24 February, 2009

Wesfarmers Ltd (WES)

Buy

Comments are dated as shown at the start of each comment

The current recommendation may not apply to all historic comments

17 February, 2009 Significant Work (and Opportunity) Ahead - For the HY to December 2008, WES reported profit before significant writedowns of $1B ($0.879B including writedowns). An interim dividend of 50 cps has been declared, as pre announced on 22 January (record date 2 March, payment date 31 March).
WES reported amortisation of $153M in the HY. Adjusting for both the significant items and amortisation, HY profit was $1,157M.
Gearing post placement will be 29.2% (ND/E) equivalent to ND/ND+E of 23%.
Whilst the debt problem has been resolved, it has come at a significant cost. The 3:7 rights issue to raise at least $2.8B is priced at 1350 cps.
Shaw's outlook for WES includes a significant downturn in profits from Resources, and an improvement in Coles. The rebound in Coles will take time, and WOW will maintain pressure on Coles during this process.
A key requirement for WES will be maintaining capex to rebuild Coles during the very tight period ahead, following several years of cash starvation by previous management.
The next 12 months will remain challenging for WES, with several businesses exposed to the resources cycle directly or indirectly, proof required of the group's ability to turn around Coles (we believe this is doable), and the reduced revenues from coal with lower coal prices. The consumer discretionary segments of Target and Kmart will suffer irrespective of Wes' turnaround strategies against a revitalised Big W, and on weaker consumer spending trends. These trends have been incorporated into our forecasts.
We have valued WES at $24.00 per share. This is based on a 20% discount to the market based on a weighted average PE for each of its segments. The discount also incorporates a risk on the rebuilding of Coles.
For further details please refer to the Shaw report dated 16 February.

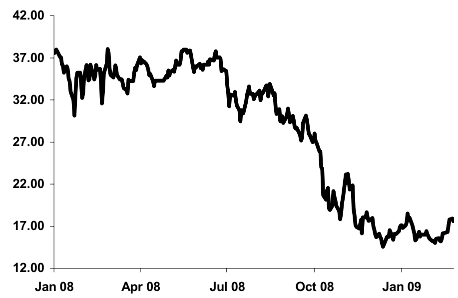
5 February, 2009 WES announced a 3:7 rights issue (and placement) on 22 January. The institutional portion of this offer was underwritten. The retail portion is not underwritten.
In summary, the retail offer is 3:7 @ $13.50 with both WES and WESN shareholders entitled to participate. Only shareholders registered in Australia and NZ can

YE 30 June	2007 (A)	2008 (A)	2009 (F)	2010 (F)
Revenue $M	9,753.7	33,585.0	51,902.5	53,378.3
Profit $M	931.8	1,227.0	2,026.2	2,030.5
Profitl Amort $M	780.3	1,050.0	1,726.2	1,730.5
Earnings cps	126.9	146.9	192.3	165.0
Dividend cps	225.0	200.0	100.0	100.0
PE x	13.9	12.0	9.2	10.7
Yield %	12.8	11.4	5.7	5.7
Franking %	100.0	100.0	100.0	100.0

Investment Summary

Share Price $ps	**$17.60**
Target Price (12 month) $ps	**$18.00**
Consumer Staples - Food & Staples Retailing	
www.wesfarmers.com.au	
Issued Capital M	872.2M
Market Cap $M	$15,603.0M
Analyst	**Scott Marshall**

Share Price Chart ($ps)



Year Hi – Lo $ps			**$38.60 - $14.24**
Avg Monthly Vol (M)			**64.0**
Performance %	**1 m**	**3 m**	**12 m**
Absolute	7.3%	3.5%	-50.0%
Rel Top 200	10.7%	9.3%	-12.6%

Shareholders * %

There are no substantial shareholders

Company Activities

WES is a diversified Australian corporation.

