LES GROUP

Coles Group Limited

ABN 11 004 089 936

Scheme Booklet Supplement

This booklet contains a copy of the Independent Expert's Report, Investigating Accountant's Report and the Scheme Implementation Agreement

For a scheme of arrangement in relation to the proposed acquisition of all your Coles Group Limited shares by Wesfarmers Retail Holdings Pty Ltd (ACN 126 199 022), a wholly owned subsidiary of Wesfarmers Limited (ABN 28 008 984 049)

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Lazard Carnegie Wylie Deutsche Bank

FINANCIAL ADVISERS

Freehills

LEGAL ADVISER

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Important notices

Nature of this document

This Scheme Booklet Supplement contains additional information about the acquisition of Coles Group by Wesfarmers (through its wholly-owned subsidiary, Wesfarmers Retail).

This additional information is in addition to the Scheme Booklet dated 27 September 2007. Coles Group Shareholders can obtain a copy of the Scheme Booklet by contacting the Coles Group Information Line on 1300 663 897 (within Australia) or +61 3 9415 4314 (outside Australia), or from Coles Group's website at www.colesgroup.com.au.

Coles Group Shareholders should read the Scheme Booklet in its entirety before deciding on whether to vote in favour of the Scheme.

Defined terms

Defined terms in this Scheme Booklet Supplement have the same meaning as in Section 14 of the Scheme Booklet.

Privacy

Coles Group and Wesfarmers may collect personal information in the process of implementing the Scheme. Such information may include the name, contact details, bank account details and shareholdings of Coles Group Shareholders and the name of persons appointed by those persons to act as a proxy, attorney or corporate representative at the Scheme Meeting. The primary purpose of the collection of personal information is to assist Coles Group and Wesfarmers to conduct the Scheme Meeting and implement the Scheme. Personal information of the type described above may be disclosed to the Coles Group Share Registry and Wesfarmers Share Registry, print and mail service providers, authorised securities brokers and Related Bodies Corporate of Coles Group and Wesfarmers. Coles Group Shareholders have certain rights to access personal information that has been collected. Coles Group Shareholders should contact the Coles Group Registry in the first instance if they wish to access their personal information. Coles Group Shareholders who appoint a named person to act as their proxy, attorney or corporate representative should ensure that they inform that person of these matters.

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1 Independent Expert's Report

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1 Independent Expert's Report

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21 September 2007

The Directors
Coles Group Limited
800 Toorak Road
Tooronga VIC 3146

Dear Directors

Wesfarmers Proposal

1 Introduction

Coles Group Limited ("Coles Group") is one of Australia's leading retail companies, with approximately 170,000 employees and operations in every State of Australia. Its major businesses are:

- the Coles and Bi-Lo supermarket chains ("Supermarkets");
- the Coles Express convenience store and fuel retailing chain;
- a liquor business ("Coles Liquor") consisting of retail liquor outlets and hotel operations (including gaming). The retail liquor outlets trade under the 1st Choice, Liquorland and Vintage Cellars brands;
- the Kmart discount department store chain;
- the Target department store chain; and
- the Officeworks office products chain.

Coles Group shares are listed on the Australian Securities Exchange ("ASX"). As at 21 September 2007, Coles Group had a market capitalisation of around $18.0 billion.

In August 2006, Coles Group announced that it had been approached by a consortium of private equity funds with a conditional proposal for the acquisition of all the shares in Coles Group, at an indicative price of $14.50 per Coles Group share. The conditional proposal was subsequently increased to $15.25. The Directors of Coles Group did not proceed with the conditional proposal as they determined that the offer price significantly undervalued the company. In February 2007, following the results for the period ended 31 January 2007, Coles Group announced that it was initiating a review of ownership options for Coles Group. Coles Group undertook an extensive sales process, including discussions with a number of potential buyers of part or all of Coles Group. On 2 July 2007, Coles Group announced that it had reached an agreement for Wesfarmers Limited ("Wesfarmers") to acquire all the shares in Coles Group. A revised proposal ("the Wesfarmers Proposal") was announced on 5 September 2007.

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Wesfarmers is a diversified Australian conglomerate. Its major business operations are:

- the Bunnings chain of hardware stores;
- coal mining operations in Queensland, New South Wales and Western Australia;
- a general insurance and insurance broking business;
- a chemicals and fertilisers business;
- an industrial products distribution business; and
- an energy business, including gas refining and distribution and the design, ownership and operation of regional power generation facilities.

Wesfarmers is also listed on the ASX, with a market capitalisation of around $15.6 billion as at 21 September 2007.

Under the Wesfarmers Proposal, which is to be effected by a scheme of arrangement ("Scheme"), the consideration ("Base Offer Consideration") consists of $4.00 cash, 0.14215 ordinary Wesfarmers shares and 0.14215 Wesfarmers Partially Protected Shares ("PPS") for each Coles Group share. The PPS:

- afford holders of PPS the same rights as ordinary shares in relation to dividends, returns of capital, voting and other matters;
- will be reclassified on a one for one basis as ordinary shares after a period of between four years (the "Lapse Date") and four years and six months. To the extent the Wesfarmers share price at that time is below $45.00, Wesfarmers will make a bonus issue of ordinary shares so as to provide value to PPS holders of $45.00, up to a maximum of 0.25 bonus shares per PPS (i.e. holders will receive less than $45.00 if the Wesfarmers share price is below $36.00); and
- will be automatically reclassified as ordinary shares prior to the end of the four year and six month period if the Wesfarmers share price exceeds $45.00 for a 20 day period. The Lapse Date can also be extended by Wesfarmers by an additional year (for up to a further three years) if the S&P/ASX 200 Industrials Index averages below 6,500 for the two months before the Lapse Date (and each anniversary thereof).

Coles Group shareholders can also participate in a mix and match facility. Shareholders can elect to receive additional cash (in lieu of ordinary shares) or ordinary shares (in lieu of cash). The extent to which such elections are satisfied will depend on the extent of offsetting elections by other Coles Group shareholders. For the purpose of the transfer of interests between Coles Group shareholders participating in the mix and match facility, Wesfarmers shares will be valued at a volume weighted average price ("VWAP") over the five trading days from the date on which the Scheme becomes effective.

All Coles Group shareholders will be entitled to the fully franked final dividend of $0.25 per share in relation to the year ended 29 July 2007. However, Coles Group shareholders will not participate in the final Wesfarmers dividend.

The Scheme is subject to the approval of the Supreme Court of Victoria and Coles Group shareholders.

The Directors of Coles Group have engaged Grant Samuel & Associates Pty Limited ("Grant Samuel") to prepare an independent expert's report setting out whether, in Grant Samuel's opinion, the Wesfarmers Proposal is in the best interests of Coles Group shareholders. A summary of this report will accompany the Notice of Meeting and Scheme Booklet to be sent to Coles Group shareholders. The full report is included in the Supplementary Booklet. This letter contains a summary of Grant Samuel's opinion and main conclusions.

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2 Summary of Opinion

In Grant Samuel's view the Wesfarmers Proposal is in the best interests of Coles Group shareholders. The Wesfarmers Proposal does not deliver a full premium for control. However, unless a superior alternative proposal emerges before the Scheme meeting, Coles Group shareholders are likely to be better off voting in favour of the Wesfarmers Proposal.

Assessment of the Wesfarmers Proposal is not straightforward. Valuation of Coles Group is subject to uncertainty and a wide range of valuation conclusions could credibly be reached. This uncertainty has been exacerbated by the recent volatility in financial markets. Similarly, there is uncertainty regarding the value of the consideration (which largely consists of equity in the expanded Wesfarmers). Accordingly, valuation analysis can provide no more than partial guidance as to whether the Wesfarmers Proposal is in the best interests of Coles Group shareholders. Other considerations include the circumstances that led to the Wesfarmers Proposal, the recent trading performance of Coles Group and the alternatives available to Coles Group should the Wesfarmers Proposal be rejected. The assessment of the Wesfarmers Proposal is an overall conclusion having regard to all these considerations.

Grant Samuel has valued Coles Group in the range $19.6-22.0 billion, or $16.21-18.23 per share. The valuation reflects the estimated full underlying value of Coles Group's businesses. The valuation range exceeds the price at which Grant Samuel would expect Coles Group shares to trade in the absence of the Wesfarmers Proposal or of speculation regarding some alternative corporate transaction.

The Supermarkets, Coles Express and Coles Liquor business represents around 65% of the total enterprise value of Coles Group. The Supermarkets business has traded poorly during the year to 29 July 2007, particularly in the second half of the year. While the current performance is a factor, the valuation of the Supermarkets business also takes into account the strategic attractions of the business, its extensive and non replicable store network and the potential for a turnaround in performance over the medium term. Based on international and local comparisons, the turnaround potential is substantial and this needs to be reflected in the valuation. However, assessment of the fair value today must be tempered by the extent of the restructuring steps yet to be taken and the associated execution risks. The future performance of the Supermarkets business is also likely to be influenced, perhaps materially, by competitor behaviour. Widely differing views could reasonably be adopted in relation to the timing and magnitude of a future turnaround in the business and the capital costs and other investment required to achieve that turnaround. The valuation of Target and Officeworks reflects their ongoing strong performance.

Grant Samuel has attributed a value of $14.87-15.44 per Coles Group share to the Base Offer Consideration. This value range is based on a Wesfarmers ordinary share price in the range $38.00-40.00, adjusted for the final Wesfarmers dividend of $1.40. The PPS have been valued at a premium of $1.00-1.50 per share (for a $40.00 share price) and $1.50-2.00 (for a $38.00 share price) over the value of a Wesfarmers ordinary share. The Wesfarmers share price has fluctuated significantly since the announcement of the Wesfarmers Proposal, falling from a high of $45.73 immediately prior to the announcement of the Wesfarmers Proposal to lows in mid-August 2007 of $37.15. In these circumstances judgements about the value of the consideration are inevitably imprecise. The value of the consideration will fluctuate with movements in the Wesfarmers share price such that the value of the Base Offer Consideration may ultimately be greater or less than the range of values adopted by Grant Samuel of $14.87-15.44. For some shareholders (to the extent that they receive Wesfarmers shares and PPS under the Wesfarmers Proposal), roll-over relief may increase the effective after tax value of the consideration.

The value attributed to the Base Offer Consideration of $14.87-15.44 per Coles Group share is less than Grant Samuel's estimate of the full underlying value of Coles Group of $16.21-18.23. Accordingly, the Wesfarmers Proposal is not currently in the fair value range and this suggests that Coles Group shareholders are not receiving a full premium for control under the Wesfarmers Proposal.

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It can be argued that Coles Group shareholders need not accept an offer that is not "fair":

- **alternative proposals could emerge. The value of the consideration has fallen significantly since the announcement of the Wesfarmers Proposal and this may encourage other parties, particularly those that previously participated in the Coles Group sale process, to re-enter the process (notwithstanding the current difficult credit market conditions). There is ample time for an alternative proposal to be made before the Scheme meeting. Wesfarmers' 12.1% voting power in Coles Group would not be an insurmountable impediment to an alternative offer;**

- **if the Wesfarmers Proposal is rejected, Wesfarmers might improve its offer; and**

- **while a return to the "status quo" is not realistic, Coles Group could ultimately deliver value above $16.21-18.23 per share through a successful turnaround of the Supermarkets business (possibly in conjunction with an equity partner), albeit over the medium term. Such a strategy could be undertaken in conjunction with a sale or spin off of businesses such as Target and Officeworks. The organisation does require a major revamp, including substantial management revitalisation across the Supermarkets business and other structural changes, but a turnaround under Coles Group ownership cannot be ruled out. Wesfarmers' plans for the Supermarkets business are not dramatically different to those of Coles Group and Wesfarmers will also need to recruit new management. It should be recognised that there are substantial risks associated with the turnaround of the Supermarkets business, whether under Coles Group or Wesfarmers ownership.**

The offer process has coincided with a low point in the performance of the Supermarkets business, a period of negative market sentiment towards the company and adverse external market conditions. It may therefore not be a propitious time for shareholders to sell.

On the other hand:

- **given the inherent uncertainty regarding valuation judgements for Coles Group, the conclusion that the Wesfarmers Proposal is not "fair" needs to be treated with some caution. The Wesfarmers Proposal was the outcome of an extensive worldwide sale process and was the only firm offer for all of Coles Group. On one view, the highest price secured through a comprehensive sale process by definition represents full underlying value. Notwithstanding the subsequent fall in the Wesfarmers share price (and consequent reduction in the value of the consideration), the Wesfarmers Proposal remains the only proposal available to Coles Group shareholders. If no superior proposal is received prior to the Scheme meeting it could be argued that the Wesfarmers Proposal still represents full value;**

- **having enhanced its offer through the introduction of PPS, the prospects of Wesfarmers increasing its offer are not high. In addition, the prospects of an alternative offer may be diminished because of the provisions of the (amended) Scheme Implementation Agreement;**

- **the Wesfarmers share price has fallen sharply from more than $45.00 on the announcement date to its current levels of $38.00-40.00. In part, this fall may be attributable to overall weakness in equity markets during this period but it is likely that the fall also reflected specific factors such as hedge fund and arbitrage activity, some adverse reaction to the proposal and Wesfarmers' results announcement. There is an argument (but no certainty) that the price has been temporarily depressed and that Wesfarmers shares would trade higher once the market settles and if the Wesfarmers Proposal is successfully implemented;**

- **continued ownership uncertainty is likely to be damaging for the Supermarkets business. There is an urgent need to strengthen Supermarkets' management team, but it is difficult to attract high quality candidates in the current circumstances. Further, the achievement of the full turnaround in the Supermarkets business may require such profound changes in the organisation that new ownership may be more effective than continuation of the current structure (even with management changes). Ownership changes (whether involving Wesfarmers or some other party) may provide the opportunity for a decisive break from the past and an accelerated transformation of the Coles Group culture; and**

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- **Coles Group shareholders (excluding Wesfarmers) would collectively have a 44%[1] economic interest in the combined business after implementation. This gives them a substantial ongoing exposure to any upside from the Coles Group businesses if Wesfarmers successfully achieves the turnaround (but equally provides exposure to 44% of any downside).**

  While control clearly passes at a Board and management level, Coles Group shareholders will have a significant ongoing participation in Wesfarmers. In view of the similar sizes of the two entities and the continued involvement of Coles Group shareholders in the merged company, the transaction could be analysed as a merger. Although this analysis is also not clear cut, it suggests that, as a merger, the terms of the Wesfarmers Proposal strike a reasonable balance between the interests of Coles Group and Wesfarmers shareholders, and arguably are favourable to Coles Group shareholders (i.e. they receive some premium). However, where an acquirer is seeking Board and management control, it is usual for a control premium to be paid.

Choosing between these two perspectives is a finely balanced judgement and shareholders could validly form either view.

The Scheme process could be a catalyst for a superior offer, by establishing a clear value benchmark and a defined timetable within which any interested third party would have to act. A counterbidder does face some hurdles but it would nevertheless be sensible for shareholders to defer any voting decision until close to the Scheme meeting. Similarly, the current volatility in financial markets (and in the Wesfarmers share price) would also suggest that decisions should be left as late as practically possible.

If a superior proposal does not emerge prior to the Scheme meeting the choice is essentially between the Wesfarmers Proposal and a standalone turnaround strategy. While the Supermarkets turnaround strategy has the potential to deliver attractive returns over the medium term, it is subject to considerable execution and competitive risk. It is likely that ongoing ownership uncertainty would continue to hamper Coles Group, which would be reliant on achieving major organisational change from within. The Coles Group share price is likely to be relatively weak for a sustained period until credibility is restored through demonstration of a material improvement in performance. While the Wesfarmers Proposal is less than the fair value range, the effect of the discount is mitigated by the fact that Coles Group shareholders will have a 44% economic interest in the combined entity.

Accordingly, if no superior proposal emerges prior to the Scheme meeting, Grant Samuel's judgement is that the Wesfarmers Proposal would be in the best interests of shareholders.

[1] The interest is potentially higher if Wesfarmers is required to issue bonus shares when the PPS are reclassified as ordinary shares. However, this would probably be in circumstances where little upside has been realised.

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3 Key Conclusions

- **Coles Group has been valued in the range $19.6-22.0 billion, representing $16.21-18.23 per share.**

Coles Group has been valued in the range of $16.21-18.23 per share. The valuation represents the full underlying value of Coles Group. The value exceeds the price at which, based on current market conditions, Grant Samuel would expect Coles Group shares to trade on the ASX in the absence of the Wesfarmers Proposal or similar change of control transaction. The valuation is summarised below:

Coles Group - Valuation Summary ($ millions)

	Value Range	
	Low	**High**
Supermarkets, Coles Express and Coles Liquor	13,500	15,200
Kmart	1,550	1,750
Target	4,000	4,300
Officeworks	1,400	1,600
Other assets and liabilities	687	707
Corporate overheads	(275)	(250)
Enterprise Value	**20,862**	**23,307**
Net debt at 29 July 2007	(1,269)	(1,269)
Equity value	**19,593**	**22,038**
Fully diluted shares on issue (millions)[2]	1,209	1,209
Value per share	**$16.21**	**$18.23**

Grant Samuel has valued Coles Group by aggregating the estimated market values of each of its operating businesss, adjusting for other assets and liabilities and the capitalised value of corporate costs, and subtracting net debt as at 29 July 2007. The operating businesses have been valued having regard to capitalisation of earnings and discounted cash flow analysis. The value does not represent a "break up" value as it does not take account of transaction costs (which could be significant).

- **The earnings multiples implied by the valuation reflect the varying performances and growth prospects of Coles Group's businesses.**

The valuation of Coles Group in the range $16.21-18.23 per share implies the following multiples of overall group earnings:

Coles Group – Implied Valuation Parameters

	Low	**High**
Multiple of EBITDA		
Year ended 30 July 2006	12.7	14.2
Year ended 29 July 2007	12.3	13.8
Multiple of EBIT		
Year ended 30 July 2006	18.2	20.3
Year ended 29 July 2007	18.1	20.3
Price earnings multiples (before significant items)		
Year ended 30 July 2006	24.9	28.0
Year ended 29 July 2007	25.7	28.9

[2] Assumes that all options vest and are exercised, and that all performance shares vest. The Coles Group Board is able to exercise its discretion in relation to some of the options and performance shares to allow them to vest. To the extent that some options and performance shares do not vest, there may be a small increase in Grant Samuel's valuation range.

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In Grant Samuel's view the multiples are reasonable. They reflect:

- the strong market positions, leading brands and extensive store networks of Coles Group's various retail chains;
- the disappointing results of the Supermarkets business during 2007, balanced against the prospects for an earnings recovery in the short to medium term;
- the steady progress and potential of Coles Express and Coles Liquor;
- early signs of an improvement in the performance of the Kmart business; and
- the strong performance and prospects for continued growth of the Target and Officeworks businesses.

- **The valuation of Coles Group's businesses has been prepared having regard to discounted cash flow and capitalisation of earnings methodologies.**

Valuations are generally based on one or both of the discounted cash flow ("DCF") and capitalisation of earnings approaches and Grant Samuel has had regard to both methodologies in the valuation of Coles Group.

The capitalisation of earnings methodology involves capitalising the earnings or cash flows of a business at a multiple that reflects the risks of the business and the stream of income that it generates. The multiples can be applied to a number of different earnings or cash flow measure including EBITDA, EBIT or net profit after tax. In determining a value for Coles Group's businesses, Grant Samuel has placed particular reliance on the EBITDA and EBIT multiples implied by the valuation range compared to the EBITDA and EBIT multiples derived from an analysis of comparable listed companies and transactions involving comparable businesses.

The valuation of Coles Group's businesses implies the following multiples of 2007 financial year earnings:

Coles Group Businesses – Implied Earnings Multiples ($ millions)

	Low	High
Supermarkets, Coles Express and Coles Liquor		
Multiple of EBITDA	12.3	13.9
Multiple of EBIT	17.5	19.7
Kmart		
Multiple of EBITDA	9.9	11.2
Multiple of EBIT	16.0	18.1
Target		
Multiple of EBITDA	11.7	12.5
Multiple of EBIT	13.8	14.8
Officeworks		
Multiple of EBITDA	13.4	15.3
Multiple of EBIT	16.4	18.7

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Grant Samuel has also cross-referenced its valuation against budgeted 2008 earnings. At Coles Group's request, Grant Samuel has not disclosed the multiples of 2008 earnings.

The DCF methodology involves discounting the cash flows to a net present value ("NPV") using a discount rate which reflects the risk associated with the cash flow stream. This methodology is able to explicitly capture the potential for a substantial turnaround in the performance of a number of businesses of Coles Group, in particular, Supermarkets and Kmart. For the purpose of the DCF analysis, Grant Samuel has prepared financial models for the operating businesses of Coles Group. The models allow the analysis of alternative scenarios for the future financial performance of the Coles Group businesses. The scenarios were developed by Grant Samuel with reference to the Coles Group 2008 budget and five year management projections prepared by Coles Group management. The projections were prepared by Coles Group management for the purpose of the sale process, and on the basis of actual results of Coles Group to 28 January 2007. They have not been updated by Coles Group management to reflect the actual trading of Coles Group for the second half of the 2007 financial year or to reflect the 2008 budget.

The financial models for Coles Liquor and Kmart run from 30 July 2007 for five years to 31 July 2012, with a terminal value as at 31 July 2012. The models for Supermarkets, Coles Express, Target and Officeworks have been extended for an additional five years to 31 July 2017 with a terminal value calculated as at 31 July 2017. The models are relatively short term, and are designed to capture the value of the turnaround potential of Supermarkets and Kmart, and the short term growth prospects of the other businesses.

Grant Samuel adopted assumptions for the scenarios to reflect its judgement on certain matters. The assumptions adopted by Grant Samuel and the associated calculations of future performance in the financial models are not, and are not necessarily consistent with, the assumptions and forecasts of Coles Group. The scenarios are based on a large number of assumptions and are subject to significant uncertainty and contingencies, many of which are outside the control of Coles Group. The scenarios allow an assessment of the impact on value of various key assumptions relating to sales growth, EBITDA margin, capital expenditure and other factors. It should be recognised that the scenarios focus on assumptions regarding key value drivers, rather than detailed "bottom up" parameters. The scenarios do not represent Grant Samuel's forecasts of the future financial performance of Coles Group and its businesses. Grant Samuel gives no undertaking and makes no warranty regarding the future financial performance of Coles Group and its businesses. Such future performance is subject to fundamental uncertainty. Rather, the scenarios have been developed purely to allow Grant Samuel to assess the impact of calculated NPVs of alternative assumptions regarding the future financial performance of Coles Group and its businesses.

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The assumptions generate the following key measures of financial performance:

Coles Group - Key Measures of Financial Performance ($ millions)					
	Financial Year				
	2008	2009	2010	2011	2012
Supermarkets, Coles Express and Coles Liquor					
Scenario A					
Revenue growth	5.5%	6.2%	6.1%	5.7%	5.2%
EBIT margin	3.3%	3.5%	3.7%	4.0%	4.0%
Scenario B					
Revenue growth	5.5%	7.4%	6.2%	5.9%	5.4%
EBIT margin	3.3%	4.1%	4.1%	4.5%	4.5%
Kmart					
Scenario A					
Revenue growth	3.2%	3.6%	3.8%	4.0%	4.0%
EBIT margin	3.0%	3.0%	3.0%	3.1%	3.1%
Scenario B					
Revenue growth	3.2%	4.3%	3.9%	4.7%	4.1%
EBIT margin	3.0%	3.4%	3.4%	3.4%	3.4%
Target					
Scenario A					
Revenue growth	7.7%	8.0%	8.0%	8.0%	7.0%
EBIT margin	8.6%	8.5%	8.5%	8.3%	8.2%
Scenario B					
Revenue growth	7.7%	8.3%	8.5%	9.9%	6.9%
EBIT margin	8.6%	8.5%	8.5%	8.6%	8.5%
Officeworks					
Scenario A					
Revenue growth	12.8%	11.1%	10.5%	8.9%	7.6%
EBIT margin	6.8%	6.9%	6.9%	7.2%	7.2%
Scenario B					
Revenue growth	12.8%	11.1%	10.5%	8.9%	7.6%
EBIT margin	6.8%	7.0%	7.4%	7.8%	8.1%

Other parameters used in the DCF analysis include:

Coles Group – Other Valuation Parameters ($ millions)				
	Discount Rates		Terminal Value Growth Rates	
	Low	High	Low	High
Supermarkets, Coles Express and Coles Liquor	10.0%	9.0%	3.0%	4.0%
Kmart	10.5%	9.5%	3.0%	4.0%
Target	10.5%	9.5%	3.0%	4.0%
Officeworks	10.5%	9.5%	3.0%	4.0%

The financial models project cash flows from 30 July 2007 and assume cash flows occur in the middle of each period. The corporate tax rate is assumed to be 29.2% in the 2008 financial year (consistent with management forecasts), and reverts to 30% from 2009 onwards.

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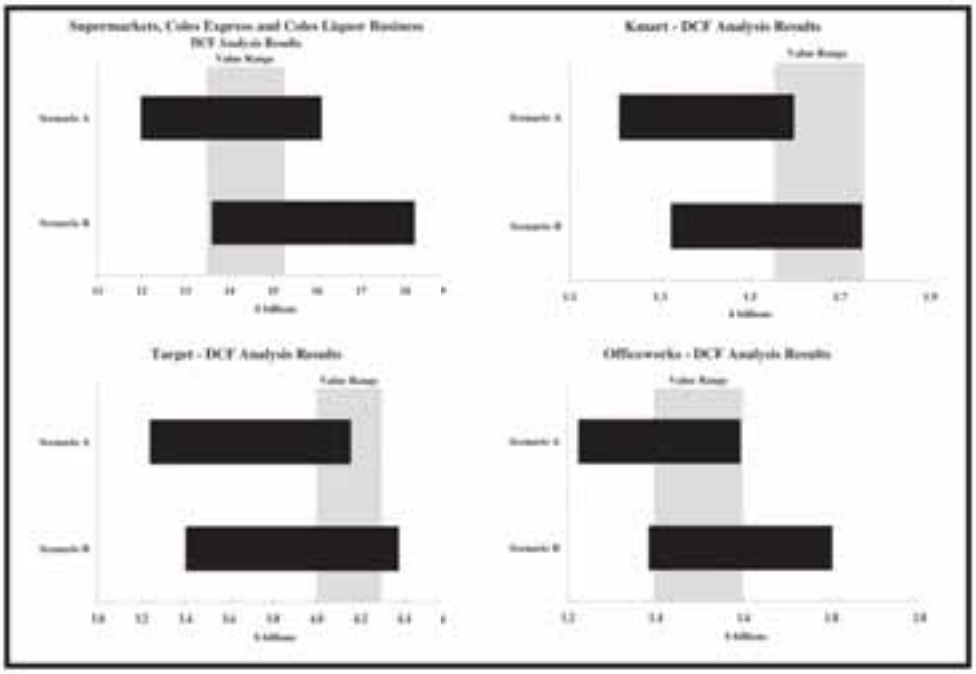
The DCF outcomes compared to Grant Samuel's value range for the Coles Group businesses is summarised below:



Grant Samuel's valuation of Kmart and Target are relatively high having regard to the results of the DCF analysis, although consistent with valuation evidence based on EBITDA multiple analysis. In Grant Samuel's view this is reasonable given the strategic value of the Kmart and Target store networks and the synergy benefits potentially available to a trade buyer, which are not fully reflected in the financial assumptions upon which the DCF analysis is based.

- **Valuation of the Supermarkets business is key to the overall assessment.**

The Supermarkets, Coles Express and Coles Liquor businesses represent around 65% of Coles Group's enterprise value. Most of this value is contributed by the Supermarkets business. Grant Samuel's valuation of the Supermarkets, Coles Express and Coles Liquor business reflects the following factors:

- following a disappointing 2006 financial year, in which the Supermarkets business recorded only modest earnings growth, Supermarkets' earnings have fallen significantly in the 2007 financial year. The decline in earnings is the result of a variety of factors, including a general deterioration in the customer offer, continued competitive pressure and various management issues. More specifically, the poorly executed conversion of the Bi-Lo chain to the Coles brand and the problematic implementation of a new centrally managed range system across the supermarket network have resulted in a loss of sales and margin. In addition, it appears that the lengthy sale process for Coles Group has been disruptive at a management level and these effects will continue in the short term;

- strong growth in earnings is expected for 2008. Coles Group management has put in place various initiatives to remedy the consequences of the Bi-Lo conversion and the implementation of centrally managed range, and to address the broader business deficiencies that have become apparent. Management expects that earnings will rebound in 2008, largely as a result of the full year effect of benefits from Coles Group's cost reduction ("Simplification") program, non-recurrence of one-off Bi-Lo store conversion costs incurred in 2007 and some initial benefits from the supply chain re-engineering ("Transformation") program. In addition, the budgeted increase in earnings also reflects an expectation that comparable store sales growth will

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accelerate and various other business initiatives will increase margins. Trading towards the end of the 2007 financial year and over the first few weeks of the 2008 financial year has shown some preliminary evidence of a sales turnaround;

- there is potential for substantial earnings growth over the medium to longer term. In particular, the Transformation program is anticipated to generate large savings in supply chain costs by 2012, with the bulk of the savings to be delivered towards the back end of the program. Management expects that supply chain cost efficiencies will be complemented by improved in-store execution, with improved range, an expanded house brand offer, a focus on fresh, a consistent value proposition, and a more aggressive store refurbishment program all contributing to sales and margin growth. The Simplification program is expected to yield ongoing incremental benefits through to the 2009 financial year. Performance benchmarks (both from local and international supermarket operators) suggest that a significant improvement in overall performance is realistic;

- while management's plans for longer term earnings growth are broadly credible, the reality is that they are subject to significant execution risk. The Supermarkets business will need to concurrently complete a complex supply chain program and substantially improve in-store execution, while also completing a business and management restructuring, including the recruiting of a number of senior executives;

- the business is exposed to the effects of competitive behaviour, principally from Woolworths Limited ("Woolworths"). The Woolworths business is highly profitable. Its lead in supply chain and lower cost structure means that it can afford to trade off margin for market share. Competition from Woolworths (or from other participants such as Aldi or IGA) in terms of price, in-store execution or otherwise could have a significant effect on the earnings of the Supermarkets business;

- synergies available to potential acquirers of the Supermarkets business would be modest at best; and

- notwithstanding the uncertainty regarding future earnings improvement, the Supermarkets business has attractive characteristics. The Coles brand is long established and the store network, one of only two such networks in Australia, could not be replicated by a new entrant to the market and is protected by significant barriers to entry.

While there is clearly considerable upside in the Supermarkets business, it is not appropriate to take this upside into account without risking it. A buyer of the Supermarkets business would not pay for all the potential upside, given the risks that the buyer would assume. A wide range of views could reasonably be taken on the likely timing, costs and extent of the expected business turnaround. Accordingly, a range of credible conclusions regarding the value of the Supermarkets business could be reached.

- **Grant Samuel has attributed a value of $14.87-15.44 to the Base Offer Consideration to be received by Coles Group shareholders.**

Shareholders who accept the Base Offer Consideration will receive 0.14215 of a Wesfarmers ordinary share, 0.14215 of a Wesfarmers PPS and $4.00 in cash for every Coles Group share. In addition, shareholders will be entitled to retain the $0.25 fully franked final dividend to be paid by Coles Group. Coles Group shareholders who receive Wesfarmers shares will not be entitled to participate in the Wesfarmers fully franked final dividend of $1.40 per share.

Assessment of the value of the Base Offer Consideration requires an estimate of the likely trading price of Wesfarmers ordinary shares and PPS at the time that the Wesfarmers Proposal becomes effective. It is normal practice to use the current market price as the starting point for estimating the value of the offer, particularly for large companies such as Wesfarmers that enjoy reasonable share liquidity and are followed by a number of analysts and other commentators (adjusted for any likely effects of the transaction not already reflected in market trading).

