

2017 Half-year Results

14 February 2017

Review of results and operations

Half-year ended 31 December 2016	Variance to pcp
<i>Reported</i>	
Operating revenue of \$34,917 million	4.3%
Earnings before interest and tax of \$2,429 million	15.1%
Net profit after tax of \$1,577 million	13.2%
Basic earnings per share of \$1.40	12.8%
Operating cash flow per share (wanos, incl. res shares) of \$2.35	9.8%
Return on equity (R12) of 10.2 per cent ^a	20 bps
Interim dividend (fully-franked) per share of \$1.03	13.2%

^a Excludes post-tax non-cash impairments of \$1,844 million relating to Target and Curragh recorded in the 2016 financial year.

Wesfarmers Limited has reported a net profit after tax (NPAT) of \$1,577 million for the half-year ended 31 December 2016, an increase of 13.2 per cent on the prior corresponding period. Earnings per share increased 12.8 per cent to \$1.40 per share, and return on equity (R12) increased 20 basis points to 10.2 per cent¹.

Managing Director Richard Goyder said it was pleasing to record strong earnings growth for the half, with the results reflecting the benefits of the Group's conglomerate structure.

"Total retail earnings were in line with the prior corresponding period, with very strong results reported for Bunnings Australia and New Zealand (BANZ), Kmart and Officeworks," Mr Goyder said. "The continued momentum in these businesses was particularly pleasing and reflects the strong market positions they have each established.

"Coles' sales performance during the half built on the strong growth achieved in the prior corresponding period. Significant investment in value, particularly in the second quarter, led to lower earnings despite a reduction in costs. BANZ delivered very strong improvements in both earnings and return on capital due to good execution of its strategic agenda. In the United Kingdom and Ireland, Bunnings (BUKI) has moved at pace, making solid progress on phase one of its transformation plan. Earnings for BUKI were affected by necessary restructuring, including clearance of deleted lines and high levels of price deflation associated with the move to 'Always Low Prices'. While reported earnings for Department Stores declined marginally, underlying earnings² were higher than the prior corresponding period, with strong growth in Kmart partially offset by difficult trading and further restructuring activity in Target. Officeworks' performance was pleasing as it continued to drive growth from its 'every channel' strategy.

"Earnings for the Industrials division were significantly above the prior corresponding period, with Resources benefitting from higher coal prices and strong production in the second quarter. The Chemicals, Energy and Fertilisers business (WesCEF) delivered a strong result for the half, primarily driven by higher chemicals earnings and growth in natural gas retailing, while earnings for Industrial and Safety also improved, benefitting from lower costs following 'Fit for Growth' restructuring activities.

¹ Excludes post-tax non-cash impairments of \$1,844 million relating to Target and Curragh recorded in the 2016 financial year.

² Underlying earnings exclude: in 2016, a provision of \$13 million recognised for restructuring costs associated with the planned relocation of Target's store support office. In 2015 for Target, rebate income of \$21 million recognised contrary to Group policy which was reversed in the second half of 2016, having no effect on the 2016 full-year results.

“The Group’s cash flow management was a highlight for the half. Operating cash flows increased \$244 million to \$2,648 million, with the cash realisation ratio improving to 119.7 per cent³. Strict disciplines were also maintained in respect of capital expenditure, which contributed to a \$566 million increase in free cash flows to \$2,231 million. This resulted in a strengthening of the Group’s balance sheet, with net financial debt at 31 December 2016 largely in line with the prior corresponding period, despite the debt-funded acquisition of Homebase in February 2016.

“In light of the overall improved Group earnings and cash flows, the directors today declared an increase of 13.2 per cent in the interim dividend to \$1.03 per share.

“The Group continues to focus on enhancing shareholder value through portfolio optimisation and, during the half, announced divestment options were being evaluated for the Resources business. This process is ongoing.

“The Group has also commenced a strategic review of Officeworks. Since Wesfarmers acquired Officeworks in 2007, the business has successfully executed a turnaround plan, more than doubling its earnings and improving its return on capital from 5.7 per cent in the 2009 financial year to 13.9 per cent in the current period. Officeworks is well positioned for future growth with a strong competitive position and ongoing initiatives to grow its addressable market. In light of its performance, options to monetise the value created for shareholders, including via an initial public offering⁴, are being evaluated. The business will be retained if divestment options do not meet Wesfarmers’ valuation hurdles.”

³ Operating cash flows as a percentage of net profit after tax, before depreciation and amortisation and NTIs.

⁴ This announcement does not constitute an offer to sell, or the solicitation of an offer to buy, any securities in any jurisdiction, including the United States. Any securities to be offered and sold in an initial public offering have not been, and will not be, registered under the U.S. Securities Act of 1933, as amended, and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements.