Shareholders sourced from ASX and includes related party associations

Level 15, 60 Castlereagh Street Sydney NSW 2000 Tel (02) 9238 1238
Level 20, 90 Collins Street Melbourne VIC 3000 Tel (03) 9268 1000
55 Phillip Street Parramatta NSW 2150 Tel (02) 9891 5644

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participate.
The entitlement date for this offer was 28 January 2009, and so the arbitrage is only available to shareholders at that date. We note shares issued in this offer are not entitled to the dividend for the period to December 2008 (ie the HY 09 dividend of 50 cps, franked).
We refer clients to the documentation issued by WES for a discussion of the full terms of this offer, and the impact on the WESN floor and cap terms.
The rights issue has created an arbitrage opportunity for existing WES or WESN shareholders. Shareholders can sell down their existing holding at the market price of $15.15 and buy back in via the rights @ $13.50, by subscribing for more than their rights entitlement. WES has stated in direct conversation that it is their present intention to allow over subscriptions in the retail offer.
The offer closes on 23 February.

23 January, 2009 (PART 1 OF 2)
Debt Problem Solved, Now The Market Will Focus on Dividends Outlook - WES has announced:
Equity raising of $2.8B @ $13.50 ps ($1.9B underwritten institutional plus $0.9B not underwritten retail) via a 3:7 accelerated, pro rata non renounceable rights issue. New shares are not entitled to the interim dividend. WES has also announced a placement to Capital Research Global Investors ($500M) and Colonial ($400M) @ $14.25 ps.
Debt renegotiations that, combined with the equity raising, means that only $1.6B needs to be refinanced over the 2 calendar years to Dec 2010 which in the worst case are covered by undrawn facilities of $2.5B. There remains $(0.4+1.7)B of debt due Dec 2011 and $1.7B due Dec 2012. The dividend will be cut to preserve cash in the organisation. The interim dividend (to December 2008) will be 50 cps, and the final dividend for FY09 is expected to be no more than 50 cps, making 100 cps for the FY (subject to review). Future dividends will be based on the company's cash position (not profits) after capex requirements.
The WESN (PPS) cap and floor prices will be changed, depending on the take-up of the retail offer. As a guide:

Retail Participation	Cap Price $ps	Floor Price $ps
Current	43.92	35.14
15%	43.27	34.62
20%	43.24	34.60
25%	43.22	34.58

23 January, 2009 (PART 2 OF 2)
The WESN (PPS) cap and floor prices will be changed, depending on the take-up of the retail offer. WES share trading is expected to recommence on 27 January after announcing the results of the institutional offer. Group gross debt is expected to reduce from $9.7B to $6.9B, and the company believes the pro forma debt level and maturity profile will be appropriate for the company. WES expects a one-off cost of $200M, relating to closing out debt hedge positions and the cost of the equity raising. The average cost of debt on the remaining $6.9B debt is 8-8.5%, slightly below the current interest rate of 8.5-8.8%, indicating FY interest cost of $550-585M.
WES has kept open the option to reduce its profit guidance given on 14 January ("actual results may differ from the guidance"), and "at this stage" does not believe further writedowns will occur from the asset valuation review (though the market expects a significant writedown of the Coles acquisition).
We will review our forecasts. This announcement is expected to remove the debt concerns of the market, however at a cost to existing shareholders. WES clearly does not expect a significant takeup of shares by the retail market. Conditions will remain difficult for WES in the short term (exposure to discretionary spending, the cost of rebuilding Coles, coal price reductions, etc) however at the time of economic recovery WES should emerge as a stronger organisation.
The market will remain focussed now on the dividend outlook for the company, with WES reluctant to give any specific guidance beyond FY09.

15 January, 2009 (PART 1 OF 2)
WES Downgrades Guidance, With Debt Refinancing the Main Lingering Issue - WES guidance for NPAT for HY 2009 is now $850-880M after some asset writedowns. Expected HY asset writedowns are $130-140M post tax, indicating normalised NPAT for the HY of $980-1020M.
(Asset writedowns include Coles property, various listed and unlisted investments, closure of obsolete Coles distribution centres, and increased self-insured worker's compensation liabilities based on altered valuation metrics)
Expect FY09 dividend to be below the 200 cps previously indicated. WES at a recent analyst briefing stated that dividend will be looked at as part of the capital management options.
Expect a more significant writedown of the Coles business to be announced with the HY, on 19 February.
We had trimmed the dividend forecast after the recent analyst briefing last year, and have now cut our forecast FY09, FY10 and FY11 dividend again.
Our profit forecasts have been reduced further, with the main cuts in Coles Food & Liquor, Coles Convenience, OfficeWorks, and Chemicals. Several segments including Insurance, Coal and Bunnings are performing better than expected in the current environment.
Our dividend forecast for the FY09 assumes a payout ratio of 60%. The dividend to be paid will be a function of capital commitments for Coles (we do not expect significant working capital releases from Coles this year), the target debt levels, and bank participation in refinancing the debt due to mature this calendar year. There will be a one-off meaningful cash injection from Coal this year.
Clearly a difficult market for WES, but the outlook comments remain.

