

Title : Open Briefing. Wesfarmers CEO on 30 per cent profit rise

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Wesfarmers Limited recently reported a 30 percent increase in net profit after tax to \$174.4 million for the 9 months to March 31, 2001. EPS was up 20 percent. In the past year you've acquired the Curragh coal mine, the Westrail Freight business and IAMA Limited. Are each of these acquisitions currently EPS positive?

CEO Michael Chaney

The Curragh coal mine and Westrail Freight are currently EPS positive but IAMA is going to take us a bit longer. When we acquired IAMA we expected it would be slightly dilutive in the current year and that's proven to be the case on a pre-goodwill basis. We will bring to account an amortisation charge for goodwill of \$8 million per annum.

We're anticipating improved returns for IAMA for each of the next three or four years and we hope it will become EPS positive during next year.

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Wesfarmers' earnings historically have been skewed towards the back end of the financial year. How would you describe the seasonality of Wesfarmers' earnings now that you've recently added or grown businesses such as coal, Bunnings, IAMA, LPG export and the chemical business?

CEO Michael Chaney

The earnings are now much less seasonal. Previously most of our earnings occurred in the last quarter, but now they should be about the same magnitude in the second, third and fourth quarters.

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To what extent do Wesfarmers' earnings benefit from the low Australian dollar?

CEO Michael Chaney

A lower dollar helps our earnings overall but it's not as large as you might imagine as we have some costs based in US dollars.

About 70 percent of our annual exports of coal from Curragh has not been hedged. Export coal accounts for about 55 percent of total coal production at Curragh. And about 50 percent of our annual production of export coal from Bengalla (Wesfarmers 40 percent) has not been hedged.

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EBIT for the rural services and insurance division was up 68 percent to \$35.8 million for the year to date. In February, your rural operations subsidiary, Wesfarmers Dalgety, completed a merger with IAMA Limited to form Wesfarmers Landmark. What were the main attractions for acquiring IAMA?

CEO Michael Chaney

The primary reason was that the large revenues generated by the joint company should allow us to achieve satisfactory returns on the capital invested. It will require some effort to achieve

our hurdle rate on investment, as the company was in poor shape when we acquired it, but we are confident that we can achieve it.

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What level of operating cost savings and working capital reductions do you expect from the Wesfarmers Dalgety/IAMA merger?

CEO Michael Chaney

We hope to achieve \$40 million p.a. in operating cost savings over time. It's possible that figure might be higher.

There is potential to improve working capital management and we have a major logistics management exercise underway at the moment to that end.

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How will the operating cost savings be achieved?

CEO Michael Chaney

By rationalising head office costs, IT systems and purchasing arrangements.

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Wesfarmers' rural operations achieved a return on capital employed of 25.3 percent for the 12 months to December 31, 2000. What capital will be employed in the merged entity and when will it achieve your target return of 18 percent?

CEO Michael Chaney

The capital will be about \$450 million and our latest corporate plan shows an 18 percent return on capital employed by about 2004. However, experience with five year planning is that you invariably end up getting surprises both on the upside and the downside.

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What current business conditions exist for your rural division?

CEO Michael Chaney

Commodity prices on the whole are favourable and so are climatic conditions, except in Western Australia where we await a good seasonal break.

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EBIT from the hardware and forest products division was up 11 percent to \$119.3 million for the year. Is the division's recent return on capital employed of around 18 percent sustainable having sold the more profitable parts of the forest products business in October 2000?

CEO Michael Chaney

Yes and we expect it to increase over the coming years. The less profitable parts of the forests business will be sold off and we expect the hardware business to exceed our 18 percent hurdle rate.

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Are both your traditional and warehouse stores still achieving store on store sales growth?

CEO Michael Chaney

Yes, but it's actually a complicated issue. The traditional stores are subject to cannibalisation, both by our own new warehouses and by our competitors. In addition, some of the bigger traditional stores are undergoing reconstruction programs which affect their sales. After normalising for those sorts of factors, the remaining part of the traditional operation is pretty insignificant and it becomes a fairly meaningless issue.

Eighty percent of Bunnings' sales are now in the warehouse stores where we are achieving healthy store on store growth.