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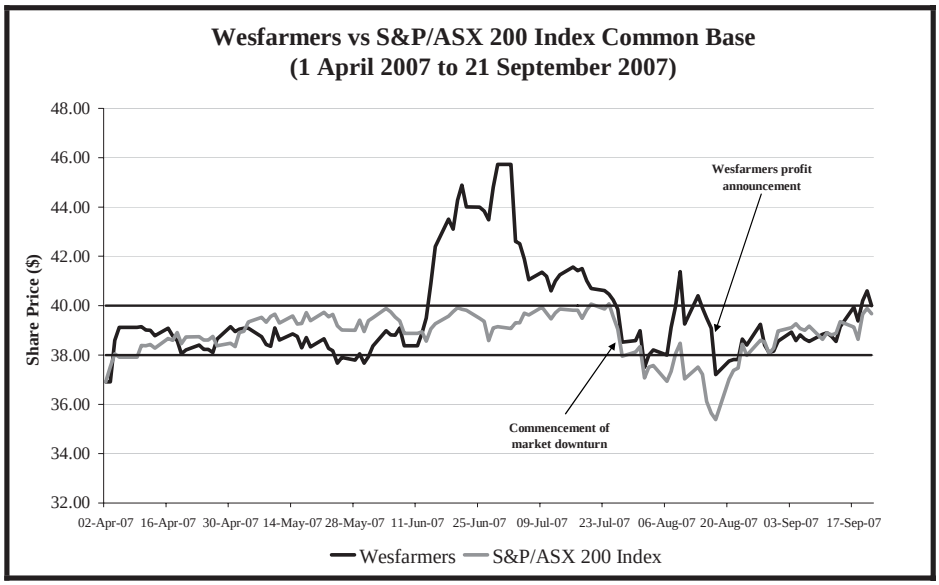
However, judgements regarding the likely trading price of Wesfarmers shares (or even a range of likely trading prices) are difficult. The Wesfarmers share price has fluctuated significantly in recent times (and its volatility is well above historical norms). During April, May and the first two weeks of June 2007, Wesfarmers shares traded reasonably consistently in the range $38.00-40.00 (with a VWAP of $38.82). During the last two weeks of June 2007, the Wesfarmers share price strengthened considerably, reaching an all time closing high of $45.73 immediately before the announcement of the initial Wesfarmers proposal on 2 July 2007. The increase appears to have coincided with a general re-rating of stocks with exposure to coal that occurred at around this time.



Source: IRESS

Following the announcement of the initial Wesfarmers proposal on 2 July 2007, the Wesfarmers share price fell significantly. Wesfarmers shares generally traded in the range $40.00-42.00 for most of July 2007, before falling further as the overall market weakened at the end of July 2007. During August 2007, Wesfarmers shares generally traded in the range $38.0-40.00, with a volume weighted average price of $38.77. The Wesfarmers share price strengthened following the announcement of the revised Wesfarmers Proposal on 5 September 2007. Since then the Wesfarmers share price has traded in the range $38.00-40.00, with a volume weighted average price of $39.39 up to 21 September 2007.

There are a number of factors that suggest that the recent Wesfarmers share price may not be representative of the price at which Wesfarmers shares would trade at the time of implementation of the Wesfarmers Proposal:

- the recent Coles Group share price (which has generally been less than the "see-through" value implied by the Wesfarmers share price) indicates that the market has been pricing in some risk that the Wesfarmers Proposal will not proceed. It is possible (although not certain) that the Wesfarmers share price will strengthen as the market becomes more confident that the Wesfarmers Proposal will complete;

- Coles Group's 2007 results were not released until 19 September 2007;

- the market has limited visibility on 2008 earnings for either Wesfarmers or Coles Group as no forecasts have been released by either company; and

- there have been suggestions that hedge fund and arbitrage trading in Coles Group and Wesfarmers may have depressed the Wesfarmers share price following the announcement of the Wesfarmers Proposal.

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The Wesfarmers share price will also continue to be exposed to the risk of overall share market volatility during the period up to implementation.

Notwithstanding these issues, in Grant Samuel's view the recent Wesfarmers share price range of $38.00-40.00 is the best current estimate of the likely Wesfarmers ordinary share price at the time of implementation of the Wesfarmers Proposal. Grant Samuel is not aware of any basis for attributing any different range of values to Wesfarmers ordinary shares.

Grant Samuel has estimated a premium for the PPS relative to Wesfarmers ordinary shares in the order of $1.00-1.50 per share (for a $40.00 share price) and $1.50–2.00 (for a $38.00 share price). The basis for this premium is discussed in the following section.

On the basis of a Wesfarmers ordinary share price in the range $38.00-40.00, the premium for PPS and a dividend "drop-off" of $1.40, Grant Samuel has attributed a value in the range $14.87-15.44 to the Base Offer Consideration (including the final Coles Group dividend of $0.25 per share to be received by Coles Group shareholders).

The after tax value of the Base Offer Consideration will vary depending upon the particular taxation position of individual shareholders. For some shareholders, the ability to defer taxation through roll-over relief in relation to the scrip component of the consideration (including the PPS) will be attractive. The Coles Group final dividend of $0.25 per share will be fully franked and the franking credits have additional value of up to 10.7 cents per share (not included in the range $14.87-15.44) for shareholders who can make full use of them.

The mix and match facility will allow shareholders to elect to receive more ordinary scrip or more cash, subject to a capped total cash payment to Coles Group shareholders and the elections of cash and ordinary scrip by other shareholders. The basis by which the proportions of scrip and cash will be determined will result in these alternatives having face values comparable to the value of the Base Offer Consideration (although there may be differences in tax consequences for some shareholders).

The value of the consideration will change with movements in the Wesfarmers share price, and the value of the Base Offer Consideration could ultimately be greater or less than the range of $14.87-15.44 adopted by Grant Samuel. Significant movements in the Wesfarmers share price (and therefore in the value of the consideration) could change the overall evaluation of the Wesfarmers Proposal.

- **The PPS, which represent 50% of the scrip consideration, are essentially ordinary shares with the added benefit of some downside protection.**

The valuation of the PPS is subject to considerable uncertainty as their features compound the uncertainty attached to the value of Wesfarmers ordinary shares. There is no existing market for PPS and they are relatively complex instruments to value requiring the use of sophisticated mathematical models.

The PPS can be characterised as an ordinary Wesfarmers share but:

- with a right to receive value of $45.00 (in ordinary shares) if Wesfarmers shares are worth less than $45.00 at reclassification date or Wesfarmers choose to reclassify the PPS ahead of this date. This is akin to having a 4 ½ year put option exerciseable at $45.00;
- below a Wesfarmers share price of $36.00 the value protection is incomplete, because the maximum bonus share issue per PPS remains at 0.25 of an ordinary share. Effectively, a holder of PPS is short 1.25 puts at $36.00. Notionally, a shareholder would need to acquire 1.25 put options exerciseable at $36.00 for the same period in order to ensure that the main put option was fully effective; and
- with the risk that, if the Wesfarmers share price trades above $45.00 for more than 20 days, the PPS will automatically be reclassified as ordinary shares and the downside protection will be

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lost. This feature means that the options described above are "barrier options" where the puts are "knocked out" when the share price breaches the $45.00 limit.

Accordingly, the PPS can be valued as an ordinary Wesfarmers share plus the net value of the price protection features. Grant Samuel has calculated the incremental value of the PPS using this approach and valuing the implicit options using a Black-Scholes formula modified for the "up and out" knock out barrier features, in order to take into account the risk of an early reclassification of the PPS as ordinary shares.

The models calculate values in the range $1.61-2.22 (for a $38.00 Wesfarmers price) and $1.13-1.72 (for a $40.00 Wesfarmers share price) depending on assumptions about dividend franking and the treatment of the Wesfarmers dividend.

These values do not take into account some detailed features of the PPS that would affect theoretical value such as the 20 day test for the barrier price and the extendibility feature (if the S&P/ASX 200 Industrials Index is below 6,500). It is difficult to put a precise value on these features.

In any event, it is necessary to take a broader view of the likely market trading price. It is important not to overemphasise the outputs of the financial models which are subject to significant limitations and involve simplifying assumptions. The aggregate market value of the PPS will be approximately $7 billion. Normal turnover will see a significant supply of stock over time. It is unclear how much natural demand there will be from investors prepared to pay such a premium over the price of Wesfarmers ordinary shares. There will of course be trading opportunities for professional investors (hedge funds etc.) but it is also unclear to what extent they will be able to undertake effective arbitrage strategies (complicated by the 4 ½ year term, early conversion and extendibility features) in sufficient volume to match the supply.

In these circumstances a cautious approach to valuing the PPS is warranted. Grant Samuel has assessed value as a premium to the ordinary share price for the purposes of valuing the Base Offer Consideration:

- a premium of $1.50–2.00 at an ordinary share price of $38.00; and
- a premium of $1.00–1.50 at an ordinary share price of $40.00.

This is, to a degree, an arbitrary judgement but it is considered reasonable. The width of the range reflects the inherent uncertainty.

The actual premium at which the PPS may trade could be higher or lower than Grant Samuel's estimate.

- **Coles Group shareholders will not realise a full premium for control under the Wesfarmers Proposal.**

The value attributed to the Base Offer Consideration of $14.87-15.44 is less than Grant Samuel's valuation of Coles Group which is in the range $16.21-18.23. Accordingly, in Grant Samuel's view, the Wesfarmers Proposal is not "fair". Coles Group shareholders will not receive a full premium for control under the Wesfarmers Proposal.

However, it must be recognised that valuation analysis should be treated with some caution. The valuation of Coles Group is subject to significant uncertainty, given that (at least in respect of the Supermarkets business) the valuation depends on judgements regarding the timing, cost and ultimate success of a future business turnaround. Moreover, changes in external market conditions (including share market prices and the availability of debt funding in credit markets) also affect underlying value. Market conditions have recently been volatile. Shareholders with different views on the future prospects for Coles Group's businesses could reasonably reach different conclusions on the value of Coles Group.

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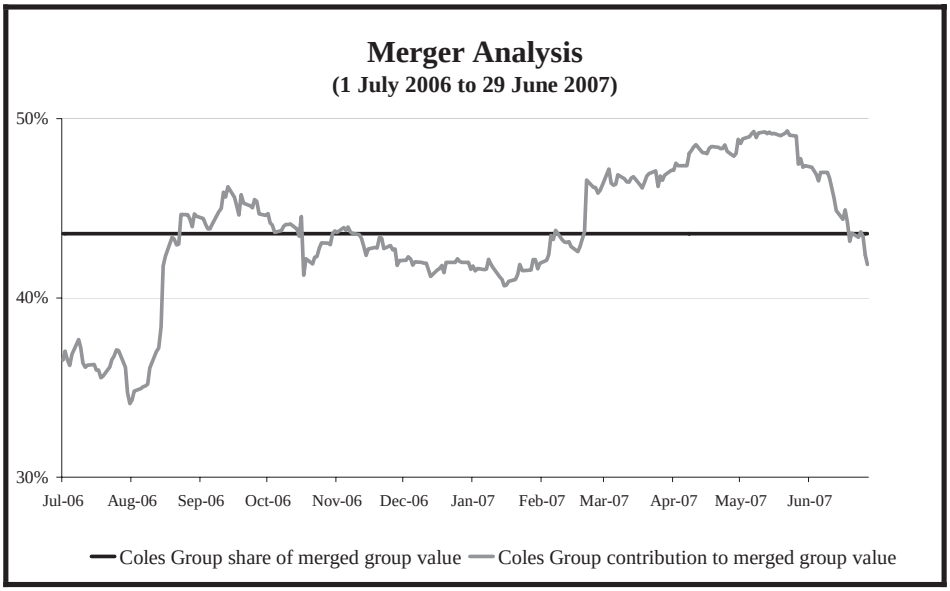
- **If analysed as a merger, the Wesfarmers Proposal strikes a reasonable balance between the interests of Coles Group and Wesfarmers shareholders.**

While, in Grant Samuel's view, Coles Group shareholders will not realise a full premium for control under the Wesfarmers Proposal, they are not losing control in an absolute sense (at least not in the same way as in a 100% cash bid). At a Board and management level, control will clearly pass to Wesfarmers. However, the issue of control is less clear at a shareholder level. Coles Group shareholders (excluding Wesfarmers) will collectively hold a 44% economic interest in the merged Wesfarmers/Coles Group and will continue to have significant economic exposure to the upside in the Coles Group businesses. The combined company will have no controlling shareholder and a widely dispersed share register.

Given that Coles Group and Wesfarmers are of similar size and that Coles Group shareholders will collectively hold a major economic interest in the merged Wesfarmers/Coles Group, it is arguable that merger analysis is also relevant to assessment of the Wesfarmers Proposal.

The following chart compares the contribution of market values made by Coles Group shareholders, based on relative Coles Group and Wesfarmers share prices since July 2006, with the share of overall market value that Coles Group shareholders will enjoy (including the $4.00 cash per share). The analysis does not adjust for dividend payments over the period and the final Coles Group and Wesfarmers dividends still to be paid and (for this purpose only) treats the PPS as equivalent to a Wesfarmers ordinary share:



Source: IRESS and Grant Samuel analysis

The chart shows that for share prices prior to August 2006, the terms of the Wesfarmers Proposal are such that Coles Group shareholders hold a significantly larger share of the value of the merged company than their contribution of value to the merger. Effectively, this suggests that the Wesfarmers Proposal delivers at least a partial premium for control. For share prices from 17 August 2006 to around the end of February 2007, the share of value held by Coles Group shareholders in the merged company is generally consistent with their value contribution (notwithstanding that Coles Group shares were trading on the basis of an expectation of some corporate transaction during this period). Coles Group shares traded at substantially higher prices during the period March to June 2007, as Coles Group undertook its formal sale process and market expectations of a competitive bidding process supported more optimistic views on value. For share prices during this period, the share of value held by Coles Group shareholders in the merged

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company is somewhat less than their value contribution (suggesting that the Wesfarmers Proposal does not deliver a full premium for control).

Although the analysis is not clear cut, given the impact of takeover speculation on the Coles Group share price, in Grant Samuel's view the analysis suggests that, if analysed as a merger, the terms of the Wesfarmers Proposal strike a reasonable balance between the interests of Coles Group and Wesfarmers shareholders, and arguably are favourable to Coles Group shareholders. The analysis suggests that Coles Group shareholders are realising at least a partial premium for control. Nevertheless, it is generally accepted that when an acquirer seeks Board and management control, a full control premium should be paid (notwithstanding the share of the merged group owned by the target shareholders).

- **There is potential for a superior alternative proposal to emerge.**

The Wesfarmers Proposal is the outcome of events that commenced more than twelve months ago. From February 2007, Coles Group and its advisers actively sought potential buyers for the company and its businesses. Given the high profile of the Coles Group and its businesses, it is reasonable to assume that every credible potential buyer of Coles Group (including international buyers) would have been aware of the opportunity. The Wesfarmers Proposal is the only firm offer put forward to acquire the whole company. While a private equity consortium led by Kohlberg Kravis Roberts & Co ("KKR") made indicative offers of $14.50 and $15.25 cash per Coles Group share during August and October 2006, these were subject to due diligence. During the first half of 2007, KKR and the other members of its consortium withdrew from the sale process.

It is possible that Coles Group could receive some alternative superior proposal. Given the fall in the value of the Wesfarmers Proposal since the announcement on 2 July 2007, one of the parties that have already examined a transaction with Coles Group could be encouraged to re-enter the process as they would now be more competitive.

The commitment of Coles Group to the Wesfarmers Proposal should help to establish whether there are any superior alternatives for Coles Group shareholders. The Scheme process should act as a catalyst to any genuinely interested party with a superior proposal, by establishing benchmarks for value and defining a time frame within which parties would have to act and which, while limited, should be sufficient to put together such a proposal. At the same time it is necessary to recognise that:

- current conditions in financial markets (particularly credit markets) make it more difficult for financial buyers to put together competitive and fully financed proposals (at least until such time as markets settle down); and
- the terms of the (amended) Scheme Implementation Agreement create some, but not insurmountable, impediments to a counterproposal. For example, the break fee has been increased to around $150 million (although this equates to only around $0.125 per share), there are tighter controls on information flows and engagement with counterbidders, and Wesfarmers now has a right to match a competing offer.

- **A turnaround of the Supermarkets business under Coles Group ownership could ultimately deliver more value to shareholders.**

A turnaround of the Supermarkets business under Coles Group ownership could conceivably deliver more value to Coles Group shareholders than the Wesfarmers Proposal (although there can be no certainty regarding the timing and extent of a successful turnaround and, at best, it would only occur over the medium term). A return to the "status quo" is probably not realistic but a viable strategy could involve:

- changes to the company's leadership; and
- the sale or spin off of some businesses outside the Supermarkets, Coles Express and Coles Liquor business, either individually or as a package. In particular, the Target and Officeworks businesses could be attractive to a number of buyers (including Wesfarmers and Woolworths)

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or could form the basis of a meaningful separate listed company. The effect would be some value realisation for shareholders (through a sale) or at least greater clarity of value (through a spin off).

The potential in the Supermarkets business is clear. Comparisons with international and local benchmarks demonstrate the scope for substantial profit improvement in terms of both sales and margins.

The company has already begun a major re-engineering of the business (including supply chain transformation and overhead reduction). The problems in 2007 are being rectified and trading in the last few weeks shows some sign of improved performance.

Much remains to be done to achieve a turnaround of the Supermarkets business. The organisation requires a major revamp with changes in structure and strengthening of the management team. The Transformation program requires considerable further capital expenditure and the implementation of major programs such as automated stock replenishment, with the bulk of the benefits only realised in the medium term. The Supermarkets business needs to maintain an improved customer offer (including through an aggressive program of store refurbishments) while dealing with the disruptions of supply chain transformation.

Notwithstanding the challenges, the turnaround of the Supermarkets business could be achieved under Coles Group ownership. Wesfarmers' plans for the Supermarkets business are not dramatically different to those of Coles Group and Wesfarmers will also need to recruit new management.

On the other hand:

- there are significant risks associated with the turnaround of the Supermarkets business. While there is a reasonably clear program that needs to be achieved, the turnaround is inevitably subject to execution risk. Moreover, the turnaround will need to be achieved in the context of what may be vigorous competition. Woolworths has a substantial cost advantage and business momentum. Competitive activity may limit the extent to which Coles Group shareholders benefit from improvements in the Supermarkets business, if the business is forced to pass on a major part of the benefits to customers (these turnaround risks will apply whether the Supermarkets business is in Coles Group or Wesfarmers ownership);

- continued ownership uncertainty is likely to be damaging for the Supermarkets business. There is an urgent need to strengthen the Supermarkets management team, but it is difficult to attract high quality candidates in the current circumstances and this problem may continue under a standalone model (at least to some extent) as ownership of the business is not really resolved;

- new leadership has to be identified and attracted to Coles Group. This may take some time and the outcome is uncertain. Selection of the right people will be a critically important judgement;

- the culture of the organisation (in particular the Supermarkets business) needs significant change. Profound organisational changes of this nature are often difficult to achieve "from within" (even with new management). In contrast, ownership changes (whether Wesfarmers or some other party) may provide the opportunity for a decisive break from the past and an accelerated transformation of the Coles Group culture; and

- the turnaround will only be achieved over time (say 3 years). The Coles Group share price is likely to be relatively weak for a sustained period until credibility is restored through demonstration of a material improvement in performance.

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- **Overall evaluation of the Wesfarmers Proposal is finely balanced. In Grant Samuel's judgement the Wesfarmers Proposal is in the best interests of shareholders, if no superior proposal emerges before the Scheme meeting.**

  There are credible arguments both for and against the Wesfarmers Proposal. Coles Group shareholders could reasonably take the view that the Wesfarmers Proposal is not in their best interests:

  - Coles Group shareholders will not receive a full premium for control under the Wesfarmers Proposal. Based on Grant Samuel's analysis, the value of the Base Offer Consideration is less than the full underlying value of Coles Group;
  - if the Wesfarmers Proposal is rejected, Wesfarmers might improve its offer. However, given Wesfarmers' enhancement of its offer through the PPS any further increase is probably unlikely and, in any event, any material increase in the offer terms could adversely affect the value of its scrip;
  - it is possible that a superior alternative proposal for all the company could be made within a reasonable period; and
  - a standalone strategy (possibly combined with some asset sales or spin offs) could deliver more value to Coles Group shareholders over time.

  The process has coincided with a period of poor performance of some key business units, negative market sentiment towards Coles Group and unfavourable external market conditions. There is an argument that shareholders would be better off deferring a sale of the company until more propitious circumstances emerge.

  The most persuasive arguments against the Wesfarmers Proposal are based on the possibility that in view of the fall in the value of the Wesfarmers Proposal and the gap to full underlying value, some superior alternative proposal could emerge. The parties most likely to make some alternative proposal have had ample opportunity during the Coles Group sales process to develop an understanding of the business. The Scheme process provides considerable time for these parties to consider their position and, if they choose to do so, make some alternative proposal. Some caution is appropriate in assessing the likelihood of such a counterproposal, but, nevertheless in these circumstances, it would be sensible for shareholders to defer any voting decision until close to the Scheme meeting. Similarly, the current volatility in financial markets (and in the Wesfarmers share price) would also suggest that decisions should be left as late as practically possible.

  While the Wesfarmers Proposal is not within the fair value range:

  - the discount from the bottom end of Grant Samuel's estimate of full underlying value is in the order of 5-9%. While this is not insignificant, the impact on Coles Group shareholders is substantially mitigated by the fact they will have a 44% economic interest in the enlarged group;
  - it provides an opportunity to move quickly to put an end to the uncertainty about ownership of the Coles Group, which appears to have undermined management morale and business performance (although Wesfarmers does not currently have supermarket retailing expertise and will need to recruit senior management);
  - shareholders need to recognise the inherent uncertainty about valuation judgements, particularly in the case of Coles Group. The Wesfarmers Proposal was the outcome of an extensive worldwide sale process and was the only firm offer for all of Coles Group. On one view, the highest price secured through a comprehensive sale process by definition represents full underlying value. The subsequent fall in the Wesfarmers share price (and consequent reduction in the value of the Base Offer Consideration) detracts from this argument but if no superior proposal is received prior to the Scheme meeting it is arguable that the Wesfarmers Proposal still represents full value. Accordingly, theoretical valuation analysis on its own cannot be determinative; and

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- in the absence of the Wesfarmers Proposal or speculation regarding some alternative transaction, it is likely that Coles Group shares would trade at prices below the range of values of $14.87-15.44 attributed to the Wesfarmers Base Offer Consideration.

Weighing up these competing arguments is not straightforward. The issues are finely balanced and shareholders could reasonably form differing views on the merits of the Wesfarmers Proposal.

Grant Samuel's judgement is that if no superior proposal emerges before the Scheme meeting, the Wesfarmers Proposal is in the best interests of Coles Group shareholders.

4 Other Matters

This report is general financial product advice only and has been prepared without taking into account the objectives, financial situation or needs of individual shareholders in Coles Group. Because of that, before acting in relation to their investment, shareholders should consider the appropriateness of the advice having regard to their own objectives, financial situation or needs. Shareholders should read the Scheme Booklet issued by Coles Group in relation to the Wesfarmers Proposal.

Voting for or against the Wesfarmers Proposal is a matter for individual shareholders, based on their own views as to value and future market conditions and their particular circumstances including risk profile, liquidity preference, portfolio strategy and tax position. Shareholders who are in doubt as to the action they should take should consult their own professional adviser.

Similarly, it is a matter for individual shareholders as to whether to continue to hold Wesfarmers shares or PPS received under the Wesfarmers Proposal (or, if the Wesfarmers Proposal does not proceed, whether to continue to hold Coles Group shares). This is an investment decision independent of a decision on whether to vote in favour of the Wesfarmers Proposal, and Grant Samuel offers no advice to Coles Group shareholders in relation to their decision as to whether to continue holding Wesfarmers shares or PPS received under the Wesfarmers Proposal (or Coles Group shares if the Wesfarmers Proposal does not proceed).

Grant Samuel has prepared a Financial Services Guide as required by the Corporations Act, 2001. The Financial Services Guide is included at the beginning of the full report.

This letter is a summary of Grant Samuel's opinion. The full report from which this summary has been extracted is included in the Supplementary Booklet.

The opinion is made as at the date of this letter and reflects circumstances and conditions as at that date.

Yours faithfully
GRANT SAMUEL & ASSOCIATES PTY LIMITED

Grant Samuel & Associates

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Financial Services Guide and Independent Expert's Report in relation to the Proposal by Wesfarmers Limited

Grant Samuel & Associates Pty Limited
(ABN 28 050 036 372)

21 September 2007

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Financial Services Guide

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> *"Grant Samuel and its related entities do not have at the date of this report, and have not had within the previous two years, any shareholding in or other relationship with Coles Group or Wesfarmers that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Wesfarmers Proposal. Grant Samuel advises that:*
>
> - *six Grant Samuel group executives hold parcels of less than 25,000 shares in Coles Group;*
> - *four Grant Samuel group executives hold parcels of less than 10,000 shares in Wesfarmers; and*
> - *in November 2006, Grant Samuel Property Pty Limited was engaged by Wesfarmers to undertake a sale and leaseback of certain property assets (selected Bunnings stores). The transaction was completed in June 2007. There is no ongoing engagement.*
>
> *Grant Samuel commenced analysis for the purposes of this report in June 2007 prior to the announcement of the Wesfarmers Proposal. This work did not involve Grant Samuel participating in the setting the terms of, or any negotiations leading to, the Wesfarmers Proposal.*
>
> *Grant Samuel had no part in the formulation of the Wesfarmers Proposal. Its only role has been the preparation of this report.*
>
> *Grant Samuel will receive a fixed fee of $3,500,000 for the preparation of this report. This fee is not contingent on the outcome of the Wesfarmers Proposal. Grant Samuel's out-of-pocket expenses in relation to the preparation of the report will be reimbursed. Grant Samuel will receive no other benefit for the preparation of this report.*
>
> *Grant Samuel considers itself to be independent in terms of Regulatory Guideline 42 issued by the ASIC (previously known as Australian Securities Commission) on 8 December 1993".*

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1 Details of the Wesfarmers Proposal

1.1 The Proposal

On 5 September 2007, Coles Group Limited ("Coles Group") announced an agreed proposal from Wesfarmers Limited ("Wesfarmers") for the acquisition by Wesfarmers of all the shares in Coles Group ("the Wesfarmers Proposal"). Under the proposal, Coles Group shareholders are to be offered $4.00 cash, 0.14215 Wesfarmers ordinary shares and 0.14215 Wesfarmers Partially Protected Shares ("PPS") for each Coles Group share ("the Base Offer Consideration"). In addition, Coles Group shareholders will be entitled to retain the fully franked final dividend of 25 cents per share in relation to the year ended 29 July 2007. Coles Group shareholders will not be entitled to the final Wesfarmers dividend for the year ended 30 June 2007 of $1.40 per share (to be paid in November 2007). The PPS are a new security to be issued by Wesfarmers. A summary of the key terms of the PPS is set out in Section 1.3.

In addition to the Base Offer Consideration, Coles Group shareholders will be able to utilise a mix and match facility in relation to Wesfarmers ordinary shares. Coles Group shareholders wishing to increase the cash or ordinary share component of their consideration can elect to do so. The extent to which such elections are satisfied will depend on offsetting elections from other Coles Group shareholders. For the purpose of the transfer of interests between Coles Group shareholders, Wesfarmers shares will be valued at a volume weighted average price ("VWAP") over the five trading days from the date on which the Scheme becomes effective.[1]

The Wesfarmers Proposal is to be effected by way of a scheme of arrangement ("Scheme") under Section 411 of the Corporations Act, 2001 ("Corporations Act").

Wesfarmers is a diversified Australian public company, with operating businesses in home improvement products and building supplies, coal mining, gas processing and distribution, industrial and safety product distribution, chemicals and fertilisers manufacture, insurance, private equity and other activities. It was listed on the Australian Securities Exchange ("ASX") in 1984 and had a market capitalisation at 21 September 2007 of approximately $15.6 billion. Wesfarmers has its headquarters in Perth, Western Australia, and focuses its operations in Australia and New Zealand.

Based on current market values, the merged group will be one of Australia's largest companies by market capitalisation listed on the ASX. Coles Group shareholders (excluding Wesfarmers) will have a 44%[2] interest in the combined group and existing Wesfarmers shareholders will hold 56%.

1.2 Background

The Wesfarmers Proposal has followed a lengthy process including an ownership review by the Board of Coles Group and consideration of a range of strategic alternatives and proposals from a number of parties. This process commenced on 17 August 2006, with the announcement by Coles Group that it had been approached on behalf of parties wishing to hold discussions in relation to the company's ownership, and involved the following sequence of events:

- on 22 August 2006, Coles Group announced that it had received a conditional proposal from a consortium of private equity funds in relation to a potential leveraged buyout;
- on 6 September 2006, Coles Group rejected the proposal from the Kohlberg Kravis Roberts & Co ("KKR") led consortium to acquire the company at an indicative price of $14.50 per share on the basis that it undervalued the company and was subject to an unacceptable level of conditions. The consortium was understood to comprise KKR, Bain Capital, The Blackstone Group LP ("Blackstone"), The Carlyle Group L.L.C. ("Carlyle"), CVC Asia Pacific Limited

[1] The Wesfarmers volume weighted average price will be calculated ex the Wesfarmers 2007 financial year final dividend.

[2] Assuming all shareholders receive the Base Offer Consideration. The interest is potentially higher if the PPS convert at more than 1:1. However, this would probably be in circumstances where little upside had been realised.

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("CVC"), Macquarie Bank Limited ("Macquarie Bank"), Merrill Lynch, Texas Pacific Group ("TPG") and Pacific Equity Partners ("PEP");

- on 21 September 2006, Coles Group announced a strategic plan to simplify and grow the business, significantly reduce costs and substantially improve shareholder returns over the following five years. In addition, Coles Group provided earnings guidance for the 2007 and 2008 financial years;

- on 19 October 2006, Coles Group rejected a revised offer of $15.25 per share for Coles Group by the KKR-led leveraged buyout consortium on the basis that it still substantially undervalued the company. The consortium then comprised KKR, Carlyle, CVC, TPG and Blackstone;

- on 23 February 2007, Coles Group provided updated earnings guidance for the 2008 financial year reflecting lower than anticipated sales and earnings in the Supermarkets and Kmart businesses, and announced a process to review ownership for the company and its businesses;

- on 26 March 2007, Coles Group announced that it was commencing a formal process of inviting expressions of interest from parties wishing to explore acquiring the business as a whole, acquiring Target and/or Officeworks or buying the whole or a significant interest in the Everyday Needs Business ("ENB") (Supermarkets, Coles Express, Coles Liquor and Kmart). Coles Group also undertook to consider the potential demerger of Target and Officeworks;

- on 3 April 2007, Wesfarmers announced that it had acquired voting power over 11.3% of Coles Group shares and made a conditional proposal to acquire the whole of the Coles Group at $16.47 per share. Wesfarmers announced that it intended to restructure the company with the ENB to be owned by Wesfarmers (approximately 50%) and its consortium partners, comprising funds advised by PEP and Permira Advisers LLP, and Macquarie Bank. On 5 April 2007, Wesfarmers announced that its voting power in Coles Group had increased to 12.8% (which subsequently declined to 12.1% following the divestment of shares by Macquarie Bank). The Coles Group Board decided to proceed with its ownership review process, with final bids for the company due on 30 June 2007;

- on 10 April 2007, Coles Group announced that a KKR-led consortium had confirmed its continuing interest in the Coles Group, and that both the Wesfarmers-led consortium and the KKR-led consortium would be given access to the due diligence data room on finalisation of Confidentiality Agreements;

- on 28 June 2007, Coles Group announced that TPG, Carlyle and Blackstone (the remaining members of the former KKR-led consortium) had advised that they would not submit any offer or proposal in relation to the Coles Group on 30 June 2007, but indicated an interest in discussing an alternative investment structure with the Coles Group; and

- on 30 June 2007, Coles Group received offers for the whole and for parts of the Coles Group, including a proposal from Wesfarmers ("the Initial Wesfarmers Proposal").

