News Release

Wesfarmers

5 February 2018

Significant items expected in 2018 half-year results

Following a review of the performance and strategic plans for Bunnings United Kingdom and Ireland (BUKI), Wesfarmers Limited advises of a number of significant items that are expected to be included in the Group's 2018 half-year (HY2018) financial results, subject to completion of Ernst & Young's review of the financial statements. These are:

- Non-cash impairment of £454 million ($795 million) before tax, with £444 million ($777 million) to be recorded against goodwill recognised on the acquisition of Homebase and £10 million ($18 million) against the remaining book value of the Homebase brand name.
- Stock write-downs of £37 million ($66 million), relating to excess, unsuitable and display stock, and store closure provisions of £40 million ($70 million).
- A write-down of BUKI deferred tax assets of £53 million ($92 million), reflecting a more conservative outlook for the business, to be reflected in the Group's income tax expense.

In addition to the significant items detailed above, BUKI is expected to report an underlying loss before interest and tax of £97 million ($165 million) for HY2018, reflecting the poor trading performance of Homebase.

Wesfarmers Managing Director Rob Scott said the Group is focused on delivering satisfactory returns to shareholders by improving its underperforming businesses, proactively managing its portfolio and investing in value-accretive growth opportunities. "We need to address underperformance in our portfolio that is detracting from positive performance in other areas, and the announcement today sets out decisive actions to achieve this," Mr Scott said.

"The Homebase acquisition has been below our expectations which is obviously disappointing. In light of this, a review of BUKI has commenced to identify the actions required to improve shareholder returns."

Wesfarmers has also assessed the carrying value of its investment in Target, resulting in a non-cash impairment of $306 million before tax, to be applied against the carrying value of its brand name ($238 million), remaining goodwill of $47 million and property and equipment ($21 million).

"The impairment of Target reflects difficult trading conditions in an increasingly competitive market. Target's earnings have stabilised and the business will continue to leverage the Department Stores structure to support its future performance," Mr Scott said.

The accounting impairments in BUKI and Target are non-cash in nature and will not impact the Group's compliance with its banking covenants. It is intended that the Group's interim and final dividends for the 2018 financial year will be determined based on the Group's net profit after tax excluding these impairment charges and in accordance with the Group's dividend policy.

BUKI review and impairment

A review of BUKI has commenced to identify the actions required to improve shareholder returns. The review is focused on options to improve the trading performance of Homebase as well as further evaluating the performance of the pilot stores to inform the future plans for BUKI.

"We will take a disciplined approach to further capital deployment in BUKI and provide an update on the outcomes of the business review and our plans for a broader conversion to Bunnings at our Strategy Briefing Day in June," Mr Scott said.

The non-cash impairment of £454 million ($795 million) before tax reflects the current trading performance of Homebase and a moderated outlook for BUKI.

BUKI management update

After a 25 year career with Bunnings, most recently as Managing Director of BUKI, Peter J (PJ) Davis has announced his retirement from the business.

The strong credentials of the new leadership team means Mr Davis' retirement will result in a smooth transition and the business will be led by Damian McGloughlin, who has been appointed Managing Director of BUKI, reporting to Bunnings Group Managing Director Michael Schneider. Damian has more than 30 years' experience in the UK home improvement and DIY market. A number of other senior leadership appointments including David Haydon as Chief Operating Officer have been made to strengthen the BUKI team and provide additional local experience and expertise.

"PJ has been instrumental in driving the growth and success of Bunnings for the past three decades and in the establishment of the Bunnings Warehouse format in Australia in the 1990s," Mr Scott said.

Mr Schneider said he was grateful for the contributions Mr Davis has made to the Bunnings organisation and the culture of the business.

BUKI first-half FY2018 earnings

BUKI is expected to report an underlying loss before interest and tax of £97 million ($165 million) for the first-half of the 2018 financial year.

"It is clear that a significant amount of change has been driven through Homebase since the acquisition and the disruption caused by the rapid repositioning of the business has contributed to greater than expected losses across the Homebase network," Mr Schneider said.

"Sales have been affected as non-core categories and concessions were exited ahead of the implementation of the Bunnings format, and investments in price and new ranges have not offset these lost sales. Trading was particularly weak during the latter part of the first half of the 2018 financial year.

"Our focus is on improving the profitability of Homebase through improved ranging and execution in stores, while continuing to develop plans for a broader conversion to Bunnings. The team has been strengthened, including through the addition of strong local expertise, to support improved outcomes."

Pilot store program update

The first Bunnings pilot store opened in February 2017 and there are 19 pilot stores currently trading. The early results from the pilot program have been encouraging, although sales uplifts achieved moderated during the winter months. The business will continue to use the pilots to test, learn, iterate, and improve the offer and roll-out process.

“Through the pilot program, we have identified ways to reduce the capital expenditure and duration of the conversions,” Mr Schneider said. “As a result, we are reviewing plans for the roll-out of Bunnings across the network, which will include a small store format in addition to the warehouse format.

“We will continue to monitor the profitability of the first tranche of pilot stores over the remainder of the 2018 financial year. Achieving proof of concept for the Bunnings format is a precursor to executing a broader roll-out plan.”

Target impairment

Since the creation of the Department Stores division in February 2016, value has been created for Wesfarmers’ shareholders as a result of the continued strong growth of Kmart, now a market leader in everyday clothing and homewares at the lowest prices, supported by world-class direct sourcing capabilities, and the stabilisation of Target. The growth in total Department Stores earnings has also been supported by greater strategic co-ordination between the two brands across ranging, sourcing and property to better meet customer needs. This has resulted in the Department Stores division achieving earnings of approximately $415 million for the first half of the 2018 financial year, representing the highest level of combined Kmart and Target first-half earnings since the 2010 financial year.

Target has progressed its strategic plan, significantly reducing its cost base and inventory levels, improving merchandise disciplines and increasing the level of direct sourcing. These improvements have stabilised its earnings base and partially mitigated the impact of difficult trading conditions in an increasingly competitive market.

“Target has made good progress to improve its financial performance and the impairment follows the continuation of difficult trading conditions in an increasingly competitive market,” Mr Scott said.

Difficult trading conditions contributed to lower than expected sales for the first-half of the 2018 financial year. As a result of the lower than expected sales performance, and reflecting a more conservative outlook for the business, the Group will record a pre-tax (post-tax) non-cash impairment of $306 million ($300 million). The applicable accounting standards do not allow Wesfarmers to recognise, in its accounts, the substantial increase in the value of Kmart since the business was acquired in 2007.

Despite a decline in sales in HY2018, Target is expected to report earnings before interest and tax of $33 million for the half, representing an improvement of 13.8 per cent on underlying earnings of $29 million in the prior corresponding period.

Given increased levels of strategic co-ordination, a brand-agnostic approach to growing the combined Department Stores business and the relative materiality of each brand, the financial results of Kmart and Target will be consolidated for reporting purposes from the first-half of the 2018 financial year. Sales performance will continue to be reported on an individual brand basis.

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