Group results summary

Half-year ended 31 December (\$m)	2016	2015	Variance %
Key financials			
Revenue	34,917	33,462	4.3
EBITDA	3,064	2,749	11.5
EBIT	2,429	2,110	15.1
NPAT	1,577	1,393	13.2
Return on equity ^a (R12, %)	10.2	10.0	20 bps
Cash flow			
Operating cash flow	2,648	2,404	10.1
Net capital expenditure	400	675	(40.7)
Free cash flow	2,231	1,665	34.0
Cash realisation ratio ^b (%)	119.7	118.3	140 bps
Share data (cents per share)			
Basic earnings per share	140.1	124.2	12.8
Operating cash flow per share (wanos, incl. res shares)	234.9	213.9	9.8
Interim ordinary dividend	103	91	13.2
Balance sheet and gearing			
Net financial debt ^c	5,360	5,261	1.9
Interest cover ^d (cash basis) (R12, times)	18.9	19.3	(2.1)
Fixed charges cover ^d (R12, times)	2.7	3.0	(10.0)

^a 2016 excludes post-tax non-cash impairments of \$1,844 million relating to Target and Curragh recorded in the 2016 financial year.

^b Operating cash flows as a percentage of net profit after tax, before depreciation and amortisation and NTIs.

^c Interest bearing liabilities less cash at bank and on deposit, net of cross currency interest rate swaps and interest rate swap contracts.

^d 2016 excludes pre-tax non-cash impairments of \$2,116 million relating to Target and Curragh recorded in the 2016 financial year.

Divisional earnings summary

Half-year ended 31 December (\$m)	2016	2015	Variance %
EBIT			
Coles	920	945	(2.6)
Home Improvement	722	701	3.0
Department Stores ^a	387	393	(1.5)
Officeworks	62	59	5.1
Industrials ^{b,c}	377	22	<i>n.m.</i>
Divisional EBIT	2,468	2,120	16.4
Other	(39)	(10)	<i>n.m.</i>
Reported EBIT	2,429	2,110	15.1

^a 2016 includes a provision of \$13 million recognised for restructuring costs associated with the planned relocation of Target's store support office. 2015 for Target includes rebate income of \$21 million recognised contrary to Group policy which was reversed in the second half of 2016, having no effect on the 2016 full-year results.

^b 2016 for WesCEF includes a profit on sale of land of \$22 million. 2015 for WesCEF includes \$30 million of one-off restructuring costs associated with the decision to cease PVC manufacturing.

^c 2015 for Industrial and Safety includes \$5 million of restructuring costs associated with the 'Fit for Growth' transformation.

Performance overview – Divisional

Coles

Earnings before interest and tax (earnings or EBIT) at Coles decreased 2.6 per cent to \$920 million for the half, with revenue in line with the previous corresponding period. Excluding the gains on the sale of Coles' interest in a number of joint venture properties to ISPT, earnings declined 6.8 per cent. Food and liquor recorded sales growth of 2.2 per cent, building on the strong growth recorded in the prior corresponding period.

"Coles' steadfast commitment to its customer-led strategy delivered continued growth in comparable transactions, basket size and sales per square metre during the half, with record results achieved on key customer feedback measures over the Christmas trading period," Mr Goyder said. "The decline in earnings was driven by lower margins following increased investments in value, which were weighted towards the second quarter, including through the absorption of cost price increases in meat. Costs of doing business were well managed, partially offsetting lower gross margins, despite Coles continuing to proactively invest to enhance the customer experience through better quality, availability and service."

"The transformation of Coles Liquor was progressed in line with expectations, with the business delivering positive comparable sales growth underpinned by transaction growth. Revenue at Coles Express decreased, due to lower fuel volumes and lower fuel prices, despite continued growth in store sales."

Home Improvement

BANZ delivered earnings growth of 9.8 per cent to \$770 million during the half, with revenue growth of 8.3 per cent. Earnings for the period included store closure provisions relating to the agreement with Home Consortium for new Bunnings sites.

"BANZ achieved another very strong result during the half, with store-on-store sales growth of 6.5 per cent and a 317 basis point improvement in return on capital to 39.0 per cent," Mr Goyder said. "The BANZ results for the half reflect its strong market position, which has been further supported through continued investment in customer value, stores and online."

BUKI reported a loss before interest and tax of £28 million (\$48 million) and revenue of £612 million (\$1,038 million).

"BUKI has made very good progress to separate Homebase from its former owner and begin repositioning the business," Mr Goyder said. "Pleasingly, the first Bunnings pilot store was successfully opened on 2 February 2017, with additional pilot stores currently under development."

Department Stores

Target's earnings of \$16 million were \$58 million lower than the prior corresponding period, with revenue decreasing 17.7 per cent.

"Target's results reflect both a difficult trading period and impacts associated with significant transition work underway," Mr Goyder said. "Key strategic priorities have been progressed, including the conversion to everyday low prices and work to reset buying disciplines. Good progress has also been made to reduce costs and improve working capital management."

Kmart's earnings increased 16.3 per cent to \$371 million on revenue growth of 8.9 per cent.