On 2 July 2007, the Directors of Coles Group announced that they had reached agreement with Wesfarmers. The Directors of Coles Group unanimously recommended that shareholders vote in favour of the Initial Wesfarmers Proposal in the absence of a superior proposal and subject to an independent expert determining that the Initial Wesfarmers Proposal is in the best interests of Coles Group shareholders.

Subsequent changes were announced on 9 August 2007 (to introduce the mix and match alternatives) and, on 5 September 2007, the Wesfarmers Proposal (which incorporated the substitution of the PPS for ordinary shares in respect of 50% of the equity component) was announced.

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1.3 Terms of the PPS

The key terms of the PPS are as follows:

- holders of PPS have the same rights as holders of ordinary Wesfarmers shares, including in relation to:
  - voting rights;
  - dividends;
  - participation in surplus assets and profits on winding up; and
  - returns on capital;
- PPS will be reclassified as Wesfarmers ordinary shares between four years (the "Lapse Date") and four years and six months after their date of issue depending on when Wesfarmers issues its notice. If the Wesfarmers share price is greater than $36.00 but less than $45.00 at the time of reclassification (based on a two month VWAP), holders of PPS will receive a bonus issue of ordinary shares (up to 0.25 ordinary shares per PPS) such that the total value of Wesfarmers ordinary shares received will be $45.00. For Wesfarmers share prices below $36.00, PPS holders will receive a bonus issue of 0.25 ordinary shares per PPS;
- if Wesfarmers shares trade above $45.00 for a 20 day period prior to reclassification, the PPS will be automatically reclassified as ordinary shares;
- if the S&P/ASX 200 Industrials Index averages less than 6,500 for the two months before the Lapse Date, Wesfarmers can extend the Lapse Date by 12 months. It can extend the Lapse Date on each of the next three anniversaries (for 12 months each time) if the index averages below 6,500 for a two month period prior to each anniversary;
- Wesfarmers can require reclassification of the PPS as ordinary shares at any time but only on the basis that PPS holders receive Wesfarmers shares with a value (based on a two month VWAP) of $45.00 per PPS, if necessary by way of a bonus issue;
- holders of PPS can require their reclassification as ordinary shares at any time (although they will then lose the protection of the potential bonus share issue); and
- in the event of a takeover or proposed scheme for Wesfarmers, holders of PPS will be able to require their PPS to be reclassified as ordinary shares and therefore participate in the takeover or scheme. However, for transaction values for Wesfarmers less than $45.00, they would lose the bonus issue protection.

It is intended that the PPS will be listed on the ASX.

1.4 Other Aspects of the Scheme

The Wesfarmers Proposal is subject to a number of conditions that are contained in the amended Scheme Implementation Agreement and set out in Section 10 of the Scheme Booklet, including:

- the approval of the Scheme by Coles Group shareholders. The Scheme must be approved by a majority in number of the Coles Group shareholders who vote at the Scheme meeting (in person or by proxy) and by at least 75% of the total number of shares voted at the meeting;
- the approval of the Scheme by the Supreme Court of Victoria; and
- no prescribed occurrences for Coles Group or Wesfarmers (which are defined to cover standard takeover prescribed occurrence events, such as changes to capital structure, share issues and insolvency events).

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The (amended) Scheme Implementation Agreement includes no-talk and no-shop provisions. Under these provisions, Coles Group (including any related parties) may not solicit or encourage any counterproposal and may not enter into any negotiations or discussions in relation to any competing proposal for Coles Group or provide any information to a third party that may lead to a competing proposal, subject to an exception for what is reasonably likely to constitute a superior proposal. Coles Group is also required to notify Wesfarmers if it is approached by another person to engage in any activity in this regard and Wesfarmers has a right to be informed about and then match the terms of any superior proposal (within a 3 day period). The (amended) Scheme Implementation Agreement also contains various provisions, under which Coles Group must seek return of information provided to third parties and enforce any breach of confidentiality undertakings.

A break fee of $150 million is payable by Coles Group to Wesfarmers in certain circumstances, including where a majority of Coles Group Directors either recommend a competing transaction or withdraw their recommendation of the Scheme if a competing transaction is successful, or if there is a material breach of the Scheme Implementation Agreement by Coles Group and the agreement is subsequently terminated.

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2 Scope of the Report

2.1 Purpose of the Report

The Wesfarmers Proposal is to be implemented by a Scheme between Coles Group and its shareholders. Under Section 411 of the Corporations Act, the Scheme must by approved by a majority in number (i.e. at least 50%) of each class of shareholders present and voting (either in person or by proxy) at the meeting, representing at least 75% of the votes cast on the resolution. If approved by Coles Group shareholders, the Scheme will then be subject to approval by the Supreme Court of Victoria.

Part 3 of Schedule 8 to the Corporations Regulations prescribes the information to be sent to shareholders in relation to schemes of arrangement pursuant to Section 411. Part 3 of Schedule 8 requires an independent expert's report in relation to a scheme of arrangement to be prepared when a party to a scheme of arrangement has a prescribed shareholding in the company subject to the scheme, or where any of its Directors are also Directors of the company subject to the scheme. In those circumstances, the independent expert's report must state whether the scheme of arrangement is in the best interests of shareholders subject to the scheme and must state reasons for that opinion.

Although there is no requirement in the present circumstances for an independent expert's report pursuant to the Corporations Act or the ASX Listing Rules, the Directors of Coles Group have engaged Grant Samuel & Associates Pty Limited ("Grant Samuel") to prepare an independent expert's report setting out whether, in its opinion, the Wesfarmers Proposal is in the best interests of Coles Group shareholders and to state reasons for that opinion. A summary of the report will accompany the Notice of Meeting and the Scheme Booklet to be sent to shareholders by Coles Group.

This report is general financial product advice only and has been prepared without taking into account the objectives, financial situation or needs of individual Coles Group shareholders. Accordingly, before acting in relation to their investment, shareholders should consider the appropriateness of the advice having regard to their own objectives, financial situation or needs. Shareholders should read the Scheme Booklet issued by Coles Group in relation to the Wesfarmers Proposal.

Approval or rejection of the Wesfarmers Proposal is a matter for individual shareholders based on their views as to value, their expectations about future market conditions and their particular circumstances including risk profile, liquidity preference, investment strategy, portfolio structure and tax position. Shareholders who are in doubt as to the action they should take in relation to the Wesfarmers Proposal should consult their own professional adviser.

This report does not purport to consider the investment merits of the merged entity. Whether to buy, hold or sell shares in Coles Group or the merged entity is a separate investment decision upon which Grant Samuel does not offer an opinion. Shareholders should consult their own professional adviser in this regard.

2.2 Basis of Evaluation

There is no legal definition of the expression "in the best interests". The Australian Securities Commission (now the Australian Securities and Investments Commission ("ASIC")) issued Regulatory Guideline 75 which established certain guidelines in respect of independent expert's reports prepared for the purposes of Sections 411, 640 and 703 of the Corporations Act. Regulatory Guideline 75 is primarily directed towards reports prepared for the purpose of Section 640 and comments on the meaning of "fair and reasonable" in the context of a takeover offer. The statement gives limited guidance as to the regulatory interpretation or meaning of "in the best interests" other than to imply that it is similar to "fair and reasonable".

Schemes of arrangement pursuant to Section 411 can encompass a wide range of transactions. Accordingly, "in the best interests" must be capable of a broad interpretation to meet the particular

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circumstances of each transaction. This involves a judgement on the part of the expert as to the overall commercial effect of the transaction, the circumstances that have led to the proposal and the alternatives available. The expert must weigh up the advantages and disadvantages of the proposal and form an overall view as to whether the shareholders are likely to be better off if the proposal is implemented than if it is not.

In Grant Samuel's opinion, the most appropriate basis on which to evaluate the Wesfarmers Proposal is to assess the overall impact on the shareholders of Coles Group and to form a judgement as to whether the expected benefits outweigh any disadvantages and risks that might result.

In forming its opinion as to whether the Wesfarmers Proposal is in the best interests of Coles Group shareholders, Grant Samuel has considered the following:

- the estimated underlying value of shares in Coles Group;
- the assessed value of the consideration offered under the Scheme to be received by Coles Group shareholders;
- the relative values to be contributed to the merged Coles Group/Wesfarmers by Coles Group and Wesfarmers shareholders by comparison with their relative interests in the merged company;
- the impact of the Wesfarmers Proposal on ownership and control of Coles Group;
- the likely market price and liquidity of Coles Group shares in the absence of the Wesfarmers Proposal;
- the likelihood of alternative transactions which could realise better value and the likely consequences if the Wesfarmers Proposal did not proceed;
- any other advantages and benefits arising from the Wesfarmers Proposal; and
- the costs, disadvantages and risks of the Wesfarmers Proposal.

2.3 Sources of the Information

The following information was utilised and relied upon, without independent verification, in preparing this report:

Publicly Available Information

- the Scheme Booklet (including earlier drafts);
- annual reports of Coles Group for the five years ended 30 July 2006;
- financial results for Coles Group for the year ended 29 July 2007;
- annual reports for Wesfarmers for the five years ended 30 June 2006;
- financial results for Wesfarmers for the year ended 30 June 2007;
- press releases, public announcements, media and analyst presentation material and other public filings by Coles Group including information available on its website;
- press releases, public announcements, media and analyst presentation material and other public filings by Wesfarmers including information available on its website;
- recent brokers' reports on Coles Group and Wesfarmers; and

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- sharemarket data and related information on Australian and international listed companies engaged in the retailing industry and on acquisitions of companies and businesses in this industry.

Non-Public Information provided by Coles Group

- management accounts for the 12 months ended 29 July 2007;
- management budget for the year ending 27 July 2008;
- management projections for the five years ending 29 July 2012 prepared by Coles Group management;
- other confidential documents, presentations and working papers including access to certain relevant documents set out in the data room made available to potential acquirers of Coles Group; and
- recent Board papers for Coles Group.

Non-Public Information provided by Wesfarmers

- management budget for the year ending 30 June 2008.

Grant Samuel has also held discussions with, and obtained information from, senior management of Coles Group and its advisers and senior management of Wesfarmers and its advisers.

2.4 Limitations and Reliance on Information

Grant Samuel believes that its opinion must be considered as a whole and that selecting portions of the analysis or factors considered by it, without considering all factors and analyses together, could create a misleading view of the process underlying the opinion. The preparation of an opinion is a complex process and is not necessarily susceptible to partial analysis or summary.

Grant Samuel's opinion is based on economic, sharemarket, business trading, financial and other conditions and expectations prevailing at the date of this report. These conditions can change significantly over relatively short periods of time. If they did change materially, subsequent to the date of this report, the opinion could be different in these changed circumstances.

This report is also based upon financial and other information provided by Coles Group and its advisers and by Wesfarmers and its advisers. Grant Samuel has considered and relied upon this information. Coles Group has represented in writing to Grant Samuel that to its knowledge the information provided by it was complete and not incorrect or misleading in any material aspect. Grant Samuel has no reason to believe that any material facts have been withheld.

The information provided to Grant Samuel has been evaluated through analysis, inquiry and review to the extent that it considers necessary or appropriate for the purposes of forming an opinion as to whether the Wesfarmers Proposal is in the best interests of Coles Group shareholders. However, Grant Samuel does not warrant that its inquiries have identified or verified all of the matters that an audit, extensive examination or "due diligence" investigation might disclose. While Grant Samuel has made what it considers to be appropriate inquiries for the purposes of forming its opinion, "due diligence" of the type undertaken by companies and their advisers in relation to, for example, prospectuses or profit forecasts, is beyond the scope of an independent expert. In this context, Grant Samuel advises that:

- it is not in a position nor is it practicable to undertake its own "due diligence" investigation of the type undertaken by accountants, lawyers or other advisers; and

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- it has had only limited access to non-public information on Wesfarmers (principally Wesfarmers budgets for the 2008 financial year) and has held only high level discussions with the senior management of Wesfarmers.

Accordingly, this report and the opinions expressed in it should be considered more in the nature of an overall review of the anticipated commercial and financial implications of the Wesfarmers Proposal rather than a comprehensive audit or investigation of detailed matters.

An important part of the information used in forming an opinion of the kind expressed in this report is comprised of the opinions and judgement of management. This type of information was also evaluated through analysis, inquiry and review to the extent practical. However, such information is often not capable of external verification or validation.

Preparation of this report does not imply that Grant Samuel has audited in any way the management accounts or other records of Coles Group or Wesfarmers. It is understood that the accounting information that was provided was prepared in accordance with generally accepted accounting principles and in a manner consistent with the method of accounting in previous years (except where noted). Grant Samuel has only had limited access to non-publicly disclosed information on Wesfarmers (except to the extent that it had earlier drafts of the Scheme Booklet and held discussions with senior management).

The information provided to Grant Samuel included the budget for Coles Group for the year ending 27 July 2008 prepared by management and adopted by the Directors of Coles Group ("2008 Budget").

Coles Group is responsible for this financial information. Grant Samuel has used and relied on this financial information for the purposes of its analysis. The major assumptions underlying the 2008 Budget were reviewed by Grant Samuel in the context of current economic, financial and other conditions. However, it should be noted that the 2008 Budget and the underlying assumptions have not been reviewed (nor is there a statutory or regulatory requirement for such a review) by an investigating accountant for reasonableness or accuracy of compilation and application of assumptions.

Subject to these limitations, Grant Samuel considers that, based on the inquiries it has undertaken and only for the purposes of its analysis for this report (which do not constitute, and are not as extensive as, an audit or accountant's examination), there are reasonable grounds to believe that the 2008 Budget has been prepared on a reasonable basis. In forming this view, Grant Samuel has taken the following factors, inter alia, into account:

- the 2008 Budget has been endorsed by the Directors of Coles Group; and

- Coles Group has sophisticated management and financial reporting processes. The prospective financial information has been prepared through a detailed budgeting process involving preparation of "ground up" projections by management and is subject to ongoing analysis and revision to reflect the impact of actual performance or assessments of likely future performance.

The information provided to Grant Samuel also included five year management projections for certain operating businesses (collectively the "Projections"). Coles Group is responsible for the Projections. Grant Samuel has not relied on the Projections for the purposes of its report. Grant Samuel has had regard to the Projections in developing financial models for each of Coles Group's businesses as discussed in Section 7 of this report but did not specifically rely on these projections for its valuation.

Grant Samuel has not undertaken any valuations of the properties owned by Coles Group and, for the purposes of this report, has relied on the independent property valuations commissioned by Coles Group for those properties in determining the underlying net asset value of investments in property assets.

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Grant Samuel has no reason to believe that the 2008 Budget reflects any material bias, either positive or negative. However, the achievability of the 2008 Budget and any other prospective financial information is not warranted or guaranteed by Grant Samuel. Future profits and cash flows are inherently uncertain. They are predictions by management of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of the company or its management. Actual results may be significantly more or less favourable.

As part of its analysis, Grant Samuel has reviewed the sensitivity of net present values to changes in key variables. The sensitivity analysis isolates a limited number of assumptions and shows the impact of the expressed variations to those assumptions. No opinion is expressed as to the probability or otherwise of those expressed variations occurring. Actual variations may be greater or less than those modelled. In addition to not representing best and worst outcomes, the sensitivity analysis does not, and does not purport to, show the impact of all possible variations to the business model. The actual performance of the business may be negatively or positively impacted by a range of factors including, but not limited to:

- changes to the assumptions other than those considered in the sensitivity analysis;
- variations in the assumptions considered in the sensitivity analysis greater or less than those modelled; and
- combinations of different variations to a number of different assumptions that may produce outcomes different to the combinations modelled.

In forming its opinion, Grant Samuel has also assumed that:

- matters such as title, compliance with laws and regulations and contracts in place are in good standing and will remain so and that there are no material legal proceedings, other than as publicly disclosed;
- the information set out in the Scheme Booklet sent by Coles Group to its shareholders is complete, accurate and fairly presented in all material respects;
- the publicly available information relied on by Grant Samuel in its analysis was accurate and not misleading;
- the Wesfarmers Proposal will be implemented in accordance with its terms; and
- the legal mechanisms to implement the Wesfarmers Proposal are correct and will be effective.

To the extent that there are legal issues relating to assets, properties, or business interests or issues relating to compliance with applicable laws, regulations, and policies, Grant Samuel assumes no responsibility and offers no legal opinion or interpretation on any issue.

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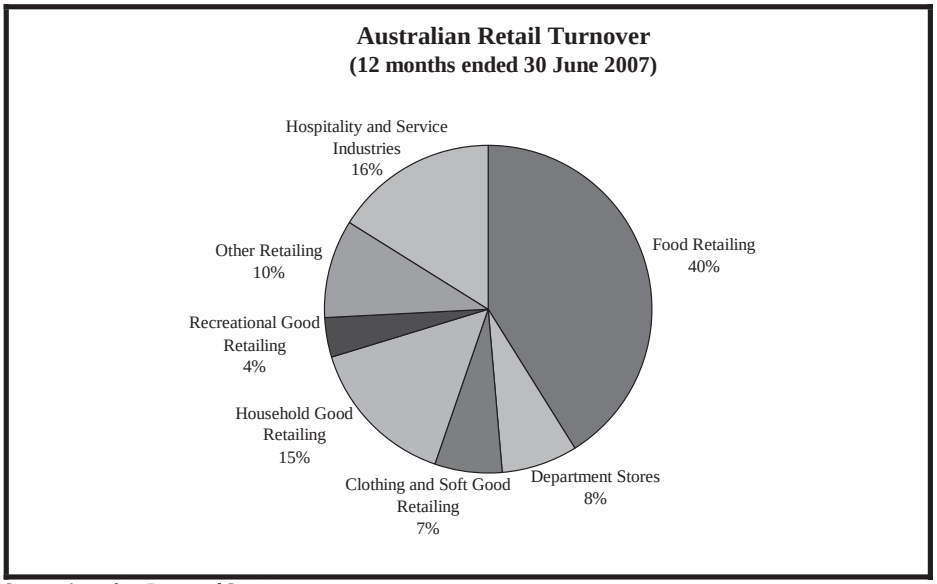
3 Overview of the Australian Retail Industry

3.1 Overview

The Australian retail industry encompasses food retailers, department stores, clothing and soft goods retailers, household goods retailers, recreational goods retailers, other retailers and hospitality and services. The industry employs around 1.5 million people (approximately 15% of Australian employment).

The following graph provides a breakdown of the total revenue of the Australian retail industry by category for the twelve months ended 30 June 2007:



Source: Australian Bureau of Statistics

Over the five years to 30 June 2007, the retail industry grew at a compound growth rate of 5.9% per annum. In the twelve months ended 30 June 2007, the Australian retail trade sector generated revenue of approximately $223 billion.

Growth in the sector is influenced by macroeconomic factors including real Gross Domestic Product ("GDP") growth, population growth and real consumer spending. The following chart illustrates the historical and forecast growth in Australian real GDP:

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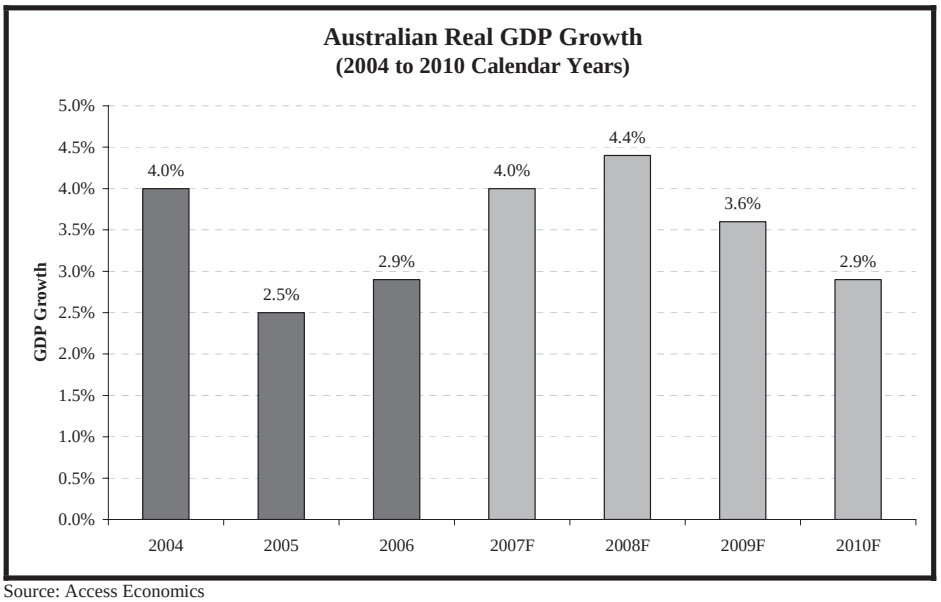

Source: Access Economics

Since the early 1990s, Australia's population has grown by around 1.2-1.3% per annum. Population growth at similar rates is expected to continue until at least 2011. Population growth is forecast to be strongest in Queensland.

Real consumer spending is influenced by factors such as:

- household disposable income, which in turn is affected by jobs growth, real wages growth, interest payments and tax payments;
- household wealth, which is influenced by sharemarket and house price performance; and
- consumer confidence.

3.2 Food Retailing

Food retailing is the largest sector of the retail industry in Australia, with food retail turnover for the twelve months ended 30 June 2007 estimated at approximately $92 billion. Supermarkets and grocery stores account for approximately 70% of total food retailing in Australia. Geographically, the largest markets are in the eastern States of Queensland, New South Wales and Victoria, which together account for over 75% of the national market.

The Australian supermarket and grocery retailing market is dominated by two major chains, Woolworths Limited ("Woolworths") and Coles Group, which have a combined market share of approximately 76% of the mass grocery market.

Woolworths and Coles Group are vertically integrated, in that they deal directly with suppliers. Independent retailers are supplied by wholesalers relying on closely linked systems for ordering and distribution. Independent retailers generally operate under retail banner groups (often operated by wholesalers). The major banner groups include Independent Grocers of Australia ("IGA"), FoodWorks, Tasmanian Independent Retailers and SPAR Australia.

The compound annual growth rate of the Australian supermarket and grocery retailing sector over the five years to June 2007 was 5.8%. Supermarket and grocery sales are relatively insensitive to changes in economic conditions. Inflation and population growth are the most significant factors in the growth of food sales and will underpin continued growth of the industry. Historically, growth has also been stimulated by range extension and category growth (e.g. supermarket chains'

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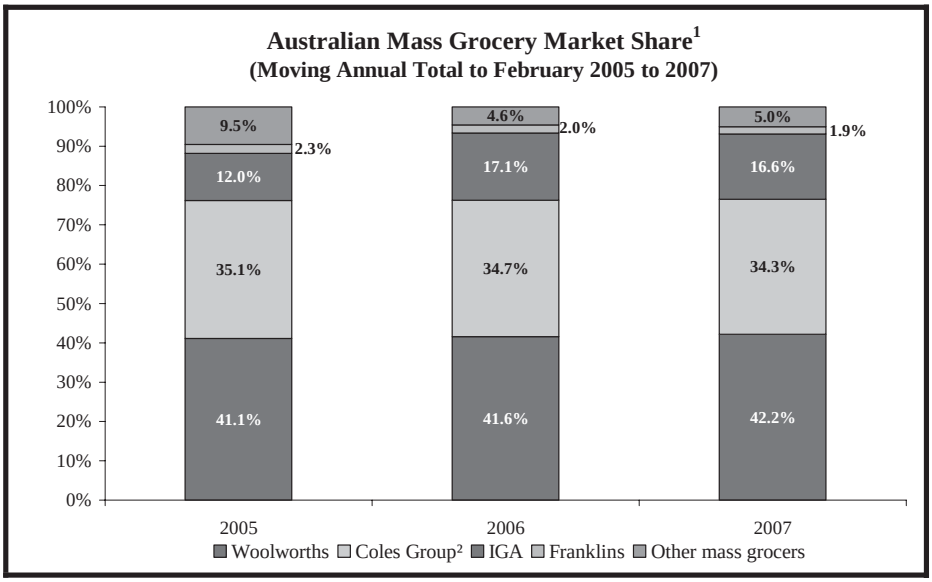
entry into petrol retailing), and similar initiatives in the future, including growth in private label sales, may attract new business to stores. Food price inflation was approximately 2.2% over the year to 30 June 2007 compared with general inflation of 2.1%.

Over the past two decades the supermarket and grocery sector has undergone significant rationalisation with the number of participants declining substantially. The major chains have grown through acquisition and the addition of new stores, and independent retailers have formed co-operatives or buying groups. Grocery wholesalers have sought to achieve economies of scale and maintain the market share of independent retailers in the face of competition from the major chains.

The market share of Australian packaged grocery[3] retailers is shown in the following chart:



Source: AC Nielsen ScanTrac
Note 1: Excludes Aldi
Note 2: Includes Coles and Bi-Lo Supermarkets

After Coles Group's Supermarkets business and Woolworths, Australia's other main grocery retailer is Aldi Stores ("Aldi"). Aldi is estimated to have a national market share of approximately 3% of the mass grocery market.

Aldi is a worldwide grocery chain based in Germany, with operations in the United States and through Europe. Aldi opened its first store in Australia in January 2001. Aldi sells a relatively limited range of products, principally of private label products, at discount prices. The Aldi stores target the lower end of the market and bulk buyers. Aldi's market share has grown as the Aldi store network has expanded and its fresh produce offer has improved. In addition, it appears that Aldi has acquired some business as a result of Coles Group's conversion of Bi-Lo stores to Coles stores, which has resulted in a perceived deterioration in the value proposition offered by those stores.

[3] The packaged grocery market excludes fresh products (e.g. fruit, vegetables, meat, bakery, fish and seafood), direct to store products (e.g. bread and milk), tobacco, coffee, disposable nappies and excludes Aldi.

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The balance of the market (approximately 15%) is principally held by independent grocery retailers, including:

- the Franklins Limited ("Franklins") chain in New South Wales, acquired in 2001 by Pick 'n Pay Stores Limited ("Pick 'n Pay"), a listed South African food retailer;
- IGA, Australia's largest independent supermarket banner group. IGA operates three store formats, Supa IGA, IGA and IGA X-press, with different sizes, ranges and customer profiles. IGA stores are supplied by Metcash Trading Limited ("Metcash"), Australia's largest grocery wholesaler;
- FoodWorks, a group of independent food retailers that was created from the merger of FoodWorks Supermarket Group and Australian United Retailers in November 2004;
- Tasmanian Independent Retailers, which services the independent supermarket retailers trading under the advertised banners of Festival IGA, Value Plus IGA and Friendly Grocer IGA; and
- the SPAR Australia banner group, consisting of independent retailers operating under the SPAR banner and sourcing product on a co-operative basis. SPAR Australia, which was established in Australia in December 2002, is associated with the SPAR network, one of the world's largest co-operative food retailing groups.

The supermarket chains have grown their businesses by building new stores, increasing new store sizes, and expanding into new product categories. Competition for sites has meant that opportunities for large size format stores are becoming harder to find. As a result, and also as a reflection of demographic trends and increasing consumer focus on convenience shopping, the major chains may pursue smaller store formats in competition with independent retailers.

The major product category expansions for the supermarket chains have been into alcoholic beverages and petrol offerings. Volume has recently shifted to supermarket-aligned fuel retailers, rewarding customers with fuel discounts on redemption of supermarket dockets. These fuel discounts have been a significant driver of supermarket sales.

Growth in sales of private label products is expected to be a key driver of profitability for the supermarket chains over the next few years. Sales of private label products currently represent only 14% of the total supermarket sales of Woolworths and Coles Group, which is significantly below international benchmarks. In the United Kingdom private label products contribute 30% of total sales. Aldi's entry into the Australian market has stimulated the growth of private label business, with the major chains responding to Aldi's private label offering. Private label products generally command higher percentage margins than branded products, although lower selling prices limit the incremental profitability they deliver to retailers.

3.3 Liquor Retailing

In the 2006 financial year the Australian packaged liquor market generated sales of $11.7 billion, through approximately 8,300 retail outlets. Coles Group and Woolworths controlled approximately 45% of the Australian liquor market in 2006, although extensive regulation and a strong independent presence mean that the market remains competitive.

The market consists of four segments: large format, convenience, specialty and direct. Convenience is the largest segment but the large format segment is growing rapidly. Large format stores enjoy economies of scale in both merchandising and distribution, and are able to pass on lower prices to consumers by way of lower operating costs. The large store format is expected to capture most of the future growth in the packaged liquor market over the next five years.

The major participants in the packaged liquor market are Woolworths (1,015 stores) and Coles Group (751 stores excluding hotels). The remainder of the retail market is highly fragmented, although many independents are aligned with banner groups, such as Cellarbrations.

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The supplier base is highly concentrated. However, given their market share, Coles Group and Woolworths have significant bargaining power and the ability to negotiate favourable supplier arrangements. Woolworths and Coles Group are well positioned to develop controlled-label ranges (i.e. exclusive distribution of certain labels) and private label ranges, which allow for substantially higher margins and will further reduce their dependence on suppliers.

The retail liquor market in Australia is highly regulated, with strict regulations surrounding liquor licensing, trading hours and store numbers per area. Queensland Government regulations require that liquor retailers own hotel licences and consequently Coles Group and Woolworths entered the hotel and gaming business to develop their liquor retailing activities. Obtaining liquor licences has become increasingly difficult, with only four new licences issued in Western Australia (on a net basis) in the last ten years, and only three in South Australia since 1998.

The hotel and gaming market is very fragmented, with Coles Group and Woolworths controlling only approximately 5% of the market. Growth in the industry is driven principally by gaming. It is estimated that 50% of the approximately 7,000 hotels operating in Australia have gaming operations. Gaming is a critical component of hotel operations in Coles Liquor, contributing around 35% of total revenue but between 50-60% of profits.

Hotels are subject to regulation of gaming machines and, more recently, smoking bans. State Governments impose a cap on the number of gaming machines allowed to operate in each State. In Victoria, third parties (Tabcorp Limited and Tattersall's Limited) operate the gaming machines and can move them between venues. In other States, the gaming machines are owned and operated by venue owners and subject to caps on a per site and State-wide basis. Full smoking bans apply in Queensland, Western Australia, Tasmania and more recently, Victoria and New South Wales, and will be more effective in South Australia from 1 October 2007. Experience in Queensland has shown that the negative impact of smoking bans on hotel trading can be mitigated through refurbishments, the development of outdoor smoking areas and other initiatives.

3.4 Fuel Retailing

Fuel retailing involves the sale of fuel and related products and convenience items. The Australian fuel retailing market measures approximately $25.5 billion in the 2006 financial year and has experienced growth of 4% per annum over the last 10 years. Retail fuel consumption has grown at 4% per annum over the last 7 years and underpins the growth of the fuel retailing market.

While the industry is still fragmented, the major oil companies and supermarkets operate a large share through franchise arrangements and other ownership structures. There are approximately 6,200 fuel retailing sites in Australia with average sales of $4 million per annum each. The site density is roughly in line with Europe and the United States.

The Coles Group/Shell alliance enjoys market leadership status in Australian fuel retailing, with a 24% market share through 10% of total sites. While two thirds of sites are operated by independent owners, the four major oil companies (Shell, Caltex Australia Limited ("Caltex"), BP plc ("BP") and Exxon Mobil Corporation ("Mobil")) now influence 75% of sites through franchising and other ownership structures and approximately a further 16% are operated by Coles Group and Woolworths. Around 9% of sites are independent. The entry of Woolworths and Coles Group has dramatically changed the fuel retailing market, with volume shifting to supermarket-aligned retailers that reward customers with a fuel discount on redemption of a supermarket docket.

Given the high margin nature of the convenience offering, as well as the increasing demand for convenience store formats in Australia, the strategy of the supermarket operators is to capitalise on the significant fuel customer traffic already frequenting their convenience stores by converting fuel customers into convenience shoppers.

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3.5 Non-Food Retailing

3.5.1 Department Stores

The department store segment is the third largest component of Australia's non-food retail industry, with approximately $16.9 billion or 12.8% of total non-food retail sales in the twelve months ended 30 June 2007. In the last five years the department store segment has recorded compound annual growth of 4.0%.

Department stores segment their businesses on a category basis, with major products and services including:

- clothing and footwear;
- consumer electronics and household appliances;
- furniture and haberdashery;
- cosmetics and beauty products;
- toys, games and sporting products;
- books, greeting cards and stationery; and
- cutlery and crockery.