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Bunnings opened four new warehouse stores in the six months to December 2000 and is on target to open another four for the full financial year. You've forecast 10-15 warehouse store openings per year in subsequent years until at least 2005. Is that growth contingent on expanding in Sydney where the scarcity of sufficiently large sites and high property prices have limited new store development?

CEO Michael Chaney

We're assuming that, of the warehouses we have up and running by 2005, some will be in metropolitan Sydney. They will constitute about 20 percent of the ultimate Sydney store numbers. Apart from the two factors you mentioned, the third impediment to opening new stores in Sydney is the difficulty in obtaining planning approvals.

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EBIT from the Energy division was up 75 percent to \$139.3 million for the year to date. Export coal prices have increased by up to 20 percent from April 1, 2001 and spot prices remain strong. Domestic coal sales are subject to longer term contracts with more stable pricing. What proportion of Wesfarmers' coal is exported and is there scope to lift that percentage?

CEO Michael Chaney

Around 55 percent of Curragh's production is exported and it is around 60 percent for Bengalla. The domestic proportion at Bengalla will disappear within the next couple of years. The growth in production from both mines over the next couple of years will be exported.

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How close is Bengalla to operating at full production and what is that rate?

CEO Michael Chaney

In the current financial year, Bengalla should produce about 5.2 million tonnes, which is about 1.4 million above budget. Ultimately, we should be producing about 6 million tonnes.

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Although margins at your domestic gas business, Kleenheat, suffer when world LPG prices are high, it is more than compensated for by higher LPG export earnings. World oil prices have fallen 20 percent from recent highs. Do you expect world LPG prices to follow?

CEO Michael Chaney

Yes. In fact, they have started to fall in the last month. The contract price has fallen from a high of US\$350 per tonne to US\$275 per tonne.

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Last financial year you sold 159,000 tonnes of LPG to the export market. What do you expect this financial year?

CEO Michael Chaney

230,000 tonnes.

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And that will be capacity?

CEO Michael Chaney

No, because our expansion only occurred on January 1, 2001. But the annual exports are very much a function of ship timing and LPG richness in the gas stream. We should export about the same amount next year.

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Can you confirm recent newspaper speculation that the Wesfarmers Energy division is looking at diversifying into electricity generation?

CEO Michael Chaney

No, I can't comment on that.

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EBIT from the fertiliser and chemicals division was up 27 percent to \$23.2 million for the year to date. However, it is the only Wesfarmers operating division not returning more than your target of 18 percent on capital employed. When do you expect the division to reach the 18 percent benchmark?

CEO Michael Chaney

Our recently completed five year plan shows the division getting to those levels within the five year period. However, last year's plan proved to be more optimistic than we've achieved this year, so I think the challenges will remain.

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In August and November, Wesfarmers CSBP achieved fertiliser price increases although you expect fertiliser sales for the year to be 916,000 tonnes compared with the 1999/2000 level of 1,089,000 tonnes. What is the outlook for fertiliser prices and volumes?

CEO Michael Chaney

Prices are fairly stable and margins have improved from last year, but not quite as much as we'd hoped. The lower volumes this year are a function of seasonal conditions, lack of cash in the system following a fairly poor season last year and some loss of market share.

If a reasonable break occurs in the next week or two, we may exceed our current estimate of tonnage.

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The new ammonia plant at Kwinana has operated with increasing reliability, while the Queensland Nitrates joint venture plant has struggled for several months. Can you please give an update on the performance of both plants?

CEO Michael Chaney

The ammonia plant at Kwinana is performing very well. We had some initial troubles in the first quarter, but it has since been running at capacity.

The Queensland Nitrates plant has suffered from continual equipment failure and sales volumes were also badly affected during the BHP coal strike. Our technical people have provided detailed plans on how they will rectify the production issues.

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What do you estimate the problems at the Queensland Nitrates plant have cost you in EBIT terms?

CEO Michael Chaney

It has cost us several million dollars in EBIT compared to our budget.

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One of the expected benefits of Wesfarmers' ownership simplification plan announced in February and completed in April was to make investing in Wesfarmers more transparent and therefore attractive. Have you seen increased interest from overseas and local institutions?

CEO Michael Chaney

We have seen some increased interest, particularly from the USA. It's hard to know whether that has resulted from the shareholding ownership simplification plan or from the recent rise in coal prices.

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Thank you Michael.