15 January, 2009 (PART 2 OF 2)
While gearing is not high (ND/ND+E = 31% @ June 2008) the capital commitments for the Coles rebuild remains an issue, and profit growth within Coles is needed in the next 18 months to offset the downturn in Coal profits next year.
2009 EBIT Interest Cover of 3.2 times is slim in today's credit market.
Our valuation assumes a 20% discount to the market average PE, and hence a re-rating over time as the company reduces its debt levels and the market reduces the risk premium for debt. An equity issue is possible, depending on the ability for WES to roll over existing debt lines. This will keep the share price depressed in the short term.
WES has noted the intention to write down further assets on top of those announced today. We expect there will be a significant writedown of Coles (the writedowns announced today do not include the Coles businesses). In assessing the likely goodwill write downs, we note that as at 30 June the WES Balance Sheet included:
* Trade names: Coles $3.3B; Target & Kmart $0.85B; OfficeWorks & Other $0.25B; Total $4.4B
* Goodwill: Coles $10.2B; Target & Kmart $2.8B; Insurance $1B; Bunnings $0.8B; OfficeWorks $0.8B; Energy & Other $0.8B; Total $16.4B.
Thus there is significant scope for write downs to be announced, given Coles was acquired at the top of the asset bubble.

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Company Directors

Dr Robert (Bob) Every
Mr James Philip Graham
Mr David Charles White
Mr Charles Macek
Mr Anthony (Tony) John Howarth
Mrs Patricia Cross
Mr Gene Thomas Tilbrook
Mr Colin Bruce Carter
Mr Richard Goyder

Company Activities

Wesfarmers Limited (WES) is a diversified Australian corporation. It operates through a portfolio of diversified business interests including retail operations covering supermarkets, general merchandise and speciality department stores, fuel and liquor outlets and home improvement and office supplies; coal mining; gas processing and distribution; electricity generation; insurance; chemicals and fertilisers; and industrial and safety product distribution.

COLES: Comprises one of Australia's largest supermarket businesses (Coles and Bi-Lo), Coles Liquor (1st Choice Liquor Superstores, the Liquorland convenience offer and the specialist chain, Vintage Cellars) and the Coles Express, fuel and convenience stores.
DEPARTMENT STORES: Target is a department store retailer offering customers quality, on-trend, fashionable apparel and soft homewares. Target operates in 270 locations across Australia, with 152 Target stores and 117 Target Country stores. K-Mart is leading discount department store retailer which operates 182 stores throughout Australia and NZ.
HOME IMPROVEMENT AND OFFICE SUPPLIES: Comprises the Bunnings and Officeworks businesses. Bunnings is the leading retailer of home improvement, gardening products and a major supplier of building materials in Australia and NZ. Officeworks is Australia's largest retailer of office products.
RESOURCES & ENERGY: Owns and operates the Curragh Mine in QLD, the Premier Mine in WA and has a 40% interest in the Bengalla Mine in NSW. Interests comprise 4 gas businesses, a power generation business and support services.
INSURANCE: Comprises of 3 general insurance companies (Wesfarmers Federation Insurance, Lumley General Australia and Lumley General NZ), 3 insurance brokers (OAMPS Australia, OAMPS UK and Crombie Lockwood), premium funding and superannuation activities and an insurance software developer.
INDUSTRIAL & SAFETY: A leading supplier of engineering products and industrial consumables, safety, packaging, materials handling and lifting products and services in Australia and NZ.

Information for Company Activities is sourced from Huntley Investment Information Pty Ltd.