There are two broad categories of department stores operating in Australia: department stores and discount department stores. Department stores focus on medium to higher income customers. Their competitiveness is based on scale and the ability to showcase a wide assortment of merchandise categories across national, international and private brands. There is a strong emphasis on fashionable and quality merchandise supported by a higher level of customer service. The two participants in Australia in this category are Myer Pty Limited ("Myer") and David Jones Limited ("David Jones"), which collectively account for less than 30% of total department store revenue.

Discount department stores focus on medium to lower income customers, operating at the value end of the segment. Competitiveness in the market is based on scale and the provision of every day apparel, general merchandise and homewares merchandise. Price is the major selling proposition and there is less emphasis on customer service than in the traditional department store model. Kmart, Target and Big W are the major participants in this category.

The department store segment faces strong competition from category specialists and the overall department store market share of retail is decreasing. Within the overall department store segment, the discount department store format is growing at the expense of traditional "full service" department stores.

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The Australian department store segment has become increasingly concentrated since the early 1980s, with the top five department stores accounting for 93.2% of segment revenue in the 2006 financial year:

Source: IBISWorld 'Department Stores in Australia' 13 February 2007

The chart below illustrates the market positioning of the leading department store chains in Australia:

Source: Coles Group

There is strong competition between the discount department store players, as the customer demographics of Kmart, Target and Big W are similar. Kmart and Big W compete closely on price, while Target's positioning is as a more upmarket, higher quality store with a higher price point.

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The major department store chains have numerous retail outlets throughout Australia, both in metropolitan and country areas. The economies of scale available to larger industry participants, as well as significant barriers to entry including establishment, fit-out, stock and staff costs, mean that smaller players have struggled to remain profitable amidst fierce industry discounting.

Kmart is the largest department store chain in Australia in terms of market share and has the second largest footprint after Target of non-food retailers in Australia and New Zealand. Kmart's customer base is value-conscious families, to which it offers a range of value-priced products including apparel, consumables, entertainment, footwear & accessories, home, outdoor lifestyle, sporting goods and toys & leisure, motoring and do-it-yourself categories. Kmart enjoys a particularly strong market share in the toy, DVD/video, childrenswear, underwear and footwear categories. Kmart also operates the Kmart Tyre and Auto business, which is primarily a tyre retailer and auto-service provider. Kmart operates 182 Kmart stores and 267 Kmart Tyre & Auto stores across Australia and New Zealand.

Target is a discount department store offering affordable and high quality fashion. The core product range of Target is fashionable apparel and soft homewares, underpinned by strong house brands. Target has developed a unique middle market positioning for quality, fashionable products at affordable prices which has resulted in Target being viewed as more upmarket than Kmart and Big W. Target operates 268 stores nationally under the Target, Target Country and Baby Target banners.

Big W (part of the Woolworths group) is a discount department store offering a range of products including family apparel and footwear, homewares, stationery and office, toys and sporting goods, health and beauty, books, home entertainment, motoring, do-it-yourself and every day needs. Big W operates 142 stores nationally.

Until mid-2006, Myer was owned by the Coles Group. Following a number of years of underperformance by the Myer business, Coles Group sold the business to a consortium, which included Newbridge Capital, TPG and The Myer Family Company, for $1.4 billion. Myer stocks a wide range of products that include apparel, furniture, consumer electronics, cosmetics, toys and homewares amongst others. Myer operates 60 department stores across Australia, typically located in central business districts and major shopping centres.

David Jones positions itself as a high-end department store retailer with a wide range of prestigious international and domestic brands. David Jones operates 35 department stores and two discount clearance stores in Australia, located on the eastern seaboard of Australia.

Other industry participants include Harris Scarfe Holdings Limited ("Harris Scarfe") (market share of 2.0% in the 2006 financial year) and Dimmey's Stores Pty Limited ("Dimmey's") (market share of 0.6% in the 2006 financial year).

The Australian department store industry is forecast to achieve total revenue growth of 19.7% during the five year period ending 30 June 2012, representing an average growth rate of 3.7% per annum.

Industry specific factors forecast to impact the Australian department store sector include:

- continued competitive pressures. The Australian department store industry is expected to remain extremely competitive. Specialist retailers will continue to take market share from the department stores, particularly in areas such as electronics and large household appliances. In an effort to maintain and grow margins, the major players will continue to invest in their private label offerings, as well as store refurbishments, the provision of value added services and more effective marketing. Store growth may slow in mature markets such as Victoria and New South Wales, although there remain growth opportunities for established players to capitalise on strong population and income growth in Queensland and Western Australia; and

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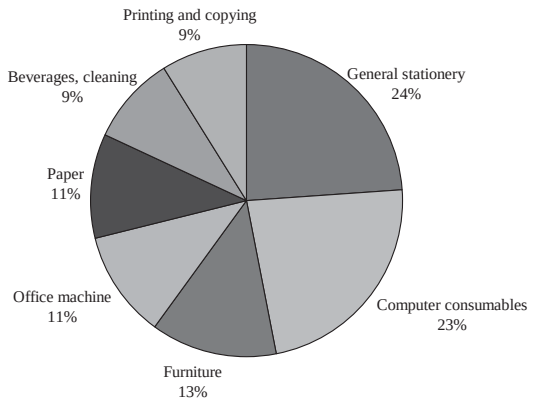
- consumer attitude to debt. Over the last five years, discount department stores have benefited from high levels of consumer discretionary spending, supported by growing household wealth and funded by increasing levels of personal debt. In more recent times, the growth in personal debt has slowed, as consumers have responded to higher interest rates. Any significant change in consumer willingness to debt fund discretionary spending has the potential to affect department store trading.

3.5.2 Office Supplies

The office supplies industry in Australia is an attractive and growing market. Annual sales for the 2005 calendar year were estimated at $9.4 billion and sales are forecast to grow at more than 5% per annum over the next five years.

The office products industry has traditionally focused on core stationery, such as pens, pencils, paper and art supplies, and consumable products such as laser cartridges. However, more recently, the office product range has extended to include furniture, computer disposables, printing services and cleaning supplies. The chart below illustrates the share of revenue of the major product categories in the office supplies industry:

Australian Office Supplies - Major Product Categories
(2005 Calendar Year)



Source: BIS Shrapnel

While growth in the office supplies sector has broadly tracked growth in GDP, specific growth drivers include the number of office employees and, in particular, growth in the number of small enterprises and home offices. Small enterprise and home office numbers are forecast to continue to grow at approximately 7% per annum until December 2008. Small enterprise and home office customers, considered retail or non-contract customers, typically have higher per capita expenditure on office products than larger businesses and have been responsible for the increasing trend towards online ordering and other direct channels.

The office supplies market is segmented by distribution channel. Broadly, office products distribution can be split into three categories:

- Retail**:** purchases made through retail outlets, an area traditionally dominated by Officeworks and specialty retailers;

- Direct (non-contract): purchases made outside retail stores, but not on the basis of a pricing contract. This is the smallest but fastest growing distribution channel, with growth reflecting the rapid uptake and ease of online ordering; and

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- Direct (contract): purchases made outside retail stores under a pricing contract. These are typically business-to-business contracts negotiated with medium/large companies. Growth in this area has significantly slowed as the market matures.

Historically, there has been a clear delineation between the retail and direct (contract) distribution segments, reflecting limited target customer overlap. The retail channel primarily serves small to medium businesses, micro offices and personal shoppers, whereas the direct channel focuses on medium to large scale corporate clients and Government departments. Recently, however, the incumbent direct (contract) players have begun to target the growing direct (non-contract) segment in order to maintain growth. Retailers have also started to develop their online proposition to target this growing and highly fragmented channel. The growth in online complements the retail business and provides an additional growth opportunity.

The Australian office supplies market, which includes both retailers and direct distributors, has undergone a period of consolidation with the four largest office supplies participants now accounting for almost 40% of the total market. This consolidation was accelerated by the entry into the Australian market place of large international participants such as Buhrmann N.V. (Corporate Express), OfficeMax Inc ("OfficeMax") and Lyreco Group HK (National 1).

In the retail segment, Officeworks has built a clear leadership position. Officeworks currently has a share of approximately 16% of the total office product market. No other business in Australia has a directly comparable proposition on a format or range basis. Primary competitors include:

- Office National Pty Limited, Office Choice Limited and ASA Australia Pty Limited, which are linked networks of independent office supplies dealers that principally target small to medium businesses and local Governments; and

- various specialty retailers across discrete product categories. These include Harvey Norman Holdings Limited ("Harvey Norman") (for computer and electrical equipment), Big W (discount department stores), Australia Post and local newsagencies.

In the direct (contract) distribution segment of the market, Corporate Express has built a clear leadership position. Corporate Express is Australia's largest contract direct supplier of office products and currently has a share of approximately 12% of the total office product market. Corporate Express is 53% owned by Buhrmann N.V. (the fourth largest office supplies company globally) and has a very small retail presence (71% of all orders come from online accounts). OfficeMax and Lyreco also operate principally in the direct (contract) segment. Historically, they have focused on contracted supplies to medium and large companies and to Government departments.

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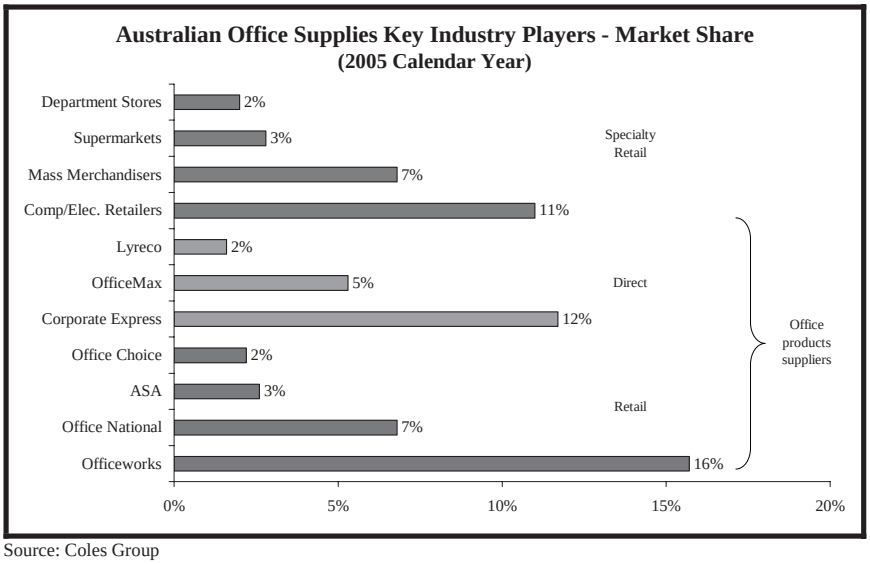
The following chart summarises the market shares of the major participants in the office supplies market:



Source: Coles Group

To date, rationalisation of the Australian office supplies market has generally involved consolidation of businesses operating within the same distribution channel. Corporate Express has developed its leading direct position principally through acquisitions (since 1995 it has made approximately 50 acquisitions, principally of small to medium sized companies) to obtain relationships, increase geographic coverage and expand into new business areas. Future consolidation may involve businesses operating in different distribution channels, as participants seek to realise synergies in distribution, procurement and other costs.

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4 Profile of Coles Group Limited

4.1 Background

The operations of Coles Group have a history of over 100 years through its two predecessor companies, Coles and Myer:

- the first Coles "variety store" was opened in Collingwood, Melbourne in 1914. G.J. Coles & Coy Limited was incorporated in 1921, and the company opened its first city store in Bourke Street, Melbourne. With eight stores in the chain, G.J. Coles & Coy Limited was floated on the Melbourne Stock Exchange in 1929. By 1933, Coles variety stores were trading in all States of Australia. In 1960, the first Coles supermarket was established in North Balwyn, Melbourne, and by 1973 Coles supermarkets had been opened in every capital city of Australia. Kmart was established as a joint venture between G.J. Coles & Coy Limited and Kmart Corporation of the United States and the first Australian store was opened in 1969. In 1978, Coles acquired full ownership of the Australian Kmart business. A long term licensing agreement allows Coles Group to use the Kmart name. Coles further diversified in the 1980s and expanded into liquor retailing with the acquisition of a number of liquor stores in 1981, and the Liquorland brand name was extended to all company liquor stores in 1982; and

- the first Myer store was opened in 1900, followed by another in 1908. In 1911, Myer bought a drapery store in Bourke Street, Melbourne, which later became the flagship Myer store. The Myer Emporium Limited was listed on the Melbourne Stock Exchange in 1929. Myer strengthened its position in 1983 as the major Australian department store retailer by purchasing Grace Bros., the largest department store retailer in New South Wales. In 1968, The Myer Emporium Limited purchased Australian rights to the Target name and logo, and subsequently launched the Target discount department store chain in Australia.

In September 1985, GJ Coles & Coy Limited and The Myer Emporium Limited merged. The official name change to Coles Myer Limited ("Coles Myer") followed in January 1986.

Following the merger, Coles Myer continued to grow through acquisition and expansion into new market sectors. Key events subsequent to the merger included:

- in 1987, Coles Myer acquired the South Australian discount supermarket operator, Bi-Lo, and expanded it to other States. In August 2006, it was announced that all Bi-Lo stores would either be rebranded as Coles stores or sold. The majority of stores have since been converted to Coles stores, except for a number of stores primarily located on the central New South Wales coast;

- in 1996, Fosseys (which comprised the Coles variety stores and the Fosseys chain acquired with Myer) and Target were merged, which resulted in the revamp of Fosseys stores to a new store design, and a focus on providing family apparel and homewares. By 1999, all Fosseys stores located close to Target stores had been closed and the remaining Fosseys stores had been rebranded Target Country stores;

- Officeworks, a chain of office stationery stores, was established in the early 1990s. The first Officeworks store opened in the inner city suburb of Richmond in Melbourne in June 1994. Following a period of store expansion in Melbourne, the chain was rolled out in Sydney, Brisbane, Adelaide and Perth;

- in 1998, Myer open the first Megamart furniture and electrical store in Coorparoo, Queensland, and ultimately expanded the chain to a total of nine stores. In 2005, Coles Myer announced plans to divest Megamart due to low profitability. Coles Myer sold six of the stores to Harvey Norman and closed the remainder;

- Coles Myer acquired Harris Technology Pty Limited ("Harris Technology"), a multi-channel high-end technology retailer in 1999. In addition to the call centres and website, a total of nine Harris Technology business centres trade as part of the Officeworks business;

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- in 2001, Target announced its first ever loss. New senior management was put in place, and Target was repositioned away from being a highly promotional discount department store. A new format was adopted, with a focus on convenience, value and fashion, particularly in clothing and homewares; and

- Coles Express is an Australian chain of fuel and convenience stores that was launched in July 2003. Coles Myer purchased the rights to the business from the existing Shell Australia multi-site franchisees. Coles Express' only affiliation with Shell is that Shell is the exclusive supplier of fuel products, leases the service station properties to Coles Group, and maintains the presence of the "pecten" and other Shell branding on price boards and other signage. Some Shell-branded service stations, particularly in country areas, remain unassociated with Coles Express.

In March 2006, Coles Myer announced that it would sell Myer to a consortium led by United States private equity group Newbridge Capital. The sale was completed in June 2006, and Coles Myer was renamed Coles Group Limited.

Today, Coles Group is Australia's second largest retailer and one of the top 30 retailers in the world. It supplies a wide range of merchandise including food, liquor, fuel, apparel, home goods and general merchandise. In the year ended 29 July 2007, Coles Group generated almost $35.0 billion in sales from continuing operations, primarily in Australia. It currently operates 3,016 stores and employs approximately 170,000 people. Coles Group had a market capitalisation at 21 September 2007 of approximately $18.0 billion.

In late July 2006, Coles Group announced a revised strategic plan that included the creation of an integrated 'Everyday Needs Business'. The ENB of Coles Group encompasses the retail outlets that are frequent shopping destinations for customers, including supermarkets, liquor, fuel and general merchandise. The following businesses are included under the ENB umbrella:

- Supermarkets;

- Coles Express;

- Coles Liquor; and

- Kmart.

The intention is for the ENB to be supported by a single supply chain, merchandising, marketing, operations and support structure. The operational structure of the Coles Group is summarised below:

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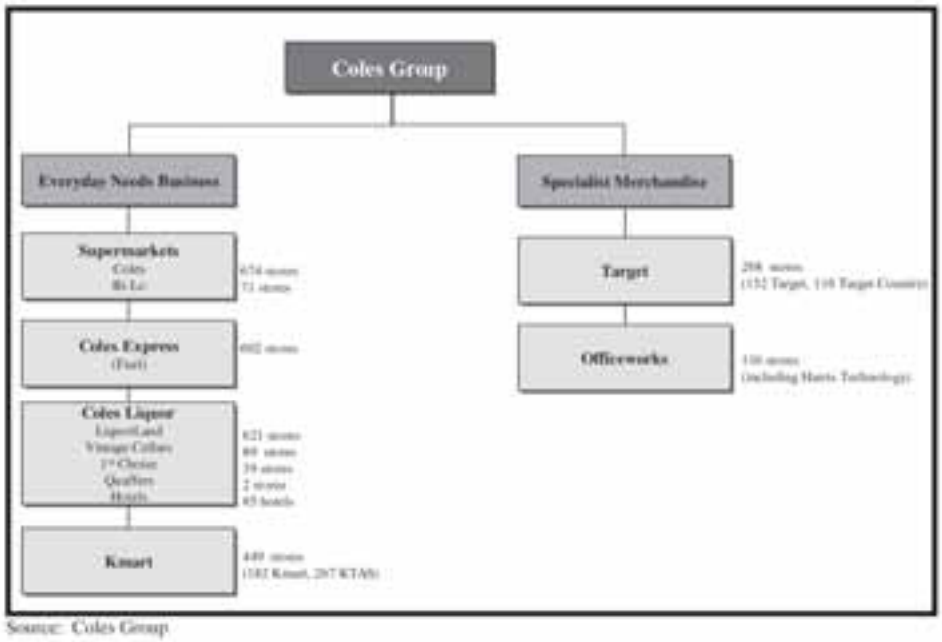
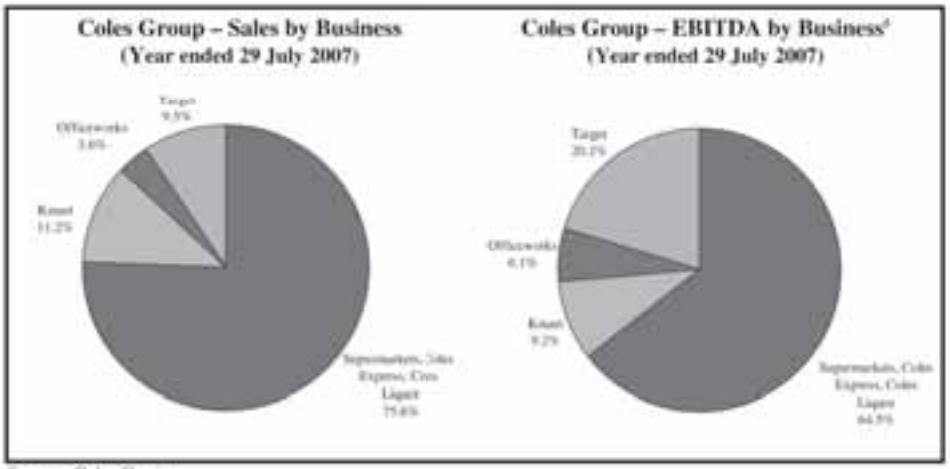


Source: Coles Group

In addition to its operating businesses, the Coles Group also has a substantial property business, which earns rental income from both internal and third party tenants, and generates property development profits when completed developments are sold to third parties.

The food and liquor group (Supermarkets, Coles Express and Coles Liquor) is the largest contributor to the sales and earnings of the Coles Group, generating 76% of sales and 65% of EBITDA[4] in the 2007 financial year:



Source: Coles Group

4 EBITDA is earnings before net interest, tax, depreciation and amortisation and significant items.

5 Excludes property and unallocated revenue and costs.

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4.2 Financial Performance

The financial performance of Coles Group for the five years ended 29 July 2007 is summarised below:

Coles Group - Financial Performance[6] ($ millions)

	Year ended				
	27 July 2003 AGAAP	25 July 2004 AGAAP	31 July 2005 AIFRS	30 July 2006 AIFRS	29 July 2007 AIFRS
Trading weeks	*52*	*52*	*53*	*52*	*52*
Supermarkets, Express & Liquor[7]	16,557.6	21,146.3	24,670.0	25,812.6	26,230.1
Kmart[8]	4,368.6	4,679.9	4,023.3	4,000.5	3,889.4
Officeworks	-	-	1,236.3	1,228.8	1,262.4
Target	2,646.9	2,851.8	3,088.6	3,170.1	3,306.0
Property and unallocated[9]	203.6	266.4	-	-	-
Sales – Continuing operations	**23,776.7**	**28,944.4**	**33,018.2**	**34,212.0**	**34,687.9**
Sales – Discontinued operations[10]	3,239.9	3,322.4	3,149.6	2,486.4	-
Total sales revenue	**27,016.6**	**32,266.8**	**36,167.8**	**36,698.4**	**34,687.9**
Supermarkets, Express & Liquor	822.7	964.7	1,054.3	1,095.0	1,095.7
Kmart	171.7	220.9	141.8	131.2	155.9
Officeworks	-	-	85.0	91.5	104.4
Target	145.6	202.2	268.8	294.7	342.9
Property and unallocated	(33.5)	(83.3)	(57.0)	24.9	(6.3)
EBITDA – Continuing operations	**1,106.5**	**1,304.5**	**1,492.9**	**1,637.3**	**1,692.6**
EBITDA – Discontinued operations	78.1	111.9	69.1	97.0	(2.4)
Total EBITDA	**1,184.6**	**1,416.4**	**1,562.0**	**1,734.3**	**1,690.2**
Depreciation and amortisation	*(504.2)*	*(528.3)*	*(521.1)*	*(524.7)*	*(543.0)*
Supermarkets, Express & Liquor	565.5	678.0	761.1	796.3	773.2
Kmart	103.8	151.0	89.0	76.0	96.8
Officeworks	-	-	68.4	74.9	85.4
Target	89.9	150.9	218.8	248.3	290.0
Property and unallocated	(88.7)	(138.3)	(109.1)	(48.1)	(95.8)
EBIT – Continuing operations	**670.5**	**841.6**	**1,028.2**	**1,147.4**	**1,149.6**
EBIT – Discontinued operations	9.9	46.5	12.7	62.2	(2.4)
Total EBIT[11]	**680.4**	**888.1**	**1,040.9**	**1,209.6**	**1,147.2**
Net interest expense	(63.2)	(13.5)	(56.2)	(100.0)	(102.8)
Significant items	-	-	(81.5)	268.3	(16.4)
Operating profit before tax	**617.2**	**874.6**	**903.2**	**1,377.9**	**1,028.0**
Income tax expense	(187.7)	(258.1)	(265.3)	(214.3)	(280.2)
Profit after tax attributable to Coles Group shareholders	**429.5**	**616.5**	**637.9**	**1,163.6**	**747.8**
Statistics					
Basic earnings per share (¢	*32.2*	*46.9*	*47.9*	*93.4*	*62.5*
Dividends per share (¢)	*26.0*	*29.0*	*33.3*	*42.0*	*44.5*
Dividend payout ratio (%)	*80.7*	*61.8*	*69.5*	*45.0*	*71.2*
Amount of dividend franked (%)	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
Total sales revenue growth	*5.9*	*21.7*	*14.1*	*3.6*	*1.4*
EBITDA growth (%)	*12.7*	*19.6*	*10.3*	*11.0*	*(2.5)*
EBIT growth (%)	*20.1*	*30.5*	*17.2*	*16.2*	*(5.2)*
EBITDA margin (%)	*4.4*	*4.4*	*4.3*	*4.7*	*4.9*
EBIT margin (%)	*2.5*	*2.8*	*2.9*	*3.3*	*3.3*
Interest cover[12] (x)	*10.8*	*65.8*	*18.5*	*12.2*	*11.2*

Source: Coles Group 2004 and 2006 Annual Reports, 2007 Financial Results and Grant Samuel analysis

6 Financial statements for the years prior to 30 July 2006 were prepared in accordance with Australian generally accepted accounting principles ("AGAAP"). Coles Group adopted the Australian equivalent to international financial reporting standards ("AIFRS") from 1 August 2005. The results for the 52 week period ended 31 July 2005 were also restated under AIFRS.

7 Supermarkets, Express & Liquor includes Pharmacy Direct for the 2006 and 2007 financial years.

8 Kmart includes Officeworks for the 2003 and 2004 financial years.

9 Includes emerging businesses for the 2003 and 2004 financial years.

10 Discontinuing operations represent Myer and Megamart.

11 EBIT is earnings before net interest, tax and significant items.

12 Interest cover is EBIT divided by net interest.

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In 2002, Coles Myer announced a five year strategic plan that contemplated a substantial strengthening of the business, a significant increase in earnings and growth in shareholder value. Following some initial successes and a continuing improvement in the performance of Target, Officeworks and Coles Liquor, the profit improvement target for the five year period was met in the 2006 financial year. However, the performance of Kmart deteriorated, although an improvement in earnings was generated in the 2007 financial year as a result of the implementation of a strategy to improve the quality of sales, product margins and to reduce costs. The Supermarkets business, after a period of steady growth, underperformed in 2006 and experienced a significant decline during the 2007 year. Key events that have affected the financial performance of the businesses since 2003 include:

- the 2003 financial year saw the announcement of the Coles Express fuel offer in Victoria. Expansion of the Supermarket and Coles Liquor networks continued, with ongoing investment in store refurbishments. In January 2003, Officeworks acquired Viking Direct Pty Limited and Viking Office Products Pty Limited ("Viking"). In May 2003, Coles Group acquired Theo's Liquor ("Theo's Liquor"), adding 47 liquor stores and four hotels to Coles Liquor. Kmart/Officeworks and Target improved sales and earnings, whilst Myer/Megamart improved on prior year earnings;

- the expansion and refurbishment of the Supermarkets and Coles Liquor businesses continued in the 2004 financial year. The national roll-out of the Coles Express format was completed by March 2004, positioning Coles Group as the largest fuel retailer in Australia. The fuel discount offer was a key driver of growth for the Supermarkets and Coles Liquor businesses, and customers demonstrated strong support for the growing house brand range;

- during the 2005 financial year, the three tier house brand range was introduced into Coles supermarkets. House brands promote customer loyalty and increase margins for the Supermarkets business. The supermarket and liquor store networks were also expanded with 30 new supermarkets and 47 liquor stores opened during the year. Coles Liquor launched the 1st Choice large format liquor offering in the 2005 financial year. Target performed particularly strongly during the 2005 financial year;

- during the 2006 financial year, Coles Group announced the divestment of its Megamart and Myer businesses. The store expansion and refurbishment program continued, particularly in the liquor business with the acquisition of The Hedley Hotel Group Pty Limited and Hedley Hotel Group No 2 Pty Limited ("Hedley Hotel Group"). The Hedley Hotel Group added 102 liquor stores, 35 hotels and potential sites for 17 1st Choice outlets, as well as providing an entrée into the fast growing far north Queensland market. Coles Group also committed to various strategic initiatives, resulting in significant write downs and provision for costs; and

- during the 2007 financial year, the performance of the Supermarkets business deteriorated, in part due to the poor trading performance of rebadged Bi-Lo stores, poor "value" perception, deterioration in on-shelf availability and a decline in fresh produce participation. The Coles Liquor business continued to grow through the integration of the Hedley Hotel Group, the Talbot Hotel Group and the Pippos Hotel Group (also known as Mr Corks), as well as the roll-out of the 1st Choice superstores. Coles Express achieved strong earnings growth through its push to grow convenience sales, via a number of initiatives including the launch of the 6 cents per litre loyalty offer and the introduction of value convenience offerings, such as 'You'll Love Coles' milk and bread. Kmart's sales declined, however, earnings improved as the business transitioned from a promotions driven strategy to an every day affordable prices position, and focussed on generating profitable sales. Target recorded further sales and earnings growth and introduced the 'Designers for Target' program, such as the Stella McCartney range. Officeworks grew sales and earnings while expanding its network to 107 stores and adding its ninth Harris Technology business centre.

"Discontinued operations" in the table above relate to Megamart and Myer, which were divested in November 2005 and June 2006 respectively.

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"Property and unallocated" consists of:

- Coles Group's property business (which earns rental income and generates profits on disposal of completed developments);
- unallocated corporate costs; and
- emerging businesses in the 2003 and 2004 financial years, which were subsequently reported in the relevant businesses.

Significant items affecting the financial performance of Coles Group are summarised below:

Coles Group – Significant Items (pre tax) ($ millions)

	Year ended				
	27 July 2003 actual AGAAP	25 July 2004 actual AGAAP	31 July 2005 actual AIFRS	30 July 2006 actual AIFRS	29 July 2007 actual AIFRS
Gain on sale of Myer	-	-	-	563.7	39.5
Strategic initiatives	-	-	-	(295.4)	-
Megamart divestment costs	-	-	(81.5)	-	-
Ownership review costs	-	-	-	-	(55.9)
Total	**-**	**-**	**(81.5)**	**268.3**	**(16.4)**

Source: Coles Group and Grant Samuel analysis

In November 2005, Coles Group announced the divestment of its nine Megamart stores. Divestment costs in relation to Megamart included the write down of non-current assets and inventory to recoverable amounts and provision for surplus leased space.

In June 2006, Coles Group sold its Myer business for $1,409.0 million. A pre-tax gain on sale of $563.7 million was recorded in the year ended 30 July 2006.

During the year ended 30 July 2006, Coles Group committed to a number of strategic initiatives, resulting in write downs and costs totalling $295.4 million. These included:

- redundancy expenses of $158.1 million associated with the consolidation of support services, simplification of back office processes and closure of the Somersby and Hampton Park distribution centres ("DCs");
- lease exit costs of $17.0 million associated with the closure of the Somersby and Hampton Park DCs;
- a write down of brand names of $22.6 million as a result of the rebadging of Theo's Liquor stores;
- asset write downs of $35.7 million and costs of $22.8 million associated with the rebadging of Bi-Lo stores to Coles, and other store rebadging as a result of changes to store formats; and
- accruals of $31.8 million associated with changes to the existing loyalty program.

During the year ended 29 July 2007, Coles Group incurred costs of $55.9 million in relation to the ownership review, and benefited from additional profit of $39.5 million from the divestment of Myer.

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Coles Group has announced two major programs to improve its short and longer term profitability:

- **Transformation program**

The Transformation program was announced in September 2003, with the objective of re-engineering the food and liquor supply chain, extracting savings from the non-food supply chain and improving back of store processes in the non-food supply chain. The program aims to improve the end-to-end supply chain involving suppliers, stores, distribution centres, transport and merchandising. The majority of benefits from the Transformation program will accrue to the ENB, especially Supermarkets. The five year program originally involved committing $604 million of capital to generate EBIT benefits of $425 million by the end of the 2008 financial year.

The most costly element of the program relates to the reconfiguration of Coles Group's DC network. The number of DCs is to be reduced from 45 to 26. The reconfiguration will involve the construction of 10 new DCs, consisting of two 'slow' national DCs and eight 'fast' regional DCs. The 'slow' DCs manage slower moving products, with the first opening in November 2006. The 'fast' DCs manage fast moving products including chilled and frozen products. Six new DCs, including the slow moving DCs, have been completed and are in various stages of ramp up. Other elements of the program include various software and systems upgrades (particularly Automated Store Replenishment ("ASR")) and the introduction of logistics innovations such as returnable plastic crates ("RPC") and roll cages to reduce stock handling costs. ASR will allow the automated electronic ordering of stock though a comparison of scanned sales data with current stock availability.

Coles Group is now three and a half years into the supply chain Transformation program. Progress has been slower than expected predominantly due to delays in the DC and ASR projects. Although Coles Group management continues to expect that the initial estimate of benefits will be achieved, these delays will result in the benefits being realised over a longer time horizon.

