Title : Open Briefing. Wesfarmers CEO Chaney on 25 per cent profit rise
Date of lodgement: 7 February 2001

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Wesfarmers Limited announced an operating profit after tax of $111.8 million (on a normalised basis) for the 6 months to December 2000, which was 25 per cent above last year. What areas are driving this profit growth?

CEO Michael Chaney
I'm pleased to say that the increase has generally occurred across the board. The energy business was the star performer with solid increases from hardware and forest products and also rural services and insurance.

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Where do you expect the profit growth to come from in the future?

CEO Michael Chaney
Over the next six months, by far the largest profit growth will come from the energy segment. We also expect some profit growth in fertilisers and chemicals over last year.
In the case of rural services and insurance, a lot depends on how IAMA performs in its first four and a half months from mid February when we take control. There are some big unknowns at the moment but we are working hard to frame budgets for that period.

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Hardware and forest products revenue was up 11 per cent for the first half, while EBIT of $86 million was up 17 per cent on the corresponding period. What do you expect in the second half?

CEO Michael Chaney
We expect continued growth on the hardware side, but that will be cancelled out in the published numbers by the absence of profits from the woodchipping, plantation services and plantation assets businesses which we sold in October 2000; and by a fall in sawn timber profits as a result of the housing slump. And so there will be a subdued performance in EBIT for the hardware and forest products segment in the second half (compared with the corresponding period) that will conceal what we believe will be continued growth in hardware earnings.

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Forest products earnings were down 19 per cent on the corresponding period due to the divestments you've mentioned. Will the remaining forest products businesses provide satisfactory returns?

CEO Michael Chaney
No. The businesses we sold had the highest return on capital of any businesses within forest products. The remaining businesses are predominantly saw-milling businesses which have never provided acceptable returns. We've mentioned in the past that we are working hard to rationalise the saw-milling business to get an acceptable return and it's diminishing in size as a result.

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What is the economic outlook for hardware trading?

CEO Michael Chaney
We don't see any signs of a downturn. Trading during January continued at a strong level and we will, if anything, revise our budget upwards slightly for the remaining five months of this year.

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Bunnings warehouse stores are clearly taking market share from competitors' traditional hardware stores within retail catchment areas. Is this trend strong enough to offset any likely downturn in economic activity?

CEO Michael Chaney
We think it is.

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Does the plan beyond 2002 remain one of opening 10-15 warehouse stores per year?

CEO Michael Chaney
Yes. During the last year we endeavoured to correct a misconception that the roll-out might cease in 2002 or 2003, or might run out of steam. In fact it will continue well beyond that.

Our latest corporate plan, which is just being finalised, details that we will still be rolling out 10-15 new stores per year at the end of 2005. And we think it will continue for some years after that. It is hard to be more definitive than that.

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Energy division EBIT of $92.4 million was 77 per cent higher than the $52.2 million recorded in the December 1999 half year. The key reason was commodity prices. What level are coal prices at now, compared to those assumed in your financial model on the Curragh acquisition?

CEO Michael Chaney
The basic export coal prices for Curragh haven't varied much from what we assumed in our acquisition model. However, due to a slightly different product mix, the average US dollar price received is about 5 per cent above what we assumed in the budget. Not all prices for the different types of coal have moved but we anticipate increases in those prices in the coming months.

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Earnings at Curragh were significantly above budget. How much of that has been due to operating efficiencies and volume outperformance rather than prices?

CEO Michael Chaney
The volume of export coal sold from Curragh in the first half was 30 per cent above our budget and, conversely, the volume of domestic sales was about 10 per cent below budget. So a fair bit of the positive profit variance from budget was driven by increased export coal volumes where prices are higher than the prices for the domestic product.

Interestingly, our cost per tonne of coal was higher than budgeted because we employed some contractors to increase the volumes to meet market demand. We've also had higher freight rates than we've been budgeting because we're still negotiating with Queensland Rail. In fact, we've rolled our current contracts forward six months to allow us some negotiating room.

The lower Australian dollar has had some beneficial impact, but it's not as high as you might expect. Under our banking arrangements, we agreed to hedge half the revenue from the export production at an exchange rate in the high 50's.

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The volume of coal delivered to the Collie mine in Western Australia was 7 per cent below the previous corresponding period because Western Power reduced its offtake below the level of your take and pay contracts. What recourse do you have?

CEO Michael Chaney
As they're take or pay contracts, we expect the customer to take or pay for the product. We are currently in discussions with them about their failure to take contract quantities and we hope that will be resolved in the coming months.

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Collie's contribution to profit was up nevertheless. Was this achieved through operating efficiencies?

CEO Michael Chaney
Yes. Our cost of sales were down and that's partly because we had a larger overburden removal. A fair proportion of that cost goes into stock. The mine is operating extremely well in terms of productivity.