"Kmart produced another very strong result, with sales growth delivered in all categories, underpinned by growth in customer transactions and units sold," Mr Goyder said. "Continued investments in the store network, product enhancements, and sourcing and supply chain efficiencies also supported sales and earnings growth."

Officeworks

Officeworks' earnings of \$62 million were 5.1 per cent higher for the period, with revenue growth of 5.9 per cent.

"Officeworks continued to deliver strong growth in earnings and sales, resulting in an increase in return on capital of 136 basis points to 13.9 per cent," Mr Goyder said. "Growth in sales and earnings reflected continued improvements in merchandise layouts, new and expanded product ranges and ongoing price investment."

Industrials

“Earnings for the Industrials division were \$377 million, \$355 million higher than the prior corresponding period, largely reflecting the significant increase in coal prices and strong production in the second quarter of the financial year,” Mr Goyder said.

Reported earnings for WesCEF of \$187 million increased 79.8 per cent, including a one-off profit on sale of land of \$22 million. Underlying earnings, excluding the land sale and costs associated with the closure of PVC manufacturing in the prior period, increased 23.1 per cent.

“Earnings growth in WesCEF was driven by a strong contribution from the chemicals business,” Mr Goyder said. “Kleenheat also delivered higher earnings for the half, supported by the continued strong growth in natural gas retailing.”

The Industrial and Safety business recorded earnings growth of 44.4 per cent to \$52 million, with revenue declining 4.6 per cent to \$884 million.

“In Industrial and Safety, sales continued to be affected by subdued levels of investment in the mining and resources sectors,” Mr Goyder said. “Earnings were higher due to cost savings achieved through the ‘Fit for Growth’ program.”

The Resources business recorded earnings of \$138 million, \$256 million higher than the prior corresponding period, with revenue increasing 24.1 per cent.

“The improved result for the half was driven by a significant increase in coal prices for both Curragh and Bengalla,” Mr Goyder said. “A continued focus on cost control and productivity also resulted in an improvement in production and mine cash costs in the second quarter of the financial year.”

Other businesses and cash flows

Other businesses and corporate overheads reported a net expense of \$39 million for the half, compared to a net expense of \$10 million in the prior corresponding period, due to a lower contribution from BWP Trust.

Operating cash flows of \$2,648 million were \$244 million higher than the prior corresponding period, driven by higher earnings and favourable working capital movements. For the half, cash realisation increased 140 basis points to 119.7 per cent⁵.

Gross capital expenditure of \$924 million was \$135 million or 12.7 per cent lower than the prior corresponding period, due to fewer store openings in Home Improvement and lower expenditure in Target. Net capital expenditure of \$400 million was 40.7 per cent lower than the prior period, due to proceeds from property divestments being \$140 million higher at \$524 million. The increase in proceeds was driven by the divestment of Coles’ interest in a number of joint venture properties to ISPT, and the sale of land by WesCEF.

Free cash flows of \$2,231 million were 34.0 per cent above the prior corresponding period. Stronger earnings and cash flow generation supported an increase in the interim dividend to 103 cents per share fully-franked.

Earlier this month, the Group announced the commencement of a ten year agreement between Coles and Citi for the distribution of Coles branded credit cards, which included the acquisition by Citi of Coles’ credit card receivables. The net proceeds from this transaction will be applied to repay Group debt, further strengthening the Group’s balance sheet.

⁵ Operating cash flows as a percentage of net profit after tax, before depreciation and amortisation and NTIs.

Outlook

The Group continues to remain generally optimistic in its outlook. Strong momentum and strong market positions provide for a positive outlook for BANZ, Kmart and Officeworks for the second half of the financial year. Coles will continue to focus on delivering a strong customer proposition to support long-term growth in earnings and returns. In the short term, margin pressures are expected to persist as the focus remains on delivering customer value in a competitive market. Target's performance in the second half is expected to improve relative to the prior corresponding period as merchandising progressively improves and restructuring costs and provisions incurred in the prior year are not repeated.

The full-year result for the Resources business is expected to benefit from the increases in coal prices experienced during the first half, but prices are expected to remain highly volatile for the remainder of the year, with recent spot prices trading significantly below their November 2016 peak. The focus for the business will remain on improving operational productivity, cost control and capital discipline. WesCEF's earnings in the second half will be subject to international commodity prices, exchange rates and seasonal conditions in fertilisers. In Industrial and Safety, improved merchandising, sourcing and pricing strategies, as well as realised cost savings, are expected to continue to mitigate the impact of subdued market conditions.

The strategic reviews of Resources and Officeworks will be progressed. There is no certainty that either review will result in a transaction, with an update to be provided to the market when appropriate.

The Group will continue to develop and manage its portfolio of businesses, prioritising cash flow generation, capital discipline and balance sheet strength in order to take advantage of opportunities, if and when they arise, to deliver satisfactory long-term returns to shareholders.

For further information:

More detailed information regarding Wesfarmers' 2017 half-year results can be found in Wesfarmers' 2017 Half-year Report.

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