- **Simplification program**

The Simplification program was launched in September 2006, with the objective of achieving substantial cost savings through a combination of business process simplification, head count reductions and other initiatives. The Simplification program had full time teams dedicated to identifying cost reduction opportunities across the whole corporate centre and from functions including merchandise, operations and supply chain. A detailed planning and tracking system is set up for each cost reduction initiative and the initiative is monitored by dedicated full time teams. The initial target for the program was to generate EBIT run-rate benefits of $363 million by the end of the 2008 financial year relative to the 2006 financial year base, based in large part on a headcount reduction of 2,500 employees.

Significant cost savings have been achieved pursuant to the Simplification program, with an EBIT benefit of over $100 million realised by the end of the 2007 financial year.

4.3 Financial Position

The financial position of Coles Group as at 30 July 2006 and 29 July 2007 is summarised below:

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Coles Group - Financial Position ($ millions)		
	As at 30 July 2006 actual	**As at 29 July 2007 actual**
Debtors and prepayments	390.8	428.8
Inventories	2,851.8	2,946.5
Creditors and accruals	(3,080.3)	(3,057.9)
Net working capital	**162.3**	**317.4**
Property, plant and equipment	3,140.9	3,467.6
Intangible assets	1,412.2	1,670.2
Investments	125.0	7.4
Assets held for sale	151.7	26.1
Derivative financial instruments (net)	(29.3)	(75.6)
Deferred tax assets (net)	406.9	415.5
Current tax liabilities	(66.4)	(38.8)
Provisions	(1,082.6)	(913.9)
Non-current amounts receivable	43.7	41.2
Other net assets/(liabilities)	(147.8)	(70.5)
Total funds employed	**4,116.6**	**4,846.6**
Cash in tills	360.9	372.8
Cash and deposits	124.7	173.3
Borrowings	(1,004.2)	(1,485.9)
Net borrowings	**(518.6)**	**(939.8)**
Equity attributable to Coles Group shareholders	**3,598.0**	**3,906.8**
Statistics		
Shares on issue at period end (million)	*1,189.9*	*1,198.8*
Net assets per share ($)	*3.02*	*3.26*
NTA[13] per share ($)	*1.84*	*1.87*
Gearing[14]	*12.6*	*19.4*

Source: Coles Group and Grant Samuel analysis

The following should be noted in relation to Coles Group's financial position as at 29 July 2007:

- property, plant and equipment consist of freehold properties, leasehold improvements and plant and equipment, as well as capital works in progress. Property, plant and equipment continues to grow due to the continued investment in store network expansion and refurbishment programs, as well as strategic initiatives including the Transformation program;
- intangible assets principally consist of goodwill, computer software (both acquired and internally generated), liquor licences and co-branded operating rights. Goodwill increased during the 2007 financial year due to the acquisitions of the Talbot Hotel Group and the Pippos Group;
- the investments of the Coles Group represent investment properties which are carried at fair value;
- assets held for sale include freehold development and investment properties;
- Coles Group is a party to derivative financial instruments in the normal course of business in order to manage its exposure to fluctuations in interest and foreign exchange rates;
- provisions primarily comprise employee entitlement provisions, as well as provisions for strategic initiatives, including redundancies and Myer divestment costs. The strategic initiatives provision largely relates to the rebadging of Bi-Lo stores to Coles, the Myer divestment provision primarily relates to property related costs and information technology change costs. Redundancy provisions primarily relate to the Simplification program (i.e. the

[13] NTA is net tangible assets, which is calculated as net assets less intangible assets.

[14] Gearing is net borrowings divided by net assets plus net borrowings.

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consolidation of support services, simplification of back office processes and headcount reductions) and the closure of the Somersby and Hampton Park DCs;

- net debt (borrowings less cash) grew significantly during the 2007 financial year, reflecting primarily lower than anticipated sales and earnings from the Supermarkets business, as well as investment in strategic initiatives, one-off redundancy payments and ownership review costs; and

- cash in tills represents the cash floats of Coles Group stores, and is working capital in nature.

4.4 Cash Flow

Coles Group's cash flows for the five years ended 29 July 2007 are summarised below:

Coles Group - Cash Flow ($ millions)

	Year ended				
	27 July 2003 actual AGAAP	30 July 2004 actual AGAAP	31 July 2005 actual AIFRS	30 July 2006 actual AIFRS	29 July 2007 actual AIFRS
EBITDA (after significant items)	**1,184.6**	**1,416.4**	**1,480.5**	**2,002.6**	**1,673.8**
Changes in working capital and other adjustments	256.5	225.2	121.3	(190.1)	(342.2)
Capital expenditure (net)	(625.2)	(704.1)	(925.0)	(1,043.1)	(1,040.8)
Operating cash flow	**815.9**	**937.5**	**676.8**	**769.4**	**290.8**
Tax paid	(179.1)	(288.5)	(402.5)	(422.7)	(313.0)
Net interest paid	(83.6)	(14.8)	(42.2)	(89.2)	(76.1)
Dividends paid	(287.6)	(307.8)	(433.2)	(453.1)	(500.7)
Acquisitions of businesses, investments and associates (net of cash)	(243.1)	(194.5)	(123.3)	(203.4)	(160.5)
Disposals of property, plant and equipment, businesses and investments	417.5	122.0	27.7	1,343.1	344.3
Proceeds from share issues/(buybacks)	-	37.1	(584.4)	(715.7)	(1.9)
Proceeds from/(repayment of) borrowings	(424.9)	(409.9)	480.1	(187.7)	481.6
Repayment of loan from Employee Share Plan	13.6	66.1	-	-	-
Net cash generated (used)	**28.7**	**(52.8)**	**(401.0)**	**40.7**	**64.5**
Cash – opening	*866.0*	*894.7*	*841.9*	*440.9*	*481.6*
Cash – closing	*894.7*	*841.9*	*440.9*	*481.6*	*546.1*

Source: Coles Group and Grant Samuel analysis

Coles Group's capital expenditure is summarised in the table below:

Coles Group – Capital Expenditure (Gross) ($ millions)

	Year ended				
	27 July 2003 actual	30 July 2004 actual	31 July 2005 actual	30 July 2006 actual	29 July 2007 actual
New and replacement	236.0	183.7	342.6	275.1	366.7
Refurbishments/redevelopments	172.4	205.0	212.7	208.4	239.0
Technology, including computer software	167.7	150.5	223.2	289.4	253.7
Acquisitions	299.0	128.8	120.2	474.9	150.3
Other	117.2	205.3	236.0	264.2	187.5
Total	**992.3**	**873.3**	**1,134.7**	**1,512.0**	**1,197.2**

Source: Coles Group

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Key cash flow items over the past five years include:

- the Theo's Liquor and Viking Office Supplies businesses were acquired during the 2003 financial year. Disposals in the 2003 financial year relate to the sale and leaseback of properties acquired as part of these acquisitions. The cash outflows for these acquisitions were offset by the proceeds from the sale of Sydney Central Plaza;

- during the 2004 financial year, Coles Group acquired the rights to operate 585 Shell fuel and convenience outlets and eight standalone Shell convenience sites, and sold five Newmart supermarkets and seven Sands and McDougall office supplies stores;

- net operating cash flow decreased in the 2005 financial year due in part to an increase in direct sourcing resulting in earlier payment to suppliers. Capital expenditure reflecting the Transformation program and ongoing net store expansion and refurbishment of supermarkets. Total tax instalments increased following Coles Group's entry into the consolidated tax regime in 2004. Payments for share buybacks also contributed to the reduction in cash generated. Coles Group's primary acquisitions in the 2005 financial year were of hotels and freehold properties in Queensland;

- during the 2006 financial year, the divestment of Myer for $1,409 million made a significant contribution to the Coles Group's cash flow for the year. The major acquisition for the year was of the Hedley Hotel Group. In addition, a further off-market share buyback was conducted and costs were incurred in relation to strategic initiatives; and

- during the 2007 financial year, the operating cash flow of Coles Group was adversely impacted by the lower than anticipated sales and earnings in the Supermarkets business. It was also affected by Coles Group's investment in strategic initiatives including $228 million of one-off redundancy and strategy cost payments, and the ownership review costs.

4.5 Taxation Position

Under the Australian tax consolidation regime, Coles Group and its wholly owned Australian resident entities have elected to be taxed as a single entity.

At 29 July 2007, Coles Group had no carried forward income tax losses. However, the Coles Group had carried forward Australian capital losses of approximately $1,010 million.

At 29 July 2007, Coles Group had $356.7 million of accumulated franking credits.

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4.6 Capital Structure and Ownership

4.6.1 Capital Structure

As at 21 September 2007, Coles Group had the following securities on issue:

- 1,198,884,888 ordinary shares;
- 5,687,753 options over unissued ordinary shares; and
- 3,942,821 performance shares.

Pursuant to Coles Group's Executive Share Option Plans, options over unissued shares may be issued to executives at Coles Group's discretion. Options are issued for nil consideration. Each option on issue is exercisable into one ordinary share and has no dividend entitlement or voting right until exercised. The holders of options are entitled to participate in bonus share issues, upon exercise.

Many of the options are subject to performance hurdle conditions that are required to be satisfied before the options can be exercised. Generally, other than vested options, they have exercise dates between September 2007 and November 2009, and exercise prices in the range $5.88 to $8.94. Options lapse after termination of employment or on the expiry date.

Under Coles Group's Senior Executive Performance Share Plan, performance shares may be issued to senior executives at Coles Group's discretion. A performance share represents the right to acquire an ordinary share in Coles Group for no consideration upon specified performance tests being met. Performance shares have no voting rights until vested. The holders of performance shares are entitled to participate in bonus share issues.

4.6.2 Ownership

At 31 August 2007, there were 329,293 registered shareholders in Coles Group. The top 20 shareholders accounted for approximately 54% of the ordinary shares on issue. Coles Group has a significant retail investor base with a majority by number of registered shareholders classified as retail, although this represents less than 38% of shares on issue. Coles Group shareholders are predominantly Australian registered investors (over 98% of registered shareholders and 99% of securities on issue).

As at 21 September 2007, Coles Group had received notices from the following substantial shareholders:

Coles Group – Substantial Shareholders as at 21 September 2007

Shareholder	Number of Shares	Percentage
Wesfarmers Limited	144,581,288	12.10%
Commonwealth Bank of Australia	71,944,935	6.00%

Source: Coles Group

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4.7 Share Price Performance

4.7.1 Share Price History

A summary of the share price and trading volume history of Coles Group since January 2001 is set out below:

Coles Group - Share Price History

	Share Price ($)			Average Weekly Volume (000s)	Average Weekly Transactions
	High	Low	Close		
Year ended 31 December					
2001	8.67	5.90	8.40	14,366	3,217
2002	9.00	5.70	6.30	18,952	3,895
2003	8.02	5.27	7.56	13,979	3,088
2004	10.11	7.26	9.86	14,665	3,631
2005	10.41	8.20	10.21	21,408	4,823
Quarter ended					
31 March 2006	10.86	9.49	10.70	23,222	5,828
30 June 2006	11.80	10.51	11.36	21,284	6,181
30 September 2006	14.80	10.56	14.39	43,133	9,312
31 December 2006	14.50	12.75	14.00	21,197	5,517
Month ended					
31 March 2007	16.33	13.71	16.25	28,062	7,477
30 April 2007	17.58	16.08	17.25	32,726	5,601
31 May 2007	17.95	16.48	16.53	22,133	6,277
30 June 2007	16.96	16.10	16.12	27,070	6,978
31 July 2007	15.94	14.02	14.51	37,236	8,290
Week ended					
3 August 2007	14.61	13.60	13.88	32,333	9,921
10 August 2007	14.73	13.64	13.87	20,754	6,589
17 August 2007	14.39	12.95	13.40	25,747	9,324
24 August 2007	14.36	13.65	14.04	16,140	7,123
31 August 2007	14.25	13.77	14.17	19,095	7,208
7 September 2007	15.19	14.13	14.57	30,114	7,569
14 September 2007	14.75	14.35	14.71	17,084	8,008
21 September 2007	15.22	14.66	14.98	22,684	8,538

Source: IRESS

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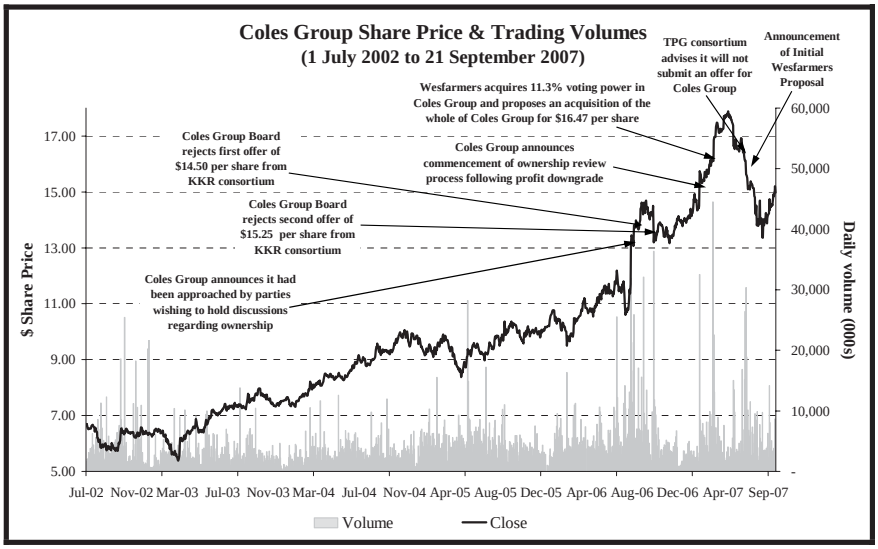
The following graph illustrates the movement in the Coles Group share price and trading volumes over the period 1 July 2002 to 21 September 2007:



Source: IRESS

Prior to Coles Group's announcement on 17 August 2006 that it had been approached by a number of parties in relation to the company's ownership, the highest price at which Coles Group shares had traded was $12.25 on 10 July 2006. The closing price on 16 August 2006 was $11.70 and the one month VWAP was $11.14. The closing price of Coles Group shares on 29 June 2007, the last trading day prior to the announcement of Wesfarmers Proposal, was $16.12.

Since the announcement in August 2006 that Coles Group had been approached by parties in relation to its ownership, Coles Group shares have traded in the range $12.75 to $17.95, with a VWAP of $14.88 (calculated to 21 September 2007).

4.7.2 Liquidity

Coles Group is a reasonably liquid stock. Average weekly volume over the twelve months prior to the announcement of the initial proposal from the KKR-led consortium in August 2006 represented approximately 1.9% of average shares on issue or annual turnover of around 97.1% of issued capital. Since that time, average weekly volume has represented approximately 3.6% of shares on issue (to 21 September 2007).

4.7.3 Relative Performance

Coles Group is a member of various indices including the S&P/ASX 200 Food & Staples Retailing Index and the S&P/ASX 200 Index. At 21 September 2007 its weighting in these indices was approximately 29.8% and 1.4% respectively.

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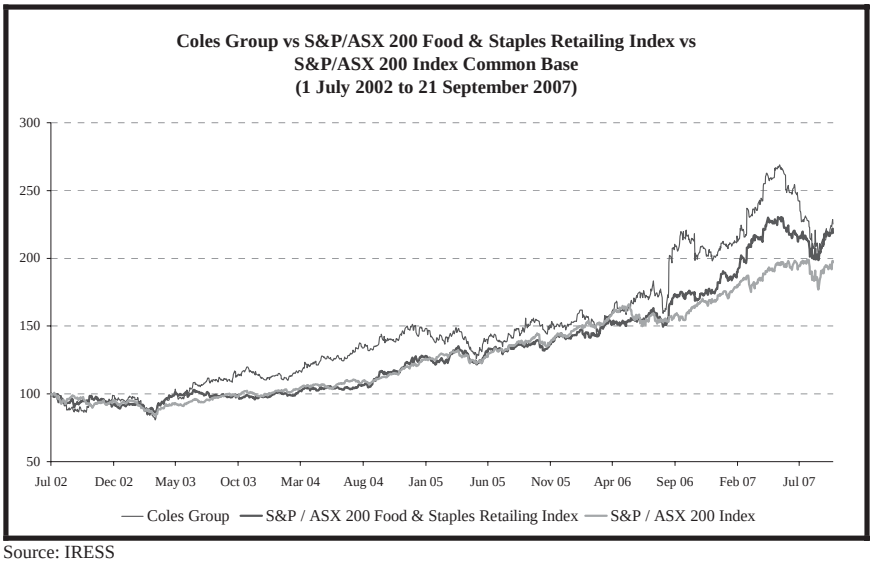
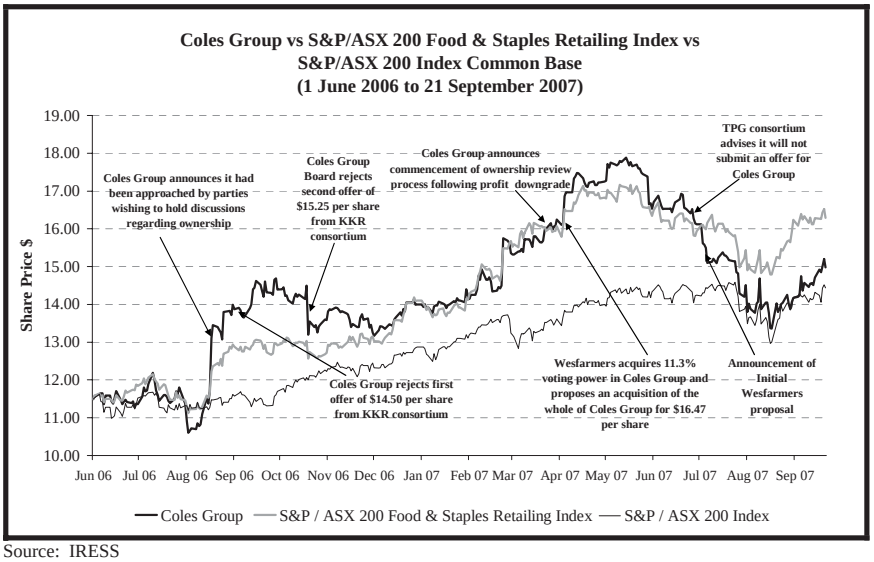
The following graph illustrates the performance of Coles Group shares since July 2002 relative to the S&P/ASX 200 Food & Staples Retailing Index and the S&P/ASX 200 Index:



Source: IRESS

Coles Group shares generally traded in line with the S&P/ASX 200 Food & Staples Retailing Index and the S&P/ASX 200 Index over the period 1 July 2002 to 31 July 2006. However, following the announcement by Coles Group in August 2006 that it had been approached by potential purchasers, the Coles Group share price strengthened significantly. Since then, the Coles Group share price appears to have reflected market expectations of a change of control transaction:



Source: IRESS

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5 Coles Group Business Operations

5.1 Supermarkets, Coles Express and Coles Liquor

5.1.1 Supermarkets

The Coles Group Supermarkets business is Australia's second largest supermarket retailer. Focused on a value and convenience proposition across its grocery, fresh and general merchandise operations, it operates a total of 745 stores nationally, consisting of 674 Coles stores across Australia and 71 Bi-Lo stores in New South Wales and Queensland. The market share of the Supermarkets business is around 34% across Australia, with slightly lower penetration in New South Wales and Tasmania. The stores are located both in metropolitan and regional areas, with an average store size of 3,000m² gross lettable area and 2,000m² selling lettable area. Each quarter, approximately 75% of Australian shoppers visit a Coles store.

Coles supermarkets have a three tiered house brand strategy targeting different customer demographics:

- Coles $mart Buy – entry level low price offering;
- You'll Love Coles – value offering with consistent quality standards; and
- Coles Finest – premium offering.

Bi-Lo has "red box" house brand products targeted at value oriented customers.

In September 2006, Coles Group announced that it intended to convert the Bi-Lo discount supermarket chain (which at the time consisted of 200 stores) to Coles branded full range supermarkets. The Bi-Lo chain was losing 0.2% market share annually, produced sales per square metre 20% below those of Coles supermarkets, and had an EBIT margin 100 basis points below that of Coles supermarkets. It was management's view that the Bi-Lo business model was unsustainable, and that rebranding to Coles would assist Supermarkets to compete more effectively. The conversion of Bi-Lo stores was expected to reduce the complexity of operating two brands side by side and allow savings in marketing, promotions and back office support. As at 29 July 2007, Coles Group had converted 129 Bi-Lo stores with 71 stores remaining to be converted, predominantly located on the central New South Wales coast.

Following a decade of consistent performance, Supermarkets, the main driver of the food and liquor results, has delivered disappointing performance over the past two years. The earnings of Supermarkets were essentially flat for the 2006 financial year and declined in the 2007 financial year. There were a number of reasons for the downturn in performance, including:

- Coles have lost customers to competitors. Supermarkets management believes that this was a result of a decline in the "customer offer", including in relation to price, fresh produce and in-store experience, a reliance on initiatives that were reaching the limits of their effectiveness (for example, the Coles fuel offer and promotions), Woolworths' expansion of its network, and the rapid expansion of Aldi since 2002;
- poor execution of the Bi-Lo store conversions resulted in a loss of customers and additional costs:
  - value offers that were important drivers in attracting Bi-Lo customers were poorly managed. Management intended to initially retain key Bi-Lo red box house brand items and bulk value meat offers and to phase them out over an 18 month period. However, contrary to plan, value offers were withdrawn almost immediately;

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- in particular, the conversion of Bi-Lo stores resulted in the termination of the Bi-Lo bulk meat offer. Meat is an important category in generating sales for supermarkets. Customers who buy meat generally also buy additional items to create and complement meals. Termination of the Bi-Lo bulk meat offer resulted in the loss of value focussed customers and a decline in both meat and other sales;

- the Bi-Lo meat sourcing model, which was based on bulk purchasing, allowed Bi-Lo stores to source meat at lower costs than the Coles supermarket meat sourcing model. Conversion of the Bi-Lo stores to Coles stores involved replacing the Bi-Lo meat sourcing model with the Coles model, increasing meat costs and reducing margins; and

- in addition to a decline in sales of converted stores, there was an increase in in-store labour costs as converted stores adopted the higher staffing levels of Coles stores. Markdowns and waste increased as Coles' product range (especially in Deli) was not suitable for the customer base in many of the stores;

- the problematic introduction of "centrally managed range", whereby the product range of each individual store is determined by a centralised buying function;

- a decline in on-shelf availability. This appears in part to have been the result of changes to store operations, including the introduction of centrally managed range, changes in management structures and staffing levels, as well as reflecting the impact of the Transformation program; and

- a decline in sales of fresh produce at Coles and Bi-Lo stores, reflecting customer perceptions of uncompetitive price and quality. This has a dual impact on profitability, because fresh produce is a high margin category and a successful fresh offer increases the frequency of customer visits and basket size.

The management of Supermarkets forecasts a turnaround of the business in the 2008 financial year. A number of business initiatives are expected to drive this turnaround, including:

- investment in the customer value proposition. In particular, this will involve improvements in meat sourcing and on-shelf availability and addressing the issues associated with the Bi-Lo conversions. In March 2007, Coles launched the 'Love Fresh' campaign. The campaign involved a focus on local competitive pricing, improvements in in-store presentation and quality, the introduction of Everyday Best Value and '$mart Buy' products as well as improved labour scheduling and standards;

- range rationalisation and growth in house brand sales. Supermarkets currently have a very large product range for its typical store size (25,000 SKUs for 2,000 m^2). Management intends to reduce the size of the product range by rationalising duplication in brands and introducing more house brand items. Supermarkets management believes that there is considerable opportunity to increase sales of Coles house brands;

- a reduction in non-store costs through the Simplification program;

- increased store capital expenditure. Under the store rejuvenation plan, the 2008 financial year will see a combination of major refurbishments, "light" refurbishments and resizes/replacements of stores; and

- the majority of benefits from the Transformation program are expected to accrue to Supermarkets, with benefits expected to be generated in the 2008 financial year from roll cages, RPCs, factory gate pricing, reconfiguration of the DC network and improvements to on-shelf availability.

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Further significant growth in profitability is expected beyond the 2008 financial year, reflecting:

- further benefits from the Simplification program; and
- an extensive ongoing capital program to refresh stores and roll-out new stores:
  - store refurbishments are a major component of any long term supermarket strategy and Supermarkets has initiated a capital program that will ensure stores are refurbished on a six year cycle. Refurbishments allow stores to be revitalised with new layouts that increase accessibility and convenience, and in some instances, expand the selling area available. About 40 stores per year will undergo a major refurbishment and about 60 stores per year will receive a "light" refurbishment. The light refurbishment program involves standard refurbishments including the replacement of front ends, widening of aisles, movement of island delis to the back of the store and the repositioning of Bakery and Fresh. It also includes repainting, re-tubing, re-laying floors, in-store fit-outs and refrigeration upgrades. Once completed, the capital program will ensure stores are refurbished on a 6 year cycle;
  - growth in the store network. Supermarkets plans to open about 30 new stores each year. After store closures, this will result in a net expansion of the store network of around 20-25 new stores each year; and
  - continued implementation of the Transformation program.

5.1.2 Coles Express

Coles Express has been operating for approximately four years, since Coles Myer acquired the rights to operate Shell's convenience store business in July 2003, and now consists of a chain of 602 retail sites Australia-wide. Coles Express is involved in fuel retailing under an alliance agreement with Shell (approximately 85% of sales) and a network of associated convenience stores ("C-stores") (approximately 15% of sales). Under the terms of the alliance agreement, Shell takes responsibility for supplying fuel and maintaining the forecourt (pumps, tanks, infrastructure and environment). Coles Express earns a margin on fuel sales, runs the sites and takes responsibility for the C-stores.

Coles Express is the Australian market leader in retail fuel sales, with a market share of approximately 24% of total retail fuel sales generated by a portfolio of sites representing around 10% of retail fuel sites across Australia. Coles Express' major competitors include Woolworths (operating in alliance with Caltex) (20% market share), Caltex (non-alliance) (20% market share), BP (17% market share), Mobil, 7-Eleven and other independent fuel retailers.

The fuel discount promotion is a key component of the Supermarkets and Coles Express customer offering and is the cornerstone of the Coles Group's loyalty proposition. There are currently a number of discount promotions operating with Coles Group companies, the cost of which is shared between Coles Group companies and Coles Express. The primary Coles Express promotion offers a 4c/litre fuel discount on Supermarkets dockets of $30 or more. Coles Express recently began to offer an additional 2 cents per litre discount for customers who spend at least $2 in the convenience store. This offer has been successful in converting fuel only customers to customers buying both fuel and convenience store merchandise. In addition to this primary promotion, Supermarkets and other Coles Group companies such as Liquorland, Officeworks, Kmart Tyre and Auto Services and hotels also run ad hoc petrol offer promotions.

In addition to Coles Express' significant supporting role in the delivery of the Supermarkets strategy, Coles Express has developed into a profitable business in its own right. Coles Express' leading fuel position and network strength has provided the platform to grow its

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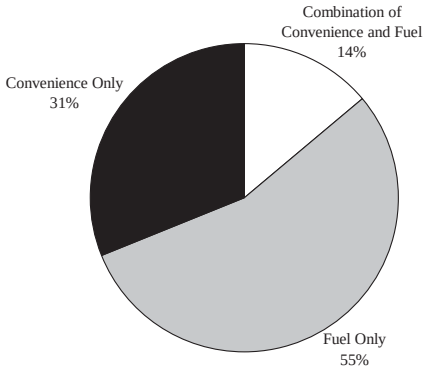
C-store business, with the petrol discount offer growing the number of C-store transactions. Although C-store sales are significantly lower than fuel sales (approximately 15% of total sales), the C-store margin makes a major contribution to the profitability of Coles Express (approximately 46% of gross margin).

The chart below analyses Coles Express sales by transaction type:

Coles Express - Sales by Transaction Type (%)
(Year ended 29 July 2007)



Source: Coles Group

Following a period of strong growth in recent years, the sales of Coles Express declined in the 2007 financial year, as a result of lower fuel prices and weaker docket redemptions, although earnings continued to improve.

The major profit growth opportunity for the Coles Express business is to leverage off the significant 'fuel only' customer traffic already frequenting the C-stores and convert these customers to 'fuel and convenience' shoppers, thus growing both sales and margins. Store refurbishments and network expansion are also expected to be important contributors to the growth of the convenience segment of the business. Capital expenditure initiatives aimed at increasing convenience sales and margin include the installation of milk, bread and beverage centres, fast lanes, coffee machines and magazine roll-outs. These initiatives are tailored according to C-stores' locations and consequent expected customer demand patterns, with differentiated fit outs for highway, suburban, traffic and urban stores. In addition, as Coles Express' prices are closely aligned with those of the Supermarkets business, Coles Express is significantly more competitive on price than some key convenience store competitors on key value items such as milk and bread. Coles Express' value position is further strengthened by its ability to introduce 'You'll Love Coles' branded 'food to go', bread and milk into its C-stores.

Population growth and consumer trends favouring convenience shopping are expected to create ongoing profit growth opportunities for Coles Express:

- management believes that there will be opportunities to grow the network through locating new sites on new highways and freeways, in new metropolitan residential communities and in growing regional communities; and

- demand for convenience store shopping is growing, with the convenience store share of Australian food retailing growing from 3.5% in 1999 to 7.1% in 2006.

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5.1.3 Coles Liquor

Coles Liquor is a key player in the Australian off-premises retail liquor sector and in the on-premises (i.e. hotels) sector, primarily in Queensland. The off-premises business of Coles Liquor generated approximately 95% of sales (excluding gaming income) and 75% of EBITDA for Coles Liquor in the 2007 financial year. The two main participants in the off-premises retail liquor sector are Coles Liquor and Woolworths, who control approximately 45% of the off-premises market. Coles Liquor has 751 retail locations and 85 hotels across Australia as at 29 July 2007. Coles Liquor had a market share of approximately 17% of the Australian packaged retail liquor market as at May 2007.

Coles Liquor has aggressively grown by acquisition over the last decade. The key acquisitions include:

- the SA Vintage Cellar Group Pty Limited in 1993, to secure the Vintage Cellar name and location. The Vintage Cellar brand was aggressively rolled out between 1994 and 2001, targeting the higher income, wine drinking demographic;
- the G&P Hotel Group Pty Limited in Queensland (including five hotels) in 1997, to provide an entry to the Queensland market;
- the Australian Liquor Group Pty Limited in 2001, which included the Phillip Murphy Wine and Spirits chain and several other brands, and provided 42 stores primarily in Western Australia and Victoria;
- the Leda Group Pty Limited in 2001, including 10 hotels and 21 retail outlets to further penetrate the Queensland market;
- the Theo's Liquor chain in 2003, with 47 stores primarily in New South Wales and the ACT;
- the Hedley Hotel Group in 2006, with 35 hotels and 102 retail stores primarily in Queensland;
- the Talbot Hotel Group and the Pippos Hotel Group during the 2007 financial year, adding 11 hotels and 24 bottle shops in Queensland; and
- five hotels from the Club Hotel Group in South Australia since the end of the 2007 financial year.

As a result of the numerous acquisitions undertaken, Coles Liquor developed an extremely fragmented position, with multiple brands to support. In early 2005, Coles Liquor undertook a review of the business and concluded that it needed to be simplified and repositioned to regain lost market share and grow profitability. The strategic review confirmed that Coles Liquor had to rationalise its brand portfolio and develop clear and distinct customer value propositions for each brand.

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Coles Liquor now operates under thre retail brands, each with its own store format. Each of these brands/formats has a distinc market position, sales mix and cost structure. The brands and their market positioning ae presented below:

Approximately 21% of Liquorland sores are co-located within Coles Group supermarkets and approximately 14% are adjacen to Coles Group supermarkets. All brands depend heavily on promotion, particularly Liuorland.

Whilst Coles Liquor entered the larg format segment later than its competitors (by the end of the 2004 financial year, Woolweths had 33 Dan Murphy stores compared to Coles Liquor's six Quaffers stores), Coles liquor has now positioned 1st Choice to capture a large share of growth in the segment. Tle inaugural large format 1st Choice store opened in May 2005, and the network had expnded to 39 stores by the end of the 2007 financial year.