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In A$ terms, international LPG prices have quadrupled since last year. Is the market showing any signs of turning?

CEO Michael Chaney
No. I must say it has amazed us to see the level of prices. That’s obviously had a positive impact on export sales, although two thirds of that benefit goes to AlintaGas and only a third to us. The result is that we've had a strong profit result in the export business which more than offsets Kleenheat coming in under budget.

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Has the reorganisation of Kleenheat Gas in 1999 improved the operating efficiency of that business?

CEO Michael Chaney
Yes. It's going well and our sales volume is actually up about 10 per cent and we feel comfortable about the operating cost structure. I think it’s a tribute to the management that our EBIT is actually up for the half, notwithstanding the high international prices creating a big margin squeeze in these domestic operations.

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EBIT for fertilisers and chemicals was $7.5 million compared to last year's $4.1 million. What drove the improvement?

CEO Michael Chaney
It was mainly on the chemical side. The ammonia plant is operating well and that’s making a decent contribution now. For fertilisers it's too early in the year to read much into the result. 70 per cent of fertiliser sales occur in the second half of the financial year.

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Fertiliser sales tonnages are expected to be around 970,000 tonnes in the full year, which is about 160,000 tonnes below your original budget. Is that explained by a reduction of your market share or the overall market demand falling?

CEO Michael Chaney
Overall market demand will fall. Western Australia had a very dry season last year, the wheat crop fell from 12 million tonnes to 7 million tonnes and farmers have less cash to buy fertilisers this year. We feel the whole market will be down but we will probably maintain our market share.

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What is the current trend on fertiliser prices?

CEO Michael Chaney
We expect more price increases. We achieved price rises in August and November and they've been driven by high international gas prices which have flowed through to ammonia and urea prices. We expected phosphate prices to continue to rise, but they seem to have stabilised in recent weeks.

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The fertiliser market in Western Australia is concentrated amongst a few players, yet competition is intense. What opportunities exist for alliances?

CEO Michael Chaney
Very few, if any.

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The new ammonia plant at Kwinana and the joint venture operation, Queensland Nitrates, have experienced operating difficulties. When do you expect them to be operating satisfactorily?

CEO Michael Chaney
Kwinana is running well and hopefully Queensland will before too long. As soon as we've had the Queensland plant running at full capacity, some other item of equipment would fail. This week we reviewed our operating practices and our strategy for resolving problems and we're comfortable with the management team and the processes they have in place.

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EBIT for the rural services and insurance business was up 77 per cent to $26.0 million. How did you achieve this with the dry season in Western Australia and floods in northern New South Wales?

CEO Michael Chaney
This result was pleasing. The dry season in Western Australia and the floods in NSW didn't help but it was made up for by favourable conditions in some other areas.
Firstly, the insurance company had a very good six months with a crop loss ratio of about half the long-term average. Higher cattle prices mean our livestock profits are running about 15 per cent ahead of budget on a gross profit basis. Merchandise earnings are up about 10 per cent on last year.

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Wesfarmers will shortly gain control of a merged vehicle combining the businesses of Wesfarmers Dalgety Limited and IAMA Limited. IAMA Limited recorded sales revenue of over $900 million for the year to September 30, 2000 yet its profitability is poor. Wesfarmers Dalgety has substantially less revenue yet is relatively more profitable. How are the cost structures so different?

CEO Michael Chaney
IAMA comprises a group of disparate companies that were thrown together and which operate with inadequate management systems. That always gives rise to unnecessary cost duplication. IAMA's distribution network is a fairly costly structure. The challenge for us is to achieve decent levels of profitability out of what will be a very strong revenue performer.

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What opportunities are there for the IAMA businesses to adopt the successful management development model used by Bunnings?

CEO Michael Chaney
We've tended to operate individually within divisions in terms of management development but there may be some potential there.

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How many months contribution did the Australian Railroad Group business make to the half year result and did it meet your expectations?

CEO Michael Chaney
Only for half a month but so far it has met our expectations.

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Net debt to equity as at 31 December, 2000 was 84.3 per cent and was well above your target range. Does this restrict investment opportunities?

CEO Michael Chaney
The debt to equity ratio is always higher in the half year because of the build up of fertiliser inventory and it should fall toward our target level over the remainder of this financial year.

The final outcome will depend upon the level of acceptances in the IAMA offer. However, we've never felt constrained by capital because if we wanted to make a major acquisition we believe that the market and the banks would support us if the numbers add up.

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What is the full year profit outlook?

CEO Michael Chaney
We're expecting a reasonable level of profit increase and above budget growth.

However, experience tells us that making forecasts for the full year in February is fraught with danger as the world changes very fast.

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Thank you Michael, we look forward to our next Open Briefing with Wesfarmers.