Wesfarmers to Spend A$5 Billion Reviving Coles Sales (Update3)

By Robert Fenner

Aug. 16 (Bloomberg) -- Wesfarmers Ltd., Australia's biggest hardware retailer, plans to spend A$5 billion ($4 billion) reviving sales growth at Coles Group Ltd. should its record takeover of the supermarket chain succeed.

Wesfarmers will accelerate cost saving programs, refurbish stores and close Coles' headquarters in Melbourne to lower overheads by A$385 million a year, the Perth-based company said in a statement today. The operator of the Bunnings Hardware chain today announced a 34 percent fall in second-half profit on lower coal earnings.

Chief Executive Officer Richard Goyder, whose businesses include mining and insurance, aims to revive profit growth by increasing the focus on retail. After the

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A$18.4 billion takeover of Coles, which will be Australia's largest, Wesfarmers will need to turn around sales at the nation's second-largest supermarket chain and stem a loss of customers to Woolworths Ltd.

``Given their expertise on Bunnings and in retail, they are the best people to turn around Coles,'' said Michael McCormick, who helps manage and advise on A $220 million at Leyland Private Asset Management in Sydney. ``If they throw all that expertise at it, they will do a good job.''

In buying Coles, Wesfarmers will gain 3,000 stores including supermarkets, Officeworks stationery supply outlets, filling stations and the Target and Kmart discount department stores.

The company will review the Kmart chain based on three options of improving its performance, rebranding some outlets or selling the business.

``My preference is to retain Kmart and build it, but time will tell,'' Goyder told reporters on a conference call.

Three Divisions

Goyder will create three divisions focused on Target, large format stores operating the Bunnings Hardware and Officeworks chains, and a food, liquor and convenience stores unit. Administrative functions, such as human resources, will be performed within each business rather than through a central office.

``The corporate office at Wesfarmers is around 130 people and that contrasts with around 6,500 at Coles so you can see this is going to be a significant change in the way we run management,'' Goyder said.

Losing Customers

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Coles sales are growing at the slowest pace on record as it loses customers to larger rival Woolworths and smaller independently owned supermarkets. Goyder expects sales growth from stores open at least a year to rise to between 3 percent and 3.5 percent by 2010, compared with the 0.8 percent pace of the most recent quarter.

``A big investment needs to be made to reposition those stores on price, service and fresh food and turn things around,'' said Grant Saligari, a retail analyst at Commonwealth Securities Ltd. in Sydney. ``They are being extremely optimistic.''

Wesfarmers shares fell 41 cents, or 1 percent, to A$39.09 at the 4:10 p.m. close of trading in Sydney. The stock has slumped 15 percent since the July 2 bid for Coles on concern it's paying too much and the purchase will cut earnings per share.

Wesfarmers last week said Coles investors may be able to opt for more cash or stock in the takeover after the slump in its share price.

Under the initial bid, Coles investors were to receive A$4 cash and 0.2843 Wesfarmers shares for each share they owned. They were also entitled to a 25-cent dividend.

Falling Profit

Second-half net income at Wesfarmers fell to A$394.4 million in the six months ended June 30 from A$601.3 million a year earlier, the company said today. Annual profit fell 25 percent to A$786.3 million.

Wesfarmers was expected to have annual earnings of A$783.3 million, according to the average of five analyst estimates compiled by Bloomberg. The year earlier result included a A$178.7 million gain from selling its rail unit.

The company expects all units except the coal mining division to report higher earnings in 2008.

Coal earnings before interest and tax for the second half fell 29 percent to A$170 million on lower prices and production.

Goyder agreed to a 15 percent cut in coking coal prices from its Curragh mine in Queensland state in April 2006. Coal output for the year was 13.7 million metric tons, 8 percent below the year-earlier figure, as port and rail congestion limited shipments.

Second-half earnings from the Bunnings unit, the nation's biggest home-improvement retailer, rose 5.7 percent to A$258.7 million on new store openings. Hardware and coal generate 63 percent of the company's profit.

Insurance, Chemicals

Insurance earnings for the half were unchanged at A$60 million. The insurance margin, or profit as a ratio of premium income, fell to 9.5 percent during the year from 14.9 percent the previous year.

Earnings before interest and tax at the chemicals & fertilizer division rose 33 percent for the half to A$72.8 million.

The industrial and safety unit, which sells workplace equipment ranging from tools to clothing, had a 25 percent rise in earnings for the half to A$63.7 million.

Wesfarmers will pay a second-half dividend of A$1.40 a share, down from A $1.50 a year earlier. In 2008 and 2009, the dividend is forecast at more than A

$2 a share subject to the Coles deal succeeding.

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