Coles Liquor also operates in the direct liquor market (online and call centre based sales) which represented 1% of total sales in the 2007 financial year.

Coles Liquor leverages Coles Grop marketing spend and catalogues, conducts joint promotions with Supermarkets and participates in Coles Express fuel promotions and the FlyBuys loyalty program. Buying erms are largely specific to Coles Liquor, and are heavily dependent on negotiations vith major suppliers, while distribution centres and logistics to store are presently largelyindependent from Supermarkets.

In the on-premises sector, Coles Liqor operated 85 pubs/hotels as at 29 July 2007. The hotel operations of Coles Liquor wee originally seen as an enabler to its liquor retailing operations, reflecting the Queenslanl licensing regime that restricts operation of retail liquor stores to owners of licensed pubs/hotels, and the limited availability of liquor licences in other States such as Westen Australia and South Australia. However, the hotels are profitable businesses in their ovn right, with their gaming operations generating predictable and growing earnings.

The sales of Coles Liquor have grown strongly in recent years. The growth in sales has been driven by Coles Liquor's rapid expansion of its 1st Choice business, as it has sought to secure a meaningful share in the growth of the large format segment. The new store roll-out and refurbishment programs have resulted in Coles Liquor generating net negative operational cash flows. Managementbelieves that cost efficiencies and sales increases will be achieved as the 1st Choice networkexpands and matures.

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Coles Liquor is planning for strong business growth over the next five years. The primary initiatives include:

- hotel and bottle shop acquisitions, to build scale in Queensland, and the pursuit of targeted acquisitions in Western Australia and South Australia to complement Coles Liquor's retail objectives;
- growth of the 1st Choice store network, with around 85 sites that have been secured for future roll-outs of 1st Choice stores;
- further development of the 1st Choice operating model to create a profitable position in the large format segment; and
- refurbishment of the Liquorland and Vintage Cellars chains and hotels.

The growth focus for Coles Liquor will be through aggressive development of the 1st Choice chain. Coles Liquor management believes that the Liquorland chain will also require significant ongoing investment, to ensure that the brand and its convenience proposition remain relevant in the context of the growing market share of the "big box" discount liquor retailers. Coles Liquor has recently piloted Liquorland Express stores, which are expected to generate considerably higher EBIT margins than the full scale stores. Coles Liquor will continue to differentiate the Vintage Cellars offer and expand its wine club.

5.1.4 Other

The Supermarkets, Coles Express and Coles Liquor group also includes various early stage businesses and prospective business initiatives:

Coles Online

Coles Online was established in 1999 to create an alternative distribution channel for the Supermarkets business. Coles Online enables customers to shop for groceries via the internet, although the product offering is more limited than in-store. Coles Online is only available to customers in the metropolitan areas of New South Wales and Victoria. The business has achieved limited sales growth and is not currently profitable. Management expects that changes to logistical arrangements and the introduction of improved website technology will improve the earnings of the business.

Pharmacy Direct

In March 2006, Coles Group purchased Pharmacy Direct, an online, mail, fax and phone order pharmacy that also operates a retail shop in western Sydney. Pharmacy Direct offers a broad range of pharmacy products, including prescription medicines, vitamins, cold and flu treatments and skin care products. The prospects for expansion of the business depend in part on the evolution of the regulatory arrangements that apply to pharmacy in Australia.

SuperCentres

Coles Group management is contemplating the introduction of a new 'SuperCentre' format. SuperCentre stores would sell general merchandise, apparel, food and liquor, in a store format similar to the Tesco superstore format in the United Kingdom. It is expected that SuperCentre store sizes would range from 6,000m^2 to 12,000m^2. There are opportunities to convert adjoining Coles and Kmart stores to SuperCentre stores in a number of locations. Management believes that ultimately there may be the potential for up to 80 SuperCentre stores throughout Australia. Coles Group announced in March 2007 that it was deferring opening the first SuperCentre as part of a reprioritisation of initiatives.

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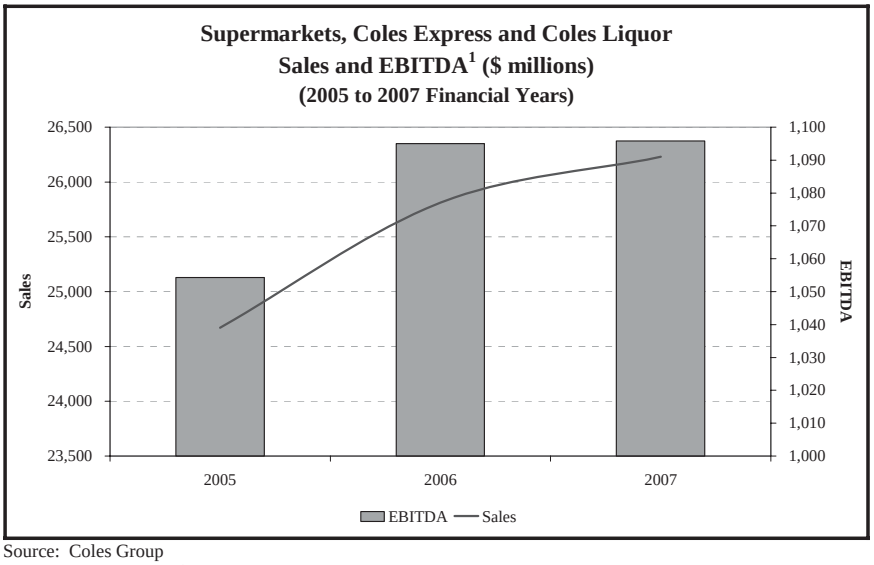
5.1.5 Financial Performance

The historical financial performance of the individual Supermarkets, Coles Express and Coles Liquor businesses has been discussed above. The aggregate financial performance of these businesses is summarised below:



Source: Coles Group
Note 1: Excludes significant items

The chart illustrates the deterioration in the overall performance of the Supermarkets, Coles Express and Coles Liquor business in the 2007 financial year, where sales growth was only 1.6% and earnings remained flat as a result of declining margins. The financial performance reflects the substantial downturn in the performance of the Supermarkets business over the past two years, which has been largely offset by the growth of Coles Liquor (by acquisition) and of Coles Express.

5.2 Kmart

Kmart is a major discount department store retailer in the Australian market place, with a total of 182 stores across Australia (168 stores) and New Zealand (14 stores). The average store size is 6,800m^2. Kmart offers general merchandise and apparel under categories including apparel, consumables, entertainment, footwear & accessories, home, outdoor lifestyle and toys and leisure, automotive and do-it-yourself ranges. Kmart's product range includes leading national brands and private label products. With approximately 12,000 employees, Kmart is estimated to have a market share of approximately 24% of the Australian department store market.

Kmart also operates the KTAS business with 267 stores. KTAS primarily operates in the tyre and auto-service market. KTAS is one of only two company owned chains in a highly fragmented market and has an extensive customer data base with more than 1 million customers.

The following chart summarises the significant deterioration in the financial performance of Kmart in the two years ended 30 July 2006, and the subsequent improvement in earnings in the 2007 financial year:

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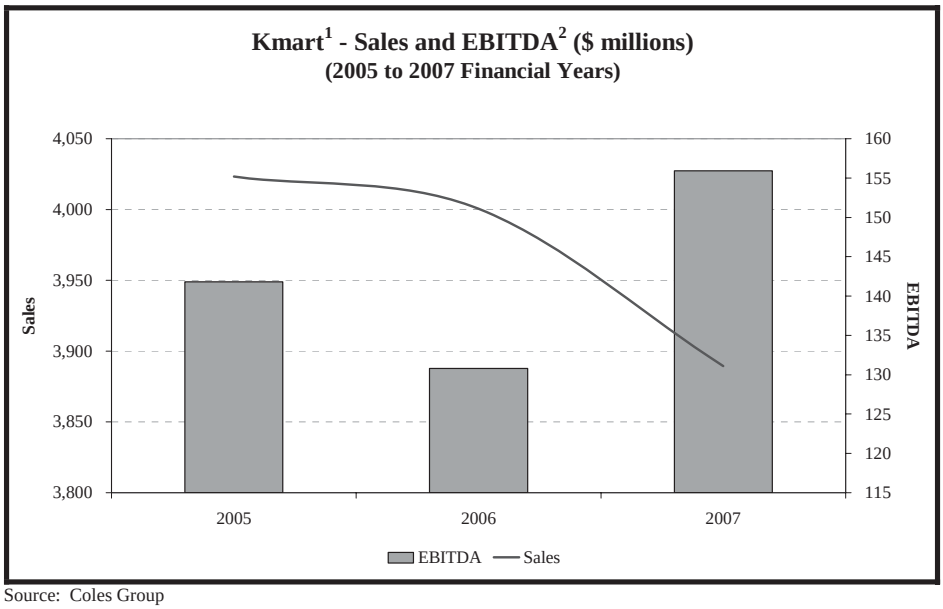

Source: Coles Group
Note 1: Includes KTAS
Note 2: Excludes significant items

Kmart has delivered disappointing sales and earnings performance for some years with EBITDA margins declining from 3.5% in the 2005 financial year to 3.3% in the 2006 financial year. This performance appears to have reflected a number of factors, including fierce competition from other discount department stores and from specialist retailers, a focus on sales growth rather than profitability, inconsistent controlled category expansion, over-reliance on periodic deeply discounted promotions to stimulate sales, and underinvestment in store refurbishments. Opportunities to grow the Kmart store chain were neglected, compounding pressure on sales and earnings.

In response, Kmart has developed and commenced the implementation of the "Revitalisation" strategy, which places focus on margins and the customer value proposition "a good life is affordable at Kmart". The aim of this strategy is to reposition Kmart from its former reliance on periodic promotional activity based on deeply discounted offers to a position based on everyday affordability. Key initiatives of this strategy include:

- reallocating space from low-performing to high-performing departments, including exiting categories with low profitability, sales and market growth;
- reducing and simplifying the product range and improving in-store presentation;
- improving the design and implementation of promotions and reducing/removing unprofitable promotions;
- applying a consistent pricing structure based on affordable prices;
- reducing inventory, resulting in supply chain cost savings;
- increasing the use of direct sourcing to improve margins;
- introducing cost saving initiatives in-store including remuneration savings; and
- refurbishing stores to improve customers' shopping experiences through creating a pleasant, clean and bright store environment.

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Although total sales again weakened in 2007, key elements of the strategy were reflected in a significant improvement in EBITDA and EBITDA margins.

Significant capital expenditure is required to be spent on store refurbishments and redevelopments. Management expects to undertake around 20 store refurbishments per annum from 2008 onwards. In addition, management plans to open around 30 new Kmart stores over the next five years.

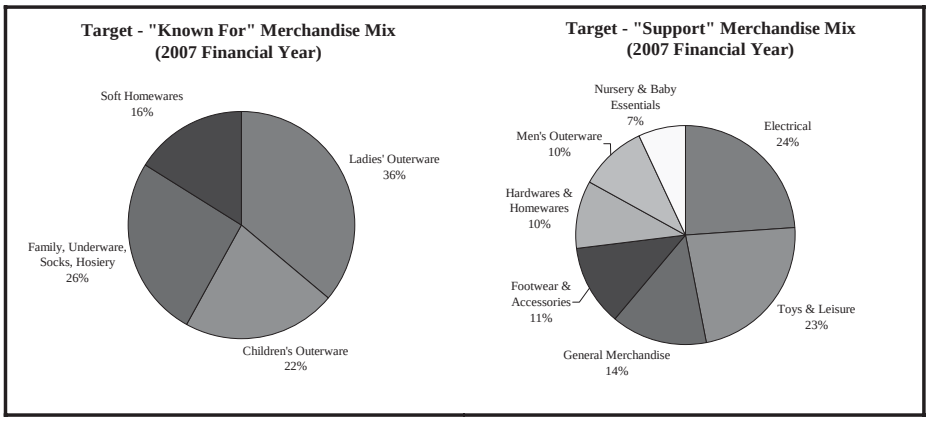
Kmart's promotional program has been significantly modified, with the reduction or cessation of promotional activities that do not favourably impact margin (the 15% off storewide and no deposit lay-by promotions were discontinued in the 2007 financial year). The reduction in deeply discounted promotional activity has resulted in a decline in sales in the 2007 financial year but earnings have improved through significantly improved margins. Kmart management believes that the changes in the merchandise mix and promotional activity have commenced to generate an improvement in profitability. The immediate challenge for the business will be to reverse the recent sales declines and achieve meaningful sales growth.

5.3 Target

Target is a discount department store with a focus on fashionable apparel and soft homewares, and a strong house brand offering. Target has 268 stores across Australia in metropolitan areas and in regional communities. Target's stores range in size from 13,000m^2 (Target branded) to 400m^2 (Target Country branded). Target is operated reasonably autonomously to the remainder of the Coles Group from premises located in Geelong in regional Victoria.

Target's average customer is a 25-54 year old female, with a family, who enters the store with an intention to purchase clothes and general merchandise. Target classifies its merchandise into two categories, "Known For" merchandise and "Support" merchandise. Target's "Known For" merchandise includes ladies outerwear, childrenswear, family underwear and soft homewares, most of which is sold under the Target brand or private labels. Private labels include Piping Hot, Hot Options, Free Fusion and Modern Living. Target has close relationships with the producers of its "Known For" merchandise, allowing it to minimise delivery times to store. As a result, Target is able to provide on-trend fashion products at low prices and can compete successfully with the specialty stores. "Known For" products are Target's highest margin products and represented 48% of Target's overall sales for the 2007 financial year. The remainder of Target's sales relate to its "Support" merchandise, which includes categories such as cosmetics and fragrances for females, and toys, interactive games, videos and DVDs for children.

The chart below provides a sales analysis for Target's "Known For" and "Support" categories:



Source: Coles Group

Target markets itself as a fashion value alternative to the specialty stores. Target delivers catalogues to around 5.5 million households a week, primarily within store catchment areas. Whilst over 60% of the company's marketing spend is on catalogues, Target also uses television,

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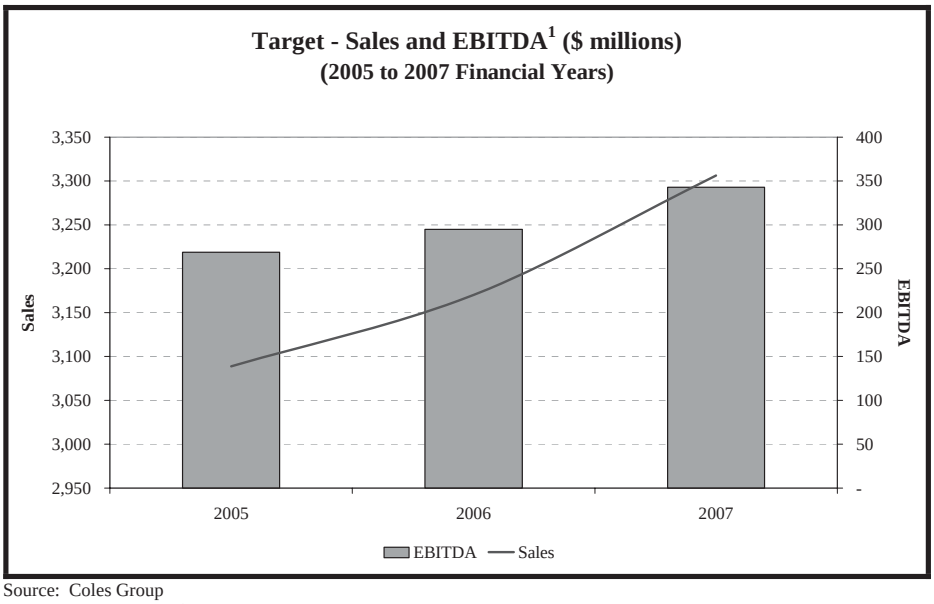
radio, press, outdoor billboards, fashion magazines and the web. Promotional activities include the periodic sale of designer inspired products, such as, recently, the Stella McCartney range.

Approximately 90% of Target's merchandise is manufactured overseas, principally from China and south east Asia. Around 37% of Target's products are imported directly, delivering cost efficiencies, improved margins and speed to market. Target utilises the administration function of Coles Group, has regional distribution centres in each State and has its own dedicated central distribution centre in Victoria.

Target store numbers were little changed in the five years to 30 July 2006, with Target opening around eight new stores and closing a similar number of less profitable stores each year. In the 2007 financial year, Target opened 17 new stores and closed 8 stores. Target management is now planning to expand the store network, and has identified a number of potential sites for new stores in both metropolitan and regional Australia. Target intends to open (after taking into account closures) a net 11 stores in the 2008 financial year.

Following the loss recorded in the 2001 financial year, Target has been repositioned successfully in the market, and has consistently achieved year on year sales and earnings growth:



Source: Coles Group
Note 1: Excludes significant items

Target's EBITDA margins have improved from 8.7% in the 2005 financial year to 10.4% in the 2007 financial year. Target expects to continue to grow sales and EBITDA through the following initiatives:

- store driven growth, by increasing selling space through new stores and improved store layouts;
- reconfigured product mix, including a greater focus on apparel; and
- margin improvements through reduced markdowns, increased direct sourcing, inventory reductions, and marketing and head office cost reductions.

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5.4 Officeworks

The Officeworks portfolio of businesses includes Officeworks retail stores, Officeworks BusinessDirect and Harris Technology. Officeworks was established by Coles Group in 1994, and was based on the "big-box" office products retail formats operating in the United States. Officeworks is Australia's largest office products retailer and primarily targets small to medium businesses, home offices, personal shoppers and students. Officeworks offers over 8,000 products including stationery, consumables, technology, office furniture and printing services. In addition to every major office product category, Officeworks supplies computer hardware for small businesses. As at 29 July 2007, the Officeworks retail store network consists of 107 Officeworks stores (excluding 9 Harris Technology stores) located in major metropolitan areas and larger regional towns around Australia, operating with two store formats, typically with floor areas of around 1,300m^2 and 800m^2 respectively. In total, Officeworks has approximately 4,200 employees. Officeworks specifically targets the non-contract segment of the home office market, in which it enjoys a strong market position.

Officeworks gained direct business-to-business capability following its acquisition of Viking in 2003, which it used as a basis to establish Officeworks BusinessDirect. Officeworks BusinessDirect is currently focusing on growing its online business to complement its catalogue business. Officeworks BusinessDirect owns and communicates with a customer database of more than 195,000 customers. In addition to providing Officeworks' existing customers with an additional avenue to shop, it provides the business with greater reach into the small business and home office markets. Management expects that Officeworks BusinessDirect's online capacity will assist Officeworks' expansion into new customer segments, such as direct selling of stationery to schools, parents and students.

Harris Technology was placed within the Officeworks business in 2005. Harris Technology sells a range of technology products to small businesses through 9 business centres, two call centres and online.

A strategic review in 2006 led management to upgrade its store roll-out program, which now targets 15 store openings per annum in each of the 2008, 2009 and 2010 financial years. In total, management intends to expand the Officeworks retail network to over 150 stores within five years, including the development of smaller format stores to suit regional and network infill opportunities.

Management also intends to refurbish the entire existing Officeworks retail portfolio in the next five years, including improvements to signage and merchandising, and changes to store layout. Commencing with the largest stores, the average refurbishment cost in the 2007 and 2008 financial years is estimated at approximately $250,000 per store.

Optimisation of the Officeworks supply chain has been an ongoing process. Most purchases (by volume) for Officeworks retail stores are ordered via a centralised replenishment system, with products passing through one of Coles Group's distribution centres. The remaining products, primarily furniture products and imported goods, are ordered manually and stored in warehouses before being distributed to stores or shipped directly to customers. All orders (except for furniture) for Officeworks BusinessDirect are ordered via centralised replenishment. Harris Technology purchases are either delivered by suppliers direct to the stores or to the Harris Technology distribution centre which is embedded within one of the Officeworks fulfilment centres.

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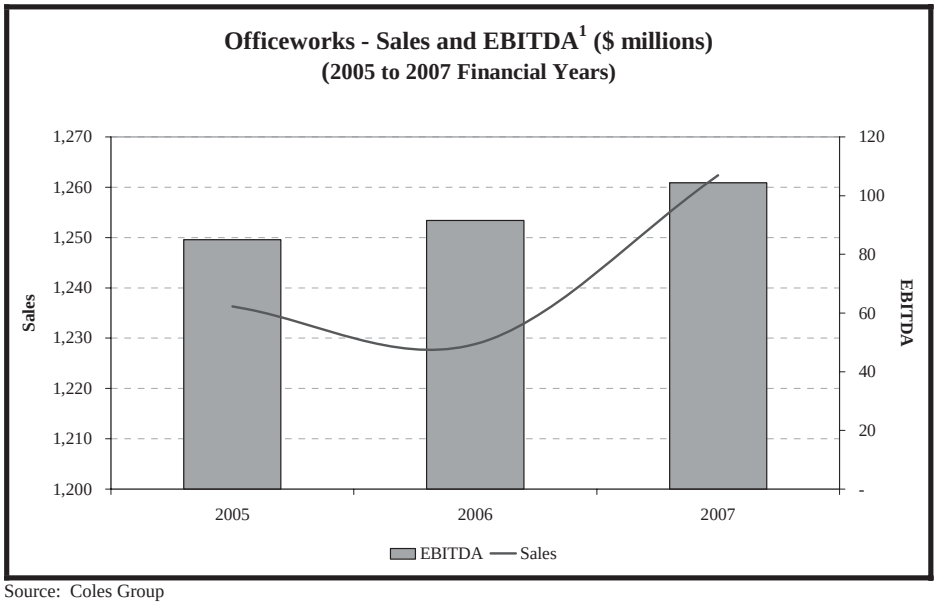
The sales of Officeworks declined in the 2006 financial year as a result of a reduction in Officeworks BusinessDirect sales, following a disruptive software implementation, and a reduction in Harris Technology sales as it closed unprofitable categories, partially offset by the opening of eight Officeworks stores. Officeworks has achieved strong sales and EBITDA growth for the financial year ended 29 July 2007 due to an improved category mix, a reduction in low value-add offers, an increase in direct product sourcing and an acceleration of new store openings:



Source: Coles Group
Note 1: Excludes significant items

Officeworks' EBITDA margins have improved from 6.9% in the 2005 financial year to 8.3% in the 2007 financial year. Officeworks' management has recently sought to refocus the business on its core stationery and consumables offerings ("Famous For" categories), the highest margin products in the Officeworks range. This refocus will be implemented by:

- increased sales of house brand products;
- more effective allocation of store space;
- reductions in the furniture range;
- increased direct sourcing from Asia; and
- improvement in the effectiveness of promotions.

5.5 Other

Property

The Coles Group Property business is responsible for securing and developing sites for the businesses within the Coles Group where external leasing arrangements do not meet the strategic objectives of the group, with a primary focus on supermarket/liquor sites. Typically, Coles Group acquires a freehold site, develops the property and holds it while the property is tenanted (including by way of a supermarket and/or other Coles Group store) and commences to trade. Once the property has developed a trading history it is sold via a sale and lease-back arrangement.

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Currently, Coles Group has around 80 active property locations, at varying stages in the property development cycle. The average holding period for properties is approximately 3-5 years. Coles Group Property targets a net nil capital expenditure outcome each year, such that capital expenditure on new property acquisitions is offset by capital inflows from property sales.

Retail Support

Retail Support provides centrally managed support services to the retail operations of Coles Group, in addition to incorporating the head office and corporate functions of Coles Group. The supply chain function is the largest component of Retail Support. The balance includes information technology, finance and administration, property, legal, risk and internal audit, human resources, corporate affairs, the office of the Chief Executive Officer, marketing and customer service. Supply chain costs are charged to the individual businesses. Approximately 90% of remaining costs are attributable to individual businesses and are recharged. The balance remains as an unallocated corporate overhead.

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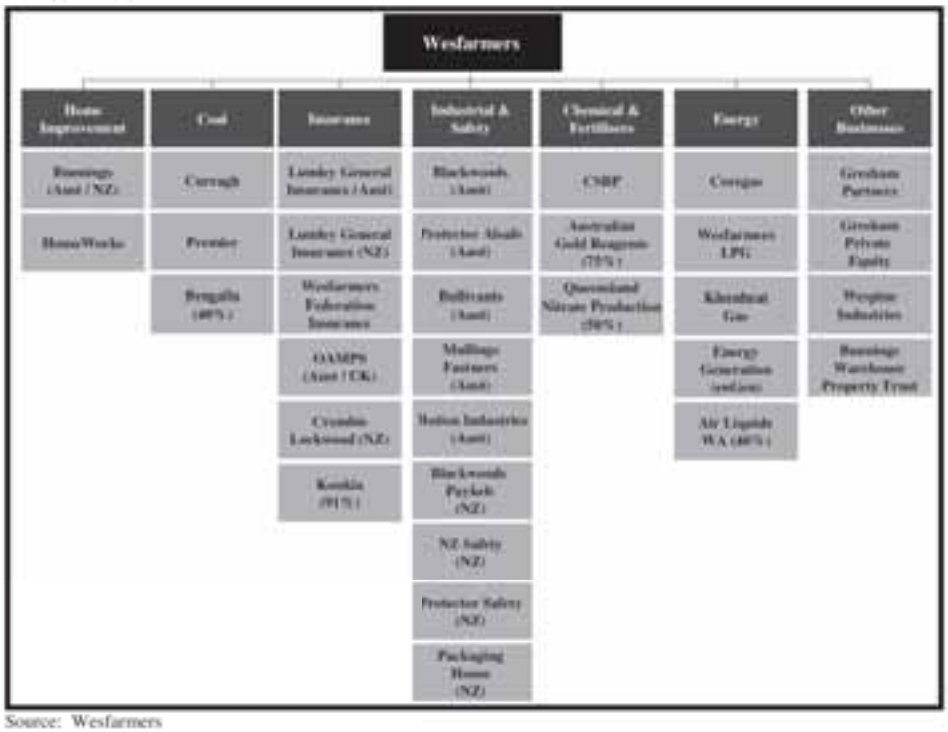
6 Profile of Wesfarmers Limited

6.1 Background

Wesfarmers originated in 1914 as a Western Australian farmers' co-operative with a focus on the provision of services and merchandise to the rural community. Today, Wesfarmers is a diversified Australian public company, with operations in home improvement products and building supplies, coal mining, gas processing and distribution, industrial and safety product distribution, chemicals and fertilisers manufacture, insurance, private equity and other activities. Wesfarmers was listed on the ASX in 1984 and had a market capitalisation of approximately $15.6 billion as at 21 September 2007. It has its headquarters in Perth, Western Australia, and operations focussed across Australia and New Zealand.

The operating structure of Wesfarmers structures is shown below:



Source: Wesfarmers

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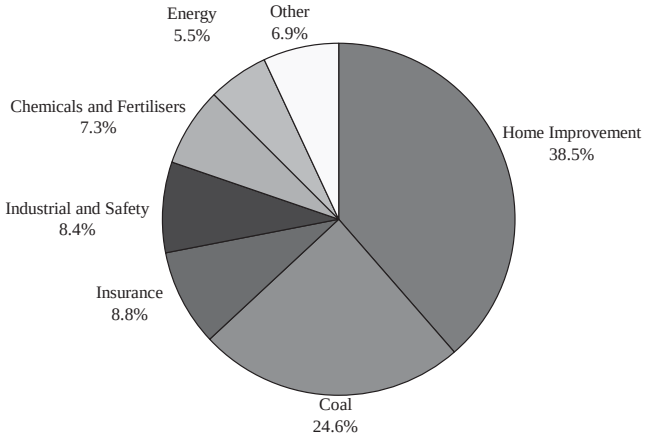
The earnings contribution from each Wesfarmers division for the 2007 financial year is shown below:

Wesfamers Contribution to EBIT by Segment
(Year ended 30 June 2007)



Source: Wesfarmers Annual Results Presentation, 16 August 2007
Note 1: EBIT is defined as earnings before interest expense and tax
Note 2: Excludes corporate overheads and consolidation adjustments

6.2 Profile of Operations

6.2.1 Home Improvement

Bunnings

Bunnings is the leading supplier of home and garden improvement products in Australia and New Zealand and is also a major supplier of building materials to these markets. Bunnings caters predominantly for do-it-yourself customers as well as builders and contractors. It operates in all States and Territories of Australia and both islands of New Zealand. Although better known for its "big box" format store, Bunnings' network includes smaller format stores and trade distribution centres. As at 30 June 2007, Bunnings had 155 warehouse stores and 65 smaller format stores.

In the financial year ended 30 June 2007, 13 new warehouse stores were opened and another 31 refurbished. Management expects that new warehouse development will continue at the rate of 10 to 14 stores per year.

In June 2007, Wesfarmers announced the successful sale and leaseback of 11 Bunnings warehouse properties in Australia and New Zealand for $203 million.

HouseWorks

Wesfarmers also owns three HouseWorks stores in Western Australia. HouseWorks is a supplier of contemporary furniture and related decorative items for the home.

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6.2.2 Coal

Wesfarmers' major coal interests are:

- the Curragh open-cut mine in Queensland;
- the Premier Coal mine in south-west Western Australia; and
- a 40% interest in the Bengalla mine operation in the Hunter Valley.

Curragh mine

The Curragh mine, situated 200 kilometres west of Rockhampton in the Bowen Basin in Queensland, produces both metallurgical and steaming coal. Curragh's metallurgical coal is exported to customers in Japan, South Korea, south east Asia and Europe. Curragh's steaming coal is used for power generation at the Stanwell and Gladstone Power Stations. In the 2007 financial year, Curragh had total sales volumes of 8.7 million tonnes (6.5 million metallurgical and 2.2 million steaming), representing an increase of approximately 1.5% compared to the previous financial year.

Premier Coal mine

The Premier Coal open-cut mine at Collie in Western Australia produces steaming coal for domestic use. The coal is mainly sold under long-term contract to Western Power for domestic power generation. Premier Coal also supplies the mineral sands processing industry in Western Australia. In the 2007 financial year, Premier Coal had total sales volumes of 3.0 million tonnes representing a 20% decrease compared to the previous financial year.

Bengalla open cut mine

Wesfarmers has a 40% interest in the Bengalla open-cut coal mining joint venture, situated at Muswellbrook in the Hunter Valley in New South Wales. The mine produces steaming coal for export and domestic use. In the 2007 financial year, Bengalla had total sales volumes of 5.5 million tonnes, comprising 4.5 million tonnes for export and 1.0 million tonnes for domestic use, representing an increase of approximately 4% compared to the previous financial year.

6.2.3 Energy

Wesfarmers' energy operations consist of interests in four gas companies and a power company:

- Coregas Pty Limited ("Coregas") (formerly known as Linde Gas Pty Limited);
- Wesfarmers LPG Pty Limited ("LPG");
- Wesfarmers Kleenheat Gas Pty Limited ("Kleenheat Gas");
- a 40% interest in Air Liquide W.A. Pty Limited ("Air Liquide"); and
- Energy Generation Pty Limited ("Energy Generation").

Coregas

Coregas produces and distributes gases for industrial, medical and specialty operations. Based at Port Kembla, New South Wales, Coregas produces oxygen, nitrogen, argon and hydrogen and distributes these products to markets in New South Wales, Victoria, Queensland and South Australia. Wesfarmers acquired Coregas in February 2007.

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LPG

LPG operates a propane and butane gas extraction plant in Kwinana, Western Australia. LPG supplies much of the domestic liquefied petroleum gas market, with the balance exported to Asia. In the 2007 financial year, LPG's production was 185,900 tonnes, representing an 18% increase compared to the previous financial year. Construction of a 175 tonne-per-day liquefied natural gas plant has also commenced on site. The plant is expected to be commissioned in March 2008.

Kleenheat Gas

Kleenheat Gas is a distributor and marketer of liquefied petroleum gas and gas appliances to the domestic, commercial, autogas and industrial markets and of liquefied natural gas to the heavy duty transport sector. Kleenheat Gas also has a 50% interest in the Unigas joint venture, a national supplier of autogas to service stations. Other activities include liquefied natural gas operations and liquid petroleum gas distribution in Bangladesh.

