash costs per tonne?

Stewart Butel
It will be slightly higher than it is now. The additional volume will be uncovered by truck and shovel, which is higher cost than dragline. We are evaluating if we can fit another dragline into the Curragh operation.

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It looks like unit cash operating costs for Curragh were up significantly in the second half compared with the first half. Do these unit costs include demurrage? What has driven the significant increase in the second half?

Stewart Butel
Demurrage is not included in Curragh Production Costs presented in slide 30 of the Information Pack. This slide presents cash site costs only. Demurrage is included in offsite costs. Curragh's production cost for the year ending June 2007 compared to the previous year shows an increase of 15%.

Based on benchmarking reports, Curragh's costs are in the lowest quartile of operating costs for Australian coking coal exporters. Despite this, we continue to see ongoing cost pressure particularly with contractor labour and contractor truck and shovel, although fuel has decreased over the last 12 months. Looking forward we'll see economies of scale benefits from increasing coal production, the Stanwell rebate will reduce by the best part of a half next year, and demurrage will reduce. The Curragh North conveyor has been commissioned and about half of all coal produced will be at a lower cost of haulage as a result. We're currently working hard to reduce costs.

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Can you explain why coal prices were settled significantly lower at the annual price settlements, but many analysts are forecasting much stronger prices in the

future? Did the producers get it wrong in setting the annual contract prices or has the market tightened since?

Stewart Butel
It’s a combination of a couple of things. Late last year demand fell due to high stocks at the steel mills, but very soon after the annual settlements the market demand strengthened and remains tight. Without giving forecasts we see the outlook for coal price being positive. Spot thermal coal prices of US$70/t will put a natural floor under export metallurgical coal prices. Hot rolled coil steel prices are high in Asia, around US$550-600/t, and we’re seeing record profitability for steel mills in Asia. The higher Australian dollar should also put upward pressure on the US$ coal price.

We see the market as very tight with strong market fundamentals and customer demand.

Richard Goyder Managing Director, Wesfarmers Limited
On coal prices, it would be too simplistic to apply contract coal prices, settled from 1 April 2007, to our earnings for the first three quarters and then the prices settled from 1 April 2008 for the final quarter. In reality our contracts are set with different terms. For example, some of our contracts are set from 1 July each year.

Insurance

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What would the underlying underwriting business be down in terms of EBITA excluding the OAMPS business? How much is the deterioration of EBITA in the underwriting business due to one off costs or industry conditions?

Rob Scott Managing Director, Wesfarmers Insurance
It’s important to look at the different underwriting businesses. Wesfarmers Federation Insurance was actually slightly up on the year. The two Lumley businesses experienced falls in earnings. There were $10 million in one-off costs and a significantly higher level of net claims. You can look at the claims ratios to see how they’ve changed and how much they have influenced the result. The decrease in rates has also clearly started to flow through to the P&L. Combined with that, there were actuarial adjustments to increase provisions and this flows through to the expense ratio.

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You stated that the insurance EBIT was, after amortisation of intangibles in 2007, $9.8 million. Is that an ongoing amortisation charge?

Rob Scott
That relates to just part of the year given the acquisition occurred during the year. The annualised charge is more likely to be around $12 million. We are amortising it over 10 years.

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You alluded to commercial motor being a problem. You held share, you surrendered premium. In terms of where the business cycle is, what is your

level of comfort with the size of the business, quality of customers and price pressures?

Rob Scott
There's no doubt that rates have come down. We made a concerted effort to retain our key customers. Lumley differentiates itself in that market through value-added services, but obviously it is not immune to rate pressure. A significant part of our commercial motor book is claims-rated so that if there is an increase in claims, the rates are increased. There were some increases in rates on our claims-rated policies, but those will take time to flow through to results.

Finance and corporate

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Wesfarmers earnings were down, but operating cash flow was up strongly. Can you explain how cash flow was so strong relative to earnings?

Gene Tilbrook Finance Director, Wesfarmers Limited
A lot of that cash flow is within the insurance businesses and the cash doesn't flow to the rest of the group. It comes from a combination of growth in premium together with an increase in provisions of the insurance businesses. While not all of the total figure was usable by the group, there were positive contributors to cash flow such as an average reduction in working capital across the other divisions.

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You mentioned that in the Group cash flow there was a lot of cash from insurance. How much? Can you quantify that?

Gene Tilbrook
Yes, it was about $300 million and if you look at the balance sheet it largely flows back to specific insurance assets.

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If it was $300 million in FY07, what would it have been in FY06?

Gene Tilbrook
It would have been under $100 million.

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Can you explain how the Bunnings Warehouse Property Trust income is accounted for because that is now fairly significant? What proportion do you own of Bunnings Warehouse Property Trust?

Gene Tilbrook
Wesfarmers owns about 23% of that Property Trust. Under the previous accounting standards, the earnings which equalled distributions of the Trust were brought to account. Under AIFRS the Trust's revaluation earnings also are bought to account. A large proportion of the increase in the Trust's earnings in FY07 was from revaluation earnings, while the cash earnings would have been up a little from last year.

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It looks like a significant portion of your debt comes up for refinancing in the next 12 months. In the current market, how will you refinance that on reasonable terms considering you are also raising a very large amount of debt for the Coles acquisition?

Gene Tilbrook
There is about $2.9 billion of underlying debt and $2.1 billion that we used to fund the acquisition of our Coles shareholding. We have an underwritten debt facility of $10 billion made up of some medium term bank debt, some bridging finance and some working capital. If everything proceeds as planned with Coles, that facility will help fund the acquisition. It will also refinance some of our existing debt and within 12 months we'll replace the bridging finance with new debt such as offshore bond issues and hybrids.

Our existing debt portfolio is so short term because we have acquisition facilities relating to acquisitions like OAMPS. We would have expected to have refinanced these by now, but the circumstances around Coles means we haven't done that yet.

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You've mentioned around $5 billion that will be spent on Coles to rejuvenate it. How will that be funded and what impact will it have on Group gearing? What's the strategy for the level of Group gearing?

Gene Tilbrook
The funding of capital expenditure over the medium term will be through a combination of operating cash flow, equity raising (in the first instance through the dividend investment plan) or hybrid equity.

We would be comfortable maintaining gearing at around the level we'll be post the Coles transaction, which is roughly 60% net debt to equity. However, we focus more on cash flow cover. That will come down from current levels of 8-10 times. We're working with the ratings agencies to understand more about how cash flow and other measures will affect our rating. That level of gearing will be OK, but we'll probably want to see a strengthening of cash flow cover over time and there are several ways we can do this, including through equity management.

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