Air Liquide WA

Air Liquide is a joint venture operation (between Wesfarmers and Air Liquide Australia Limited) which manufactures industrial and medical gases and supplies customers in Western Australia, Northern Territory and some export markets. Air Liquide has commenced construction of an air separation unit at Kwinana in Western Australia, which will have capacity to produce 880 tonnes of oxygen and 800 tonnes of nitrogen per day.

Energy Generation

Energy Generation is a supplier of electricity to resource and industrial businesses operating in regional centres in Western Australia and South Australia. Energy Generation designs, operates and maintains power supply infrastructure.

6.2.4 Insurance

Wesfarmers' insurance division comprises:

- general insurance businesses, consisting of Wesfarmers Federation Insurance Limited ("Wesfarmers Federation Insurance"), the Lumley General Insurance business in Australia and New Zealand and the specialist insurance businesses of OAMPS Limited ("OAMPS");
- the Lumley premium funding businesses;
- insurance broking businesses, consisting of the broking businesses of OAMPS and Crombie Lockwood Holdings (New Zealand) Limited ("Crombie Lockwood"); and
- a specialist general insurance software developer, Koukia Pty Limited ("Koukia").

Wesfarmers Federation Insurance

Wesfarmers Federation Insurance is a general insurer specialising in rural insurance. Founded in 1919, Wesfarmers Federation Insurance now operates through more than 80 branches across Australia. Among other things, Wesfarmers Federation Insurance specialises in providing crop, dairy, feedlot, office and contractors insurance to farmers, business people and individuals.

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Lumley

Lumley Insurance Group consists of Lumley General Insurance Australia, Lumley General Insurance New Zealand, Lumley Finance and Lumley Technology and was acquired by Wesfarmers in 2003.

The Lumley General Insurance business offers a range of products covering commercial and fleet motor, marine and engineering business. Lumley General Insurance clients include federal, State and local Government, large corporations, small business, the rural community and individual customers. It focuses its sales through a network of agents and brokers.

Lumley Insurance Group also includes Lumley Finance and Lumley Technology. Lumley Finance provides a range of businesses and individuals with insurance premium finance in order to spread the lump sum burden of insurance costs. Lumley Technology is a developer of insurance software and provides the information technology support to all entities of the Lumley Insurance Group.

OAMPS

In November 2006 Wesfarmers acquired OAMPS, at the time Australia's largest publicly-owned insurance broking group. OAMPS has branches in every State and Territory across Australia as well as operations in the United Kingdom. OAMPS is a leading provider of broking and financial services for:

- insurance;
- risk management;
- workers' compensation and occupation health and safety; and
- financial planning services.

OAMPS' insurance business consists of underwriting, agency and broking operations. The underwriting and agency businesses provide specialist insurance cover. The broking business is one of the largest Australian owned broking businesses by premiums handled.

Crombie Lockwood

In March 2007, Wesfarmers acquired Crombie Lockwood. Established in 1978, Crombie Lockwood is the third largest insurance broker in New Zealand and the largest domestic broker. Dealing with small to medium enterprises, Crombie Lockwood has 16 offices and 300 staff throughout New Zealand, and also operates a specialist underwriting agency and premium funding business. Crombie Lockwood products include:

- life, medical and health products;
- domestic insurance;
- in-house client funding; and
- Safety Assist - (electronic workplace health and safety management solution).

Crombie Lockwood is branded and operated independently from Lumley General Insurance in New Zealand.

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6.2.5 Industrial and Safety

Wesfarmers' Australian industrial and safety businesses include:

- Blackwoods, which, together with Bakers Construction and Atkins, is the leading supplier of general industrial, engineering and safety products;
- Bakers Construction, a distributor of construction and industrial products;
- Bullivants, a distributor of materials handling products and services;
- Atkins, a distributor of electrical and industrial products;
- Motion Industries, a specialist bearings and power transmission distributor;
- Mullings Fasteners, a national fastener specialist; and
- Protector Alsafe, a specialist supplier of safety products.

Wesfarmers' New Zealand industrial and safety businesses include:

- Blackwoods Paykels, New Zealand's largest distributor of industrial and engineering supplies;
- New Zealand Safety and Protector Safety Supply; and
- Packaging House Limited ("Packaging House").

These businesses employ more than 3,000 people. With the exception of Blackwood Paykels and Bullivants, these businesses were acquired in August 2001 through the acquisition of Howard Smith Limited. Blackwood Paykels and Bullivants were acquired by Wesfarmers in July 2003 and December 2006 respectively.

Blackwoods

Blackwoods is the largest distributor of industrial and engineering supplies in Australia and New Zealand with over 104 stores supplying over 400,000 products. Blackwoods also distributes in southern Asia and the South Pacific. Blackwoods operates specialist product distribution networks under the Blackwoods, Blackwoods Paykels, Bakers, Atkins, Motion Industries, and Mullings Fasteners trading names.

Protector Alsafe

Protector Alsafe was formed in 2002 by the merger of the Alsafe Safety and Protector Safety Supply (Australia) businesses. Protector Alsafe is Australasia's largest safety distribution company, selling a range of safety equipment products from 44 branches.

Bullivants

Bullivants was acquired by Wesfarmers in December 2006 and is Australia's leading supplier of lifting, rigging and material handling products and services.

Mullings Fasteners

Mullings Fasteners provides a range of fastener products, such as Unbrako, James Glen and Exafast.

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Motion Industries

Motion Industries provides a full engineering service for power transmission, bearing and mechanical applications. It also provides design services in relation to a range of products including chain drives, belt drives, gear boxes, speed controls and power packs.

Blackwoods Paykels

Blackwoods Paykels is New Zealand's largest supplier of industrial and engineering products including hose fittings, tools, safety, abrasives, power transmission and conveyor products.

New Zealand Safety and Protector Safety Supply

New Zealand Safety supplies safety products and services through a network of 24 branches throughout New Zealand. It provides a product range with industry specific education, training and consultation services. Protector Safety Supply is a New Zealand supplier of workplace safety products operating from a branch network of 22 branches.

Packaging House

Packaging House is the largest distributor of packaging and related products in New Zealand with 10 branches nationally.

6.2.6 Chemicals and Fertilisers

Wesfarmers' chemicals and fertilisers division manufactures a broad range of chemicals and fertilisers that are marketed to the agricultural, mining and industrial sectors. The division includes:

- CSBP Limited ("CSBP");
- Australian Gold Reagents Pty Limited ("Australian Gold Reagents"); and
- Queensland Nitrates Pty Limited ("QNP").

CSBP

CSBP is a supplier of chemicals, fertilisers and related products and services to the resource, industrial and agricultural sectors. Established in 1910, CSBP's head office and production complex is situated at Kwinana, 40 kilometres south of Perth, Western Australia.

CSBP's chemicals business is the largest producer of industrial chemicals in Western Australia, supplying the mining, minerals processing, metal refining and water treatment industries. Three separate production units produce ammonia-ammonium nitrate, industrial chemicals and sodium cyanide.

CSBP's fertiliser business develops, manufactures and markets fertilisers for the Western Australian farming market. CSBP's products and services are used in broad acre cropping, livestock, horticulture and dairy operations.

Australian Gold Reagents

Through CSBP, Wesfarmers has a 75% interest in Australian Gold Reagents. Australian Gold Reagents manufactures sodium cyanide, primarily used for gold extraction in the mining industry.

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QNP

Wesfarmers has a 50% interest in QNP, a joint venture between Dyno Nobel Asia Pacific and CSBP. QNP is an integrated ammonium nitrate manufacturing facility located at Moura in central Queensland, with a production capacity of 185,000 tonnes per annum.

6.2.7 Other Businesses

Gresham Partners

Wesfarmers has a 50% interest in Gresham Partners Group Limited ("Gresham"). With offices in Sydney, Melbourne and Perth, Gresham's main activities are corporate finance and funds management in the areas of private equity and mezzanine property investment.

Gresham Private Equity

Wesfarmers is also an investor in two funds established by Gresham Private Equity. Gresham Private Equity was established in 1999 as a specialist in management buyouts, targeting investment opportunities in Australia and New Zealand.

Wespine Industries

Wesfarmers has a 50% interest in Wespine Industries, which operates a plantation softwood sawmill at Dardanup, Western Australia. The mill's main product is machine-graded pine used in roof frames and other building construction.

Bunnings Warehouse Property Trust

Wesfarmers has a 23% interest in the ASX listed Bunnings Warehouse Property Trust, a property trust which primarily owns warehouse retailing properties. As at 21 September 2007, Bunnings Warehouse Property Trust had a market capitalisation of approximately $702.3 million.

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6.3 Financial Performance

The historical and forecast financial performance of Wesfarmers for the five years ended 30 June 2007 are summarised below:

Wesfarmers - Financial Performance[15] ($ millions)

	Year ended 30 June				
	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2007 actual AIFRS
Operating revenue	7,753.4	8,407.5	8,158.6	8,858.8	9,753.7
EBITDA[16]	**1,124.9**	**1,217.3**	**1,259.1**	**1,671.1**	**1,639.0**
Depreciation and amortisation	(291.9)	(279.4)	(188.9)	(283.5)	(344.7)
EBIT[17]	**833.0**	**937.9**	**1,070.2**	**1,387.6**	**1,294.3**
Net interest expense	(71.2)	(54.5)	(51.4)	(98.6)	(128.7)
Corporate overheads[18]	(53.6)	(51.7)	(52.2)	(56.9)	(66.8)
Profit on sale of businesses	80.5	400.7	-	234.9	6.2
Operating profit before tax	**788.6**	**1,232.4**	**966.6**	**1,467.0**	**1,105.0**
Income tax expense	(250.7)	(363.8)	(264.8)	(418.9)	(318.5)
Profit after tax	**537.9**	**868.6**	**701.8**	**1,048.1**	**786.5**
Outside equity interest	0.3	4.5	-	-	(0.1)
Profit after tax attributable to Wesfarmers shareholders	**538.2**	**873.1**	**701.8**	**1,048.1**	**786.4**
Statistics					
Basic earnings per share (¢)	*142.9*	*232.4*	*192.0*	*284.0*	*210.5*
Dividends per share (¢)	*127.0*	*140.0*	*180.0*	*215.0*	*225.0*
Dividend payout ratio (%)	*88.9*	*60.2*	*93.8*	*75.7*	*106.9*
Amount of dividend franked	*100%*	*100%*	*100%*	*100%*	*100%*
Total sales revenue growth (%)	*5.0*	*8.4*	*(3.0)*	*8.6*	*10.1*
EBITDA growth (%)	*7.8*	*8.2*	*3.4*	*32.7*	*(1.9)*
EBIT growth (%)	*10.9*	*12.6*	*14.1*	*29.6*	*16.8*
EBITDA margin (%)	*14.5*	*14.5*	*15.4*	*18.9*	*16.8*
EBIT margin (%)	*10.7*	*11.2*	*13.1*	*15.7*	*13.3*
Interest cover[19] (x)	*10.4*	*11.7*	*10.3*	*10.4*	*6.5*

Source: Wesfarmers Annual Reports for the four years ended 30 June 2006, financial results for the year ended 30 June 2007 and Grant Samuel analysis

15 Financial statements for the years prior to 30 June 2005 were prepared in accordance with Australian generally accepted accounting principles ("AGAAP"). Wesfarmers adopted the Australian equivalent to international financial reporting standards ("AIFRS") from 1 July 2005. The results for the year ended 30 June 2005 were also restated under AIFRS.

16 EBITDA is earnings before net interest paid, tax, depreciation and amortisation and corporate overheads.

17 EBIT is earnings before net interest paid, tax and corporate overheads.

18 Includes consolidation adjustments.

19 Interest cover is EBIT divided by net interest.

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The performance of Wesfarmers by business segment is set out below:

Wesfarmers – Segment Performance ($ millions)					
	Year ended 30 June				
	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2007 actual AIFRS
Sales revenue					
Home improvement	3,474.5	3,845.7	4,065.3	4,275.5	4,938.9
Coal	677.5	627.8	763.7	1,304.2	1,133.7
Energy	406.3	380.8	397.7	371.9	463.0
Industrial & Safety	1,112.0	1,150.6	1,174.7	1,177.7	1,208.0
Insurance[20]	1,495.1	1,095.6	1,125.6	1,117.2	1,409.6
Chemicals & Fertilisers	473.6	518.5	586.9	595.2	592.1
Other	114.3	788.6	44.6	17.1	8.4
Total sales revenue	**7,753.4**	**8,407.5**	**8,158.6**	**8,858.8**	**9,753.7**
EBITDA [21]					
Home improvement	401.5	443.4	463.1	470.4	586.4
Coal	327.8	234.8	305.7	720.8	519.5
Energy	91.9	84.2	88.2	74.1	104.1
Industrial & Safety	127.9	124.4	124.9	111.0	128.2
Insurance	96.5	113.4	142.6	132.8	144.1
Chemicals & Fertilisers	116.7	123.4	128.0	123.1	137.6
Other	52.1	520.3	59.5	308.9	96.9
Total EBITDA	**1,214.4**	**1,643.8**	**1,311.9**	**1,941.2**	**1,716.8**

Source: Wesfarmers Annual Reports for the four years ended 30 June 2006, financial results for the year ended 30 June 2007 and Grant Samuel analysis

The "Other" segment includes the rail transport, forest products, property investment, investment banking and private equity investment activities of Wesfarmers. Wesfarmers' interest in rail transport activities (its share in the Australian Railway Group Pty Limited ("ARG") joint venture with Genesee & Wyoming Australia Pty Limited ("Genesee & Wyoming")) was sold in the 2006 financial year.

Key items affecting Wesfarmers' financial performance since 2003 are summarised below:

- in the year ended 30 June 2003, the Bunnings retail hardware business recorded strong growth in revenues and earnings due to expansion of the store network and integration of the Howard Smith "BBC" branded hardware stores. The energy segment (coal and gas) achieved a record profit. The industrial and safety businesses recorded a significant increase in earnings, mainly due to cost reductions resulting from the integration of various businesses. In July 2003, Wesfarmers acquired Paykels, New Zealand's largest distributor of maintenance, repair and operating supplies, which resulted in an expanded distribution network in New Zealand. Profit on sale of businesses of $80.5 million related to the sale of the Girrah coal deposit. Earnings from the group's rural services and insurance businesses were lower than for the prior year due to the severe drought conditions at the time;

[20] Includes the contribution from Rural Services in the 2003 and 2004 financial years.

[21] EBITDA is defined as earnings before interest expense, tax, depreciation, amortisation and consolidation adjustments.

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- the significant profit increase in the year ended 30 June 2004 was due to a combination of factors including the acquisition of the Edward Lumley insurance business. The results for the year included the results from Lumley Insurance Group for eight and a half months in the "Insurance" segment. Profit on sale of businesses of $400.7 million related to the sale of Wesfarmers' Landmark rural services business on 29 August 2003. Disposal proceeds and gains were included in the "Other" segment. Wesfarmers' investment in the Gresham Private Equity Fund made a material contribution to the group's results for the year, with the fund realising investments in the Repco Corporation Pty Limited and Cashcard Australia Limited businesses;

- in the year ended 30 June 2005, the Bunnings hardware business lifted earnings due to the opening of 10 new stores and the coal business benefited from higher export coal prices;

- in the year ended 30 June 2006, the coal segment generated significantly higher profits due to the increase in export sales of metallurgical coal from the Curragh mine in Queensland at coal prices substantially higher than historical averages. Profit on sale of businesses of $234.9 million related to the sale of Wesfarmers' share in the ARG railway joint venture with Genesee & Wyoming;

- Wesfarmers reported a fall in earnings in the 2007 financial year, due to lower earnings from its coal division. The deterioration in earnings of the coal division reflected lower export coal prices, increased costs and port and rail infrastructure constraints. The earnings of the five other divisions improved during the 2007 financial year. The acquisitions of OAMPS (November 2006), Coregas (February 2007) and Crombie Lockwood (March 2007) boosted earnings for the year. The full year result also included profit before tax of $26.5 million on the sale of non-current assets. These contributions were partially offset by the $33.4 million interest cost on borrowings to fund Wesfarmers' acquisition of a substantial shareholding in Coles Group and $14.2 million in insurance integration and other one-off expenses; and

- Wesfarmers expects that, with the exception of its coal business, all of its businesses will record increased earnings in the 2008 financial year. Earnings from the coal division will be affected by lower export coal prices and continuing cost pressures. Growth in the Bunnings business will be underpinned by store openings and better performance from the trade business. Recent acquisitions and other business initiatives are expected to drive earnings growth for the insurance division, despite continued competitive pressures in the underwriting business. The strength of the resources and infrastructure sectors is expected to support the growth of both the chemicals and industrial and safety businesses, with the chemicals business also expected to benefit from increased ammonium nitrate production. These improvements will be somewhat offset by a poor start to the 2007 agricultural season, which will affect the fertiliser business. The energy – gas division is expected to grow earnings through a full year contribution from Coregas.

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6.4 Financial Position

The financial position of Wesfarmers as at 30 June 2006 and 30 June 2007 is summarised below:

Wesfarmers - Financial Position ($ millions)		
	As at 30 June 2006 actual	**As at 30 June 2007 actual**
Trade and other receivables	1,194.6	1,512.5
Inventories	1,140.6	1,235.0
Creditors, accruals and provisions	(894.0)	(1,423.4)
Net working capital	**1,441.2**	**1,324.1**
Property, plant and equipment	2,396.2	2,715.9
Intangible assets	1,470.2	2,698.1
Investment in associates	279.2	389.2
Assets held for sale	5.8	2,064.0
Derivative financial instruments (net)	63.3	149.3
Deferred tax liabilities (net)	(57.3)	(144.4)
Tax payable	(213.7)	(98.0)
Provisions	(258.8)	(169.9)
Amounts receivable	113.6	112.5
Insurance liabilities (net)	(530.3)	(601.8)
Other	(32.2)	31.8
Total funds employed	**4,618.9**	**8,407.2**
Cash and cash equivalents	90.0	218.5
Borrowings	(1,542.9)	(5,122.6)
Net borrowings	**(1,452.9)**	**(4,904.1)**
Net assets	**3,165.9**	**3,503.1**
Outside equity interests	0.1	(0.2)
Equity attributable to Wesfarmers shareholders	**3,166.0**	**3,502.9**
Statistics		
Shares on issue at period end (million)	*378.0*	*388.1*
Net assets per share ($)	*8.38*	*9.03*
NTA[22] per share ($)	*4.59*	*2.08*
Gearing[23]	*46.1%*	*146.3%*

Source: Wesfarmers Annual Report for the financial year ended 30 June 2006, financial results for the year ended 30 June 2007 and Grant Samuel analysis

The following should be noted in relation to Wesfarmers financial position as at 30 June 2007:

- Wesfarmers' gearing as at 30 June 2007 was 146.3%, reflecting the $2.1 billion in borrowings drawn down to fund Wesfarmers' purchase of a direct 10.6% shareholding in Coles Group;
- working capital is seasonal, largely due to the retail nature of Wesfarmers' Bunnings operations;
- intangible assets primarily consist of goodwill associated with acquisitions. Goodwill increased in the 2007 financial year due to the acquisitions of Coregas, OAMPS and other businesses;

22 NTA is net tangible assets, which is calculated as net assets less intangible assets.

23 Gearing is net debt divided by equity.

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- investments in associates includes Wesfarmers investments in Air Liquide WA Pty Limited (40%), Albany Woolstores Pty Limited (35%), Bengalla Agricultural Company Pty Limited (40%), Bengalla Coal Sales Company Pty Limited (40%), Bengalla Mining Company Pty Limited (40%), Bunnings Warehouse Property Trust (22.6%), Gresham Partners Group (50%), Gresham Private Equity Fund No 1 (50.6%), Gresham Private Equity Fund No 2 (67.4%), Queensland Nitrates Management Pty Limited (50%), Queensland Nitrates Pty Limited (50%), Unigas (50%), Centrepoint Alliance Pty Limited (25%) and Wespine Industries Pty Limited (50%);

- assets held for sale consist of the direct 10.6% stake in Coles Group shares; and

- insurance liabilities represent unpaid claims plus actuarial estimates of outstanding claims on public liability and workers compensation policies.

6.5 Cash Flow

Wesfarmers' cash flows for the five years ended 30 June 2007 are summarised below:

Wesfarmers - Cash Flow ($ millions)

	Year ended 30 June				
	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2007 actual AIFRS
EBITDA	**1,124.9**	**1,217.3**	**1,259.1**	**1,671.1**	**1,639.0**
Changes in working capital and other adjustments	(219.1)	(202.9)	(6.6)	(186.3)	248.7
Capital expenditure (net)	(218.3)	(258.2)	(429.4)	(598.4)	(631.5)
Operating cash flow	**777.0**	**756.2**	**823.1**	**886.3**	**1,256.2**
Tax paid	(142.9)	(243.1)	(296.3)	(307.2)	(411.3)
Net interest paid	(67.1)	(58.7)	(50.2)	(87.1)	(126.7)
Dividends paid	(333.4)	(479.6)	(528.2)	(707.7)	(764.9)
Acquisitions (net of cash)	(27.5)	(630.9)	(25.7)	(18.5)	(3,459.5)
Disposals	255.6	861.1	-	438.2	10.7
Proceeds from share issues (net buybacks) and equity	(54.3)	(923.0)	(268.4)	36.5	246.6
Other	24.0	95.3	138.1	22.7	202.3
Net cash generated (used)	**431.4**	**(622.7)**	**(207.6)**	**263.3**	**(3,451.3)**
Net cash (borrowings) – opening	*(1,317.3)*	*(885.9)*	*(1,508.5)*	*(1,716.2)*	*(1,452.9)*
Net cash (borrowings) – closing	*(885.9)*	*(1,508.5)*	*(1,716.2)*	*(1,452.9)*	*(4,904.1)*

Source: Wesfarmers Annual Reports for the four years ended 30 June 2006, financial results for the year ended 30 June 2007 and Grant Samuel analysis

The major items affecting the historical cash flows of Wesfarmers are as follows:

- in the 2003 financial year, Wesfarmers sold the Girrah coal deposit in Queensland;

- during the 2004 financial year, Wesfarmers acquired Lumley's Australian and New Zealand insurance business for a net cash outlay of $301 million. The sale of Wesfarmers' rural services business, Landmark, realised $830 million. Wesfarmers undertook a significant capital restructuring, making a capital return to shareholders totalling $934 million;

- in the 2005 financial year, Wesfarmers increased its capital expenditure to approximately $465 million. Approximately $140 million was spent on the development of the Curragh North coal deposit and 10 new Bunnings warehouse stores were opened; and

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- in the 2006 financial year, Wesfarmers received proceeds of approximately $425 million from the sale of its share in the ARG joint venture. Divestments from Gresham Private Equity Funds also contributed to an increase in cash generated for the year. In 2006, capital expenditure increased significantly to $615 million as Wesfarmers spent more than $200 million on the Bunnings store roll-out and refurbishment program and over $200 million on the Curragh North expansion; and

- in the 2007 financial year, cash flows were affected by the $2.1 billion debt-funded acquisition of the direct 10.6% interest in Coles Group. The interest expense in relation to this debt amounted to $33.4 million for the year. In addition to the acquisition of Coles Group shares, Wesfarmers acquired OAMPS, Linde Gas Pty Limited and other businesses. Wesfarmers also maintained its commitment to a significant capital expenditure program.

6.6 Capital Structure and Ownership

6.6.1 Capital Structure

As at 21 September 2007, Wesfarmers had 388,069,969 ordinary shares on issue. It had no other securities on issue.

There are no options issued over Wesfarmers shares.

6.6.2 Ownership

At 21 September 2007 there were 164,900 registered shareholders in Wesfarmers. The top 20 shareholders accounted for approximately 30.9% of the ordinary shares on issue. The top twenty registered shareholders are principally institutional nominee or custodian companies. Wesfarmers has a significant retail investor base with a majority of registered shareholders classified as retail. Wesfarmers shareholders are predominantly Australian based investors (over 98.5% of registered shareholders and 99.4% of securities on issue).

There were no substantial shareholders of Wesfarmers at the last notice.

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6.7 Share Price Performance

6.7.1 Share Price History

A summary of the share price and trading history of Wesfarmers since July 2001 is set out below:

Wesfarmers - Share Price History

	Share Price ($)			Average Weekly Volume (000s)	Average Weekly Transactions
	High	Low	Close		
Year ended 31 December					
2001	28.65	14.41	27.57	2,873	1,492
2002	29.36	22.57	23.67	2,952	1,960
2003	26.83	19.33	25.81	4,673	3,080
2004	39.37	25.54	38.79	4,304	2,773
2005	42.45	34.89	36.97	4,719	4,340
Quarter ended					
31 March 2006	38.50	34.75	34.88	5,534	5,694
30 June 2006	38.15	34.05	35.33	6,121	6,180
30 September 2006	37.19	32.65	34.93	5,430	6,121
31 December 2006	38.00	33.83	37.54	4,353	5,227
Month ended					
31 March 2007	37.81	34.50	37.75	6,014	8,648
30 April 2007	39.42	36.91	39.15	4,357	7,308
31 May 2007	39.39	37.30	37.94	3,536	8,518
30 June 2007	45.90	38.01	45.73	7,706	10,721
31 July 2007	44.00	38.20	38.99	8,654	11,845
Week ended					
3 August 2007	39.00	37.50	38.20	6,576	12,005
10 August 2007	41.44	37.60	39.25	6,470	11,221
17 August 2007	40.98	37.15	37.20	6,652	12,758
24 August 2007	39.50	38.26	38.40	6,483	11,569
31 August 2007	39.28	37.60	38.56	7,496	10,095
7 September 2007	39.97	38.25	38.55	7,669	9,346
14 September 2007	39.29	38.00	39.15	6,840	10,761
21 September 2007	40.95	39.00	40.00	10,351	11,704

Source: IRESS

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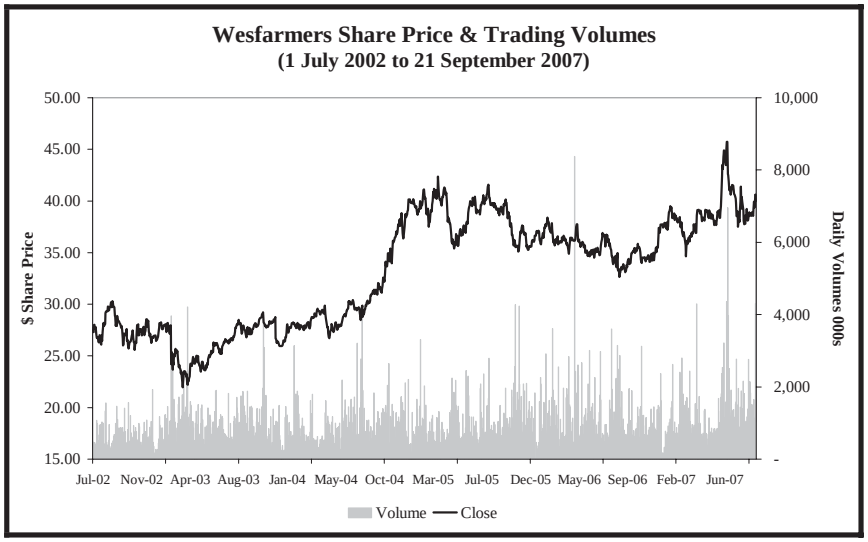
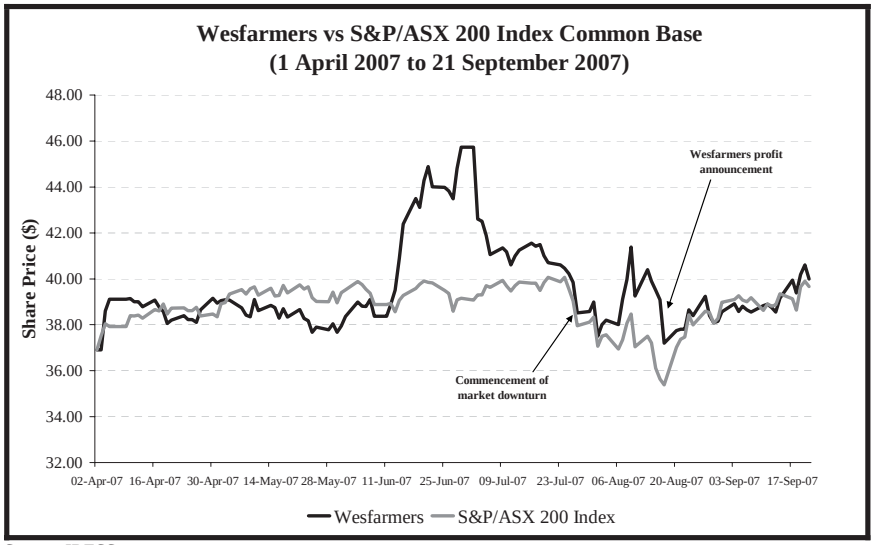
The following graph illustrates movements in the Wesfarmers share price and trading volumes since July 2002:



Source: IRESS

Since Wesfarmers' announcement of its original proposed $16.47 per share offer for Coles on 3 April 2007, Wesfarmers shares have traded in the range $37.15 to $45.90 with a VWAP of $40.10 (calculated to 21 September 2007). The closing price on 29 June 2007, the last Wesfarmers trading day prior to the announcement of the Initial Wesfarmers Proposal to acquire Coles Group, was $45.73. The increase in the last two weeks of June 2007 appears to have coincided with a general re-rating of stocks with exposure to coal that occurred at around this time.

The Wesfarmers share price declined immediately upon the announcement of the Initial Wesfarmers Proposal on 2 July 2007, as illustrated in the graph below:



Source: IRESS

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The initial decline in the Wesfarmers share price may have reflected hedge fund and arbitrage activity and/or an adverse reaction by the market to the proposal. The subsequent fall in the Wesfarmers share price may be attributable to the overall weakness in equity markets and the Wesfarmers profit announcement (with the Insurance division results being regarded as disappointing), although it has generally traded in line with the S&P/ASX 200 Index, albeit with more pronounced fluctuations.

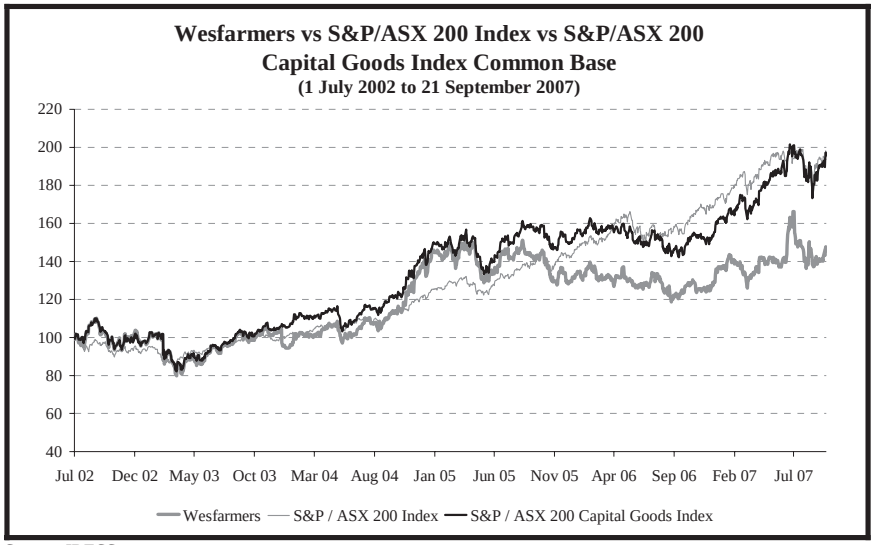
6.7.2 Liquidity

Wesfarmers has been a reasonably liquid stock. Average weekly volume over the twelve months prior to the announcement of the proposal to Coles Group on 3 April 2007 represented approximately 1.4% of average shares on issue or annual turnover of around 74.0% of total average issued capital. Since the announcement of the Initial Wesfarmers Proposal on 2 July 2007, average weekly volumes have represented approximately 2.7% of average shares on issue (to 21 September 2007).

6.7.3 Relative Performance

Wesfarmers is a member of various indices including the S&P/ASX 200 Capital Goods Index and the S&P/ASX 200 Index. At 21 September 2007 its weighting in these indices was approximately 38.7% and 1.3% respectively.

The following graph illustrates the performance of Wesfarmers shares since July 2002 relative to the S&P/ASX 200 Capital Goods Index and the S&P/ASX 200 Index:



Source: IRESS

Wesfarmers has performed broadly in line with the S&P/ASX 200 Capital Goods Index and the S&P/ASX 200 Index over the period July 2002 to October 2005.

Following the initial decline in the Wesfarmers share price upon announcement of the Initial Wesfarmers Proposal on 2 July 2007, the Wesfarmers share price has generally performed in line with both indices.

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7 Profile of Wesfarmers after the acquisition ofColes Group

7.1 Overview

Pursuant to the Wesfarmers Proposal, Wesfarmers will combine Coles Group's retail assets with its diversified businesses. Wesfarmers will hen have operations in retail, coal mining, insurance, industrial and safety product distribution, chmicals and fertiliser manufacture, gas processing and energy related activities, across Australia ani New Zealand.

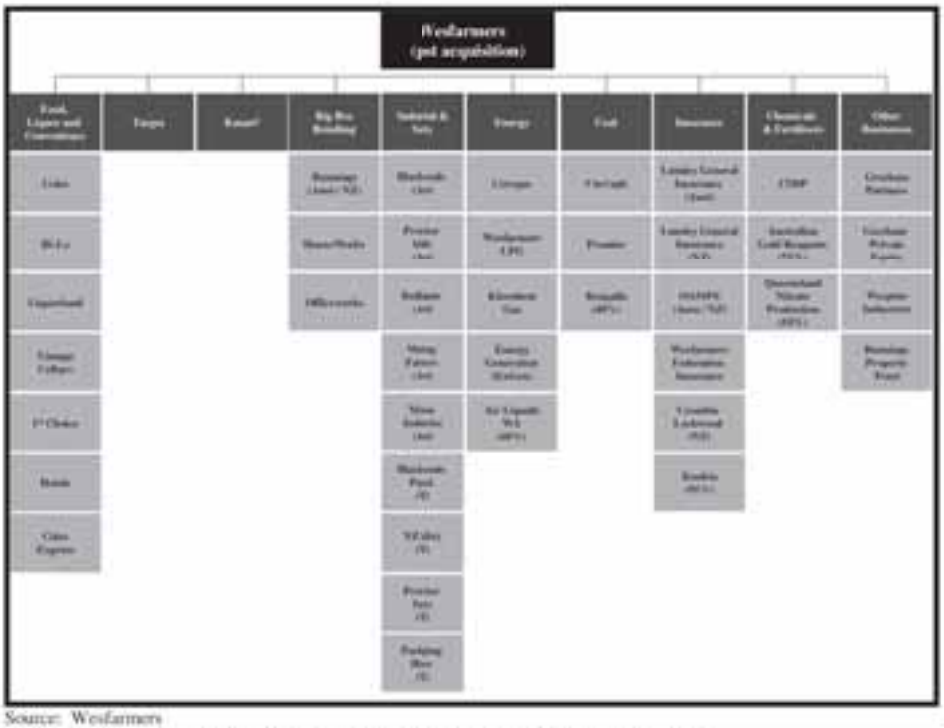
The acquisition of the Coles Group will hve a significant impact on the assets, liabilities and earnings of Wesfarmers. Wesfarmers is expected to become one of Australia's largest companies on the ASX by market capitalisation of nore than $30 billion, and will have approximately 200,000 employees across Australia and Nev Zealand.

On a pro forma basis, Wesfarmers (post th acquisition of Coles Group) would have combined revenue of $44.4 billion, combined EBITDA of $3.3 billion and combined EBIT of $2.5 billion for the notional financial year ended 30 June 207.

Wesfarmers' intentions in relation to Cols Group are set out in Section 8.6 of the Scheme Booklet. Detailed information regarding th profile of Wesfarmers following the acquisition of Coles Group is also set out in Section 8 of th Scheme Booklet.

7.2 Operations

If the Wesfarmers Proposal is successful, Wsfarmers will operate the Coles Group businesses and its existing business divisions under its decetralised business model.



Source: Wesfarmers
Note 1: Kmart will be a separate division until completon of a strategic review by Wesfarmers

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The Supermarkets, Coles Express and Coles Liquor business, Target and Kmart will be operated as separate divisions (subject to a further review of Kmart). Officeworks will be managed together with Bunnings as part of a Big Box Retailing division. Each division will have its own separate Board consisting of Wesfarmers corporate and divisional executive management. Each division will report directly to the Managing Director of Wesfarmers and will be supported by Wesfarmers corporate head office. Accordingly, Wesfarmers intends to relocate the Coles Group employees at the head office in Tooronga to alternative sites, subject to the commercial implications of doing so. The current Board of Wesfarmers will remain unchanged.

Wesfarmers intends to undertake a strategic review to determine the best option to maximise the value of Kmart. Alternatives to be considered as part of this strategic review include:

- improving the trading performance of the business;
- converting certain Kmart stores to the Target format; and
- the potential sale of all or part of the business.

Wesfarmers' preferred option is to retain the Kmart business.

Wesfarmers intends to continue with, and to build on, the Transformation and Simplification initiatives of the Coles Group. Wesfarmers is targeting cost savings through overhead reductions of $385 million per annum on an annualised basis by late in the 2009 financial year. These benefits include over $100 million of savings achieved under Coles Group's Simplification program to date. Wesfarmers believes it will require $10 million more than the amount already provided at the date of acquisition to deliver these benefits. Wesfarmers is targeting net EBIT benefits from the supply chain initiative of approximately $540 million per annum to be achieved on an annualised basis by late in the 2013 financial year. These benefits include approximately $90 million of savings from Transformation that have accrued to Coles Group by the end of the 2007 financial year. Wesfarmers expects that it will incur a total of approximately $250 million of non-recurring operating costs to achieve those benefits. In addition, Wesfarmers estimates that the remaining capital expenditure required to achieve these benefits from 2008 to 2012 will total approximately $320 million. Wesfarmers expects that over 75% of the additional one-off costs and capital expenditure required to achieve these benefits will be incurred by the end of the 2009 financial year.

7.3 Pro Forma Capital Structure and Ownership

Following the issue of new Wesfarmers shares, Wesfarmers will have approximately 541.9 million Wesfarmers ordinary shares and 153.8 million Wesfarmers PPS on issue, of which Coles Group shareholders will account for approximately 44%[24].

Should the acquisition be successful, Wesfarmers will arrange for Coles Group shares to be removed from the ASX.

7.4 Financial Impact of the Acquisition

Wesfarmers has estimated that the acquisition of Coles Group will increase pro forma sales from $9.7 billion to $44.4 billion and EBITDA from $1.7 billion to $3.3 billion, for the financial year ended 30 June 2007.

[24] Excluding the Coles Group shares already held by Wesfarmers prior to implementation of the Scheme. This percentage will also increase if bonus shares are issued when the PPS convert into ordinary shares.

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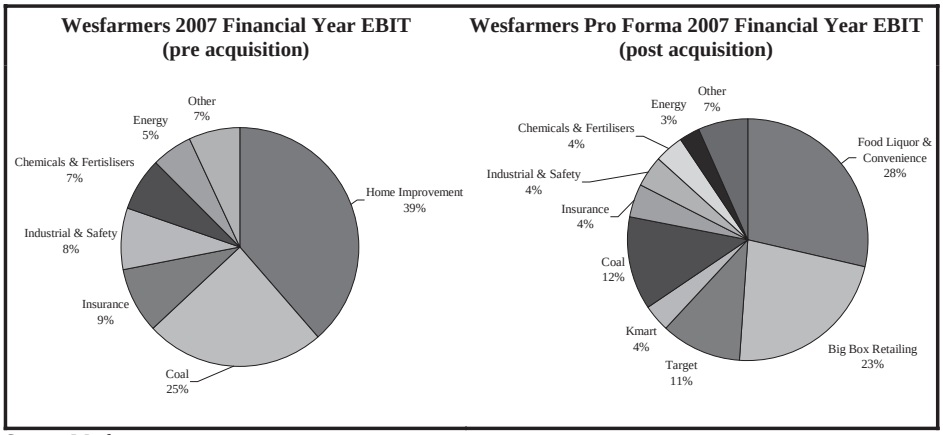
The composition of EBIT of Wesfarmers before and after the acquisition of Coles Group is illustrated in the charts below:



Source: Wesfarmers

Wesfarmers has stated that it has corporate debt facilities in place to fund the cash component of the acquisition. It has also indicated that final debt levels associated from the transaction are subject to a range of potential capital management alternatives.

The debt funding for the Wesfarmers Proposal and the indicative net debt of Wesfarmers following its implementation is summarised below:

Wesfarmers Proposal – Debt Funding ($ billions)	
Cash component of Wesfarmers Proposal	4.3
Coles Group net debt[25]	1.3
Refinanced bridge facility	2.1
Transaction costs	0.4
Total Acquisition Debt	**8.1**
Wesfarmers net debt at 30 June 2007	2.9
Average working capital	0.5
Wesfarmers Indicative Net Debt	**11.5**

Source: Wesfarmers presentation dated 16 August 2007

Wesfarmers has reviewed the anticipated capital requirements of the Coles Group businesses and estimates that an annual capital investment of approximately $1.0 billion to $1.2 billion will be required in the 2008 and 2009 financial years to support the planned network growth, store refurbishment program and continuation of the supply chain initiative. Wesfarmers expects the level of capital expenditure to be approximately $900 million and $1.0 billion per annum thereafter.

Wesfarmers is targeting the release of more than $300 million of working capital in the next five years.

[25] Net debt is based on consensus net debt adjusted for the payment of the Coles Group dividend of 25 cents per share.

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7.5 Pro Forma Financial Information

Wesfarmers has provided unaudited historical pro forma financial information for the merged group for illustrative purposes. Wesfarmers has not provided any forecast information in relation to the expected financial performance and position of the merged group.

The following should be noted in relation to the Wesfarmers pro forma financial information for the twelve months ended 30 June 2007:

- no synergistic benefits, additional capital expenditure or allowances for restructuring have been included in the unaudited pro forma financial information;
- it has been assumed that there are no separately identifiable intangibles; and
- control of the Coles Group is assumed to occur through a single purchase of Coles Group shares rather than as a stepped acquisition.

The unaudited pro forma financial performance of Wesfarmers for the year ended 30 June 2007 is summarised below:

Wesfarmers (post acquisition) - Financial Performance ($ millions)

	Notional year ended 30 June 2007			
	Wesfarmers (pre acquisition) Pro forma	Coles Group	Pro forma Adjustments	Wesfarmers (post acquisition) Pro forma
Sales revenue	9,666.4	34,687.9	-	44,354.3
EBITDA	**1,650.0**[26]	**1,725.9**[27]	**-**	**3,375.9**
Depreciation and amortisation	(344.7)	(543.0)	-	(887.7)
EBIT	**1,305.3**[28]	**1,182.9**[29]	**-**	**2,488.2**
Interest expense	(167.0)	(136.1)	(503.5)	(806.6)
Profit before tax and significant items	**1,138.3**	**1,046.8**	**(503.5)**	**1,681.6**
Income tax expense	(328.5)	(282.1)	151.1	(459.5)
Profit after tax from continuing operations	**809.8**	**764.7**	**(352.4)**	**1,222.1**
Profit from discontinued operations	-	27.7	-	27.7
Profit after tax from continuing and discontinued operations	**809.8**	**792.4**	**(352.4)**	**1,249.8**
Pro forma adjustments and significant items	(23.3)	(44.6)	23.3	(44.6)
Reported profit after tax	**786.5**	**747.8**	**(329.1)**	**1,205.2**
Statistics				
Basic earnings per share (¢) on profit from continuing operations	*216.8*			*179.4*
Dividends per share (¢) on reported profit	*210.5*			*177.0*
Weighted average shares on issue	373.6		307.6	681.2
Year end shares on issue	388.1		307.6	695.7

Source: Wesfarmers

The pro forma statement of financial performance assumes that Coles Group and Wesfarmers have identical reporting periods (which is not the case), and represents the performance for the twelve months ending 30 June 2007. The following should be noted in relation to the unaudited pro forma financial performance of Wesfarmers for the year ended 30 June 2007:

26 Wesfarmers (pre acquisition) pro forma EBITDA is earnings before interest paid, tax, depreciation and amortisation. It includes corporate overheads and consolidation adjustments ($66.8 million) and profit on sale of business ($6.2 million).

27 Coles Group EBITDA is earnings before interest paid, tax, depreciation, amortisation and significant items.

28 Wesfarmers (pre acquisition) pro forma EBIT is earnings before interest paid and tax. It includes corporate overheads and consolidation adjustments ($66.8 million) and profit on sale of business ($6.2 million).

29 Coles Group EBIT is earnings before interest paid, tax and significant items.

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- the $503.5 million adjustment to interest expense relates to the interest associated with the increased debt required to fund the acquisition of Coles Group;
- the $151.1 million adjustment to income tax expense reflects the tax benefit associated with the increase in interest expense; and
- the $307.5 million adjustment to shares on issue reflects the scrip portion of the consideration offered under the Wesfarmers Proposal.

The unaudited pro forma financial position of Wesfarmers for the year ended 30 June 2007 is summarised below:

Wesfarmers (post acquisition) - Financial Position ($ millions)

	30 June 2007 (notional)			
	Wesfarmers (pre acquisition) Pro forma	Coles Group	Pro forma Adjustments	Wesfarmers (post acquisition) Pro forma
Trade and other receivables	1,512.5	428.8		1,941.3
Inventories	1,235.0	2,946.5		4,181.5
Creditors, accruals and provisions	(1,254.2)	(3,057.9)		(4,312.1)
Net working capital	**1,493.3**	**317.4**		**1,810.7**
Property, plant and equipment	2,715.9	3,467.6		6,183.5
Intangible assets	2,698.1	1,670.2	14,652.5	19,020.8
Investment in associates	389.2	7.4		396.6
Insurance and other assets	1,057.9	27.8		1,085.7
Other current liabilities	(1,491.5)	(723.2)		(2,214.7)
Non-current receivables	112.5	41.2		153.7
Net other non-current assets/(liabilities)	(610.9)	38.2		(572.7)
Total funds employed	**6,364.5**	**4,846.6**	**14,652.5**	**25,863.6**
Cash and cash equivalents	218.5	546.1		764.6
Borrowings	(3,045.5)	(1,485.9)	(6,758.4)	(11,289.8)
Net borrowings	**(2,827.0)**	**(939.8)**	**(6,758.4)**	**(10,525.2)**
Net assets	**3,537.5**	**3,906.8**	**7,894.1**	**15,338.4**
Equity attributable to shareholders	**3,537.5**	**3,906.8**	**7,894.1**	**15,338.4**

Source: Wesfarmers

The pro forma statement of financial position assumes that the acquisition of Coles Group by Wesfarmers is effective as at 30 June 2007. Pro forma adjustments include:

- a $14.7 billion increase in intangible assets reflecting the fair value of goodwill and other assets and liabilities of the Coles Group on acquisition, calculated as the excess of the consideration offered over the book value of the net assets to be acquired; and
- a $6,758.4 million increase in interest bearing loans and borrowings relating to the draw down in debt to fund the cash consideration offered under the Wesfarmers Proposal and related transaction costs.

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The unaudited pro forma cash flow of Wesfarmers for the year ended 30 June 2007 is summarised below:

Wesfarmers (post acquisition) - Cash Flow ($ millions)				
	30 June 2007 (notional)			
	Wesfarmers (pre acquisition) Pro forma	Coles Group	Pro forma Adjustments	Wesfarmers (post acquisition) Pro forma
EBITDA	1,650.0	1,707.1	-	3,357.1
Operating cash flow	1,323.9	942.5	(352.4)	1,914.0
Investing cash flow	(2,117.0)	(857.0)	(6,758.4)	(9,732.4)
Free cash flow	**(793.1)**	**85.5**	**(7,110.8)**	**(7,818.4)**
Financing cash flow	948.9	(21.0)	6,758.4	7,686.3
Net cash flow	**155.8**	**64.5**	**(352.4)**	**(132.1)**

Source: Wesfarmers

The pro forma cash flow statement assumes that Coles Group and Wesfarmers have identical reporting periods and represents the cash flow for the twelve months ended 30 June 2007. Pro forma adjustments include:

- a decrease in operating cash flow relating to the additional costs associated with an increase in debt, which are assumed to be paid in the same period those costs are incurred;
- an increase in operating cash flow relating to the tax savings derived from the additional interest expense, which are assumed to be realised in the same period they are generated;
- a decrease of $6,758.4 million in investing cash flows relating to the cash consideration due under the Wesfarmers Proposal and related transactions costs; and
- an increase of $6,758.4 million in financing cash flows relating to the drawdown in debt.

7.6 Dividends

Wesfarmers' current dividend policy is to pay out all available franking credits to shareholders in the form of fully franked dividends. Should the acquisition be successful, Wesfarmers will be able to utilise any unused franking credits held by Coles Group. Wesfarmers expects to be able to pay fully franked dividends in excess of $2.00 per Wesfarmers ordinary share and Wesfarmers PPS for the financial years ending 30 June 2008 and 2009 (subject to the availability of retained earnings and franking credits).

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8 Valuation of Coles Group

8.1 Summary

Coles Group has been valued in the range $19.6-22.0 billion, which corresponds to a value of $16.21-18.23 per share. The valuation represents the estimated full underlying value of Coles Group assuming 100% of the company was available to be acquired and includes a premium for control. The value exceeds the price at which, based on current market conditions, Grant Samuel would expect Coles Group shares to trade on the ASX in the absence of the Wesfarmers Proposal or some similar change of control transaction.

The value for Coles Group is the aggregate of the estimated market value of Coles Group's operating businesses and other assets less external borrowings and non-trading liabilities. The valuation is summarised below:

Coles Group - Valuation Summary ($ millions)

	Section Reference	Valuation Range	
		Low	High
Supermarkets, Coles Express and Coles Liquor	8.4	13,500	15,200
Kmart	8.5	1,550	1,750
Target	8.6	4,000	4,300
Officeworks	8.7	1,400	1,600
Other assets and liabilities	8.8	687	707
Corporate overheads	8.9	(275)	(250)
Enterprise value		**20,862**	**23,307**
Net borrowings at 29 July 2007	8.10	(1,269)	(1,269)
Value of equity		**19,593**	**22,038**
Fully diluted shares on issue (millions)[30]		1,209	1,209
Value per share		**$16.21**	**$18.23**

The value attributed to the various operating businesses is an overall judgement having regard to a number of valuation methodologies and parameters, including capitalisation of earnings (multiples of EBITDA, EBIT and net profit after tax) and discounted cash flow ("DCF") analysis.

[30] Assumes that all options vest and are exercised, and that all performance shares vest. The Coles Group Board is able to exercise its discretion in relation to some of the options and performance shares to allow them to vest. To the extent that some options and performance shares do not vest, there may be a small increase in Grant Samuel's valuation range.

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The earnings multiples implied by the valuation of Coles Group's operating businesses and overall net equity are summarised below:

Coles Group – Implied Valuation Parameters

	Variable ($ millions)	Low	High
Multiple of EBITDA			
Year ended 30 July 2006	1,637.3	12.7	14.2
Year ended 29 July 2007	1,692.6	12.3	13.8
Multiple of EBIT			
Year ended 30 July 2006	1,147.4	18.2	20.3
Year ended 29 July 2007	1,149.6	18.1	20.3
Multiple of net profit after tax (before significant items)			
Year ended 30 July 2006	787.3	24.9	28.0
Year ended 29 July 2007	763.0	25.7	28.9
Multiple of NTA (at 29 July 2007)			
Geared	2,236.6	8.8	9.9
Ungeared	3,176.4	6.2	6.9

Grant Samuel believes that the multiples implied by the valuation are reasonable having regard to the market position and outlook for each of the Coles Group businesses and the market evidence for comparable companies. The multiples reflect the following factors:

- the Supermarkets, Coles Express and Coles Liquor business contributes around 65% of earnings and, based on Grant Samuel's valuation, approximately 65% of the total enterprise value of Coles Group. Accordingly, judgements regarding the value of the Supermarkets, Coles Express and Coles Liquor business are critical to the overall valuation;

- the overall performance of the Supermarkets, Coles Express and Coles Liquor business in the 2006 financial year was disappointing, with only modest growth, and the 2007 financial year saw a significant decline in Supermarkets earnings. Coles Group management expects a strong turnaround in Supermarkets' earnings in the 2008 financial year. Grant Samuel's valuation of the Supermarkets business takes into account the recent poor performance of the business, the expectations of near term earnings growth, the potential for substantial improvements in the business over the medium to longer term, and the execution and competitive risks associated with those potential improvements. In addition, the valuation reflects the brand strength of the Supermarkets business, its extensive and non-replicable store network, and its position as one of two major participants in a market that is characterised by strong barriers to entry. The Coles Express and Coles Liquor businesses have shown steady progress and have potential for continued development;

- after some years of declining performance, Kmart recorded a recovery in earnings for the 2007 financial year. The challenge for the business will be to achieve sales growth while maintaining recent margin improvements; and

- Target and Officeworks continued their recent strong performance by recording further growth in earnings in the 2007 financial year. Coles Group expects that this earnings growth will continue for 2008, assisted by a greater focus on the opening of new stores by both businesses.

Because the valuation to a significant extent reflects judgements regarding the likely timing, cost and extent of a turnaround in the Supermarkets business (and the extent to which an acquirer could be expected to pay today for that uncertain future growth potential), a higher than usual level of uncertainty attaches to the valuation and different valuation conclusions could reasonably be reached.

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8.2 Methodology

8.2.1 Overview

Grant Samuel's valuation of Coles Group has been estimated by aggregating the estimated market value of its operating businesses together with the realisable value of non-trading assets and deducting external borrowings and non-trading liabilities as at 29 July 2007. The value of the operating businesses has been estimated on the basis of fair market value as a going concern, defined as the maximum price that could be realised in an open market over a reasonable period of time assuming that potential buyers have full information.

The valuation of Coles Group is appropriate for the acquisition of the company as a whole and, accordingly, incorporates a premium for control. The value is in excess of the level at which, under current market conditions, shares in Coles Group could be expected to trade on the sharemarket. Shares in a listed company normally trade at a discount of 15-25% to the underlying value of the company as a whole (but this discount does not always apply).

The most reliable evidence as to the value of a business is the price at which the business or a comparable business has been bought and sold in an arm's length transaction. In the absence of direct market evidence of value, estimates of value are made using methodologies that infer value from other available evidence. There are four primary valuation methodologies that are commonly used for valuing businesses:

- capitalisation of earnings or cash flows;
- discounting of projected cash flows;
- industry rules of thumb; and
- estimation of the aggregate proceeds from an orderly realisation of assets.

Each of these valuation methodologies has application in different circumstances. The primary criterion for determining which methodology is appropriate is the actual practice adopted by purchasers of the type of business involved.

Valuations are generally based on one or both of the discounted cash flow and capitalisation of earnings approaches and Grant Samuel has had regard to both methodologies in the valuation of Coles Group. The DCF methodology is able to explicitly capture the potential for a substantial turnaround in the performance of a number of businesses of Coles Group, in particular, Supermarkets and Kmart.

8.2.2 Discounted Cash Flow

Discounting of projected cash flows has a strong theoretical basis. It is the most commonly used method for valuation in a number of industries, including resources, and for the valuation of start-up projects where earnings during the first few years can be negative but it is also widely used in the valuation of established industrial businesses. DCF valuations involve calculating the net present value of projected cash flows. This methodology is able to explicitly capture the effect of a turnaround in the business, the ramp up to maturity or significant changes expected in capital expenditure patterns. The cash flows are discounted to a net present value ("NPV") using a discount rate which reflects the risk associated with the cash flow stream.

Considerable judgement is required in estimating future cash flows and it is generally necessary to place great reliance on medium to long term projections prepared by management. The discount rate is also not an observable number and must be inferred from other data (usually only historical). None of this data is particularly reliable so estimates of the discount rate necessarily involve a substantial element of judgement. In addition, even where cash flow forecasts are available, the terminal or continuing value is usually a high proportion of value. Accordingly, the multiple used in assessing this

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terminal value becomes the critical determinant in the valuation (i.e. it is a "de facto" cash flow capitalisation valuation). The NPV is typically extremely sensitive to relatively small changes in underlying assumptions, few of which are capable of being predicted with accuracy, particularly beyond the first two or three years. The arbitrary assumptions that need to be made and the width of any value range mean the results are often not meaningful or reliable. Notwithstanding these limitations, DCF based valuations are commonly used and can at least play a role in providing a check on alternative methodologies, not least because explicit and relatively detailed assumptions as to expected future performance need to be made.

8.2.3 Capitalisation of Earnings or Cash Flows

Capitalisation of earnings or cash flows is the most commonly used method for valuation of industrial businesses. This methodology is most appropriate for industrial businesses with a substantial operating history and a consistent earnings trend that is sufficiently stable to be indicative of ongoing earnings potential. This methodology is not particularly suitable for start-up businesses, businesses with an erratic earnings pattern or businesses that have unusual capital expenditure requirements. This methodology involves capitalising the earnings or cash flows of a business at a multiple that reflects the risks of the business and the stream of income that it generates. These multiples can be applied to a number of different earnings or cash flow measures including EBITDA, EBIT or net profit after tax. These are referred to respectively as EBITDA multiples, EBIT multiples and price earnings multiples. Price earnings multiples are commonly used in the context of the sharemarket. EBITDA and EBIT multiples are more commonly used in valuing whole businesses for acquisition purposes where gearing is in the control of the acquirer but are also used extensively in sharemarket analysis.

Where an ongoing business with relatively stable and predictable cash flows is being valued, Grant Samuel uses capitalised earnings or operating cash flows as a primary reference point.

Application of this valuation methodology involves:

- estimation of earnings or cash flow levels that a purchaser would utilise for valuation purposes having regard to historical and forecast operating results, non-recurring items of income and expenditure and known factors likely to impact on operating performance; and

- consideration of an appropriate capitalisation multiple having regard to the market rating of comparable businesses, the extent and nature of competition, the time period of earnings used, the quality of earnings, growth prospects and relative business risk.

The choice between parameters is usually not critical and should give a similar result. All are commonly used in the valuation of industrial businesses. EBITDA can be preferable to EBIT if depreciation or non-cash charges distort earnings or make comparisons between companies difficult. On the other hand, EBIT can better adjust for differences in relative capital expenditure intensity.

Determination of the appropriate earnings multiple is usually the most judgemental element of a valuation. Definitive or even indicative offers for a particular asset or business can provide the most reliable support for selection of an appropriate earnings multiple. In the absence of meaningful offers it is necessary to infer the appropriate multiple from other evidence.

The primary approach used by valuers is to determine the multiple that other buyers have been prepared to pay for similar businesses in the recent past. A pattern may emerge from transactions involving similar businesses with sales typically taking place at prices corresponding to earnings multiples within a particular range. This range will generally reflect the growth prospects and risks of those businesses. Mature, low growth businesses

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will, in the absence of other factors, attract lower multiples than those businesses with potential for significant growth in earnings.

An alternative approach in valuing businesses is to review the multiples at which shares in listed companies in the same industry sector trade on the sharemarket. This gives an indication of the price levels at which portfolio investors are prepared to invest in these businesses. Share prices reflect trades in small parcels of shares (portfolio interests) rather than whole companies and it is necessary to adjust for this factor.

In interpreting and evaluating such data it is necessary to recognise that:

- multiples based on listed company share prices do not include a premium for control and are therefore often (but not always) less than multiples that would apply to acquisitions of similar companies. However, while the premium paid to obtain control in takeovers is observable (typically in the range 20-35%) it is inappropriate to simply add a premium to listed multiples. The premium for control is an outcome of the valuation process, not a determinant of value. Premiums are paid for reasons that vary from case to case and may be substantial due to synergy or other benefits available to the acquirer. In other situations premiums may be minimal or even zero. There are transactions where no corporate buyer is prepared to pay a price in excess of the prices paid by sharemarket investors;

- acquisition multiples from comparable transactions are therefore usually seen as a better guide when valuing 100% of a business but the data tends to be less transparent and information on forecast earnings is often unavailable;

- acquisition multiples are a product of economic and other circumstances at the time of the transaction. However, each transaction will be the product of a unique combination of factors, including:

  - economic factors (e.g. economic growth, inflation, interest rates) affecting the markets in which the company operates;

  - strategic attractions of the business - its particular strengths and weaknesses, market position of the business, strength of competition and barriers to entry;

  - the company's own performance and growth trajectory;

  - rationalisation or synergy benefits available to the acquirer;

  - the structural and regulatory framework;

  - investment and sharemarket conditions at the time; and

  - the number of competing buyers for a business.

- acquisition multiples are based on the target's earnings but the price paid normally reflects the fact that there were synergies available to the acquirer (at least if the acquirer is a "trade buyer" with existing businesses in the same or a related industry). If the target's earnings were adjusted for these synergies, the effective multiple paid by the acquirer would be lower than that calculated on the target's earnings;

- acquisitions and listed companies in different countries can be analysed for comparative purposes, but it is necessary to give consideration to differences in overall sharemarket levels and ratings between countries, economic factors (economic growth, inflation, interest rates) and market structures (competition etc) and the regulatory framework. It is not appropriate to adjust multiples in a mechanistic way for differences in interest rates or sharemarket levels;

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- the analysis will give a range of outcomes from which averages or medians can be determined but it is not appropriate to simply apply such measures to the company being valued. The most important part of valuation is to evaluate the attributes of the specific company being valued and to distinguish it from its peers so as to form an appropriate judgement as to value; and

- while EBITDA multiples are commonly used benchmarks they are an incomplete measure of cash flow. The appropriate multiple is affected by, among other things, the level of capital expenditure (and working capital investment) relative to EBITDA. In this respect:

  - EBIT multiples can in some circumstances be a better guide because (assuming depreciation is a reasonable proxy for capital expenditure) they effectively adjust for relative capital intensity and present a better approximation of free cash flow. However, capital expenditure is lumpy and depreciation expense may not be a reliable guide. In addition, there can be differences between companies in the basis of calculation of depreciation; and

  - businesses that generate higher EBITDA margins than their peer group companies will, all other things being equal, warrant higher EBITDA multiples because free cash flow will in relative terms be higher (as capital expenditure is a smaller proportion of earnings).

The analysis of comparable transactions and sharemarket prices for comparable companies will not always lead to an obvious conclusion as to which multiple or range of multiples will apply. There will often be a wide spread of multiples and the application of judgement becomes critical. Moreover, it is necessary to consider the particular attributes of the business being valued and decide whether it warrants a higher or lower multiple than the comparable companies. This assessment is essentially a judgement.

In determining a value for Coles Group's businesses, Grant Samuel has placed particular reliance on the EBITDA and EBIT multiples implied by the valuation range compared to the EBITDA and EBIT multiples derived from an analysis of comparable listed companies and transactions involving comparable businesses, but has also considered price earnings multiples.

8.2.4 Industry Rules of Thumb

Industry rules of thumb are commonly used in some industries. These are generally used by a valuer as a "cross check" of the result determined by a capitalised earnings valuation or by discounting cash flows. While they are only used as a cross check in most cases, industry rules of thumb can be the primary basis on which buyers determine prices in some industries. Grant Samuel is not aware of any commonly used rules of thumb that would be appropriate to value the business of Coles Group. In any event, it should be recognised that rules of thumb are usually relatively crude and prone to misinterpretation.

8.2.5 Net Assets/Realisation of Assets

Valuations based on an estimate of the aggregate proceeds from an orderly realisation of assets are commonly applied to businesses that are not going concerns. They effectively reflect liquidation values and typically attribute no value to any goodwill associated with ongoing trading. Such an approach is not appropriate in Coles Group's case.

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8.3 Valuation Issues and Assumptions

8.3.1 DCF Scenario Analysis

For the purpose of its DCF analysis, Grant Samuel has prepared financial models for the operating businesses of Coles Group. The models allow the analysis of alternative scenarios for the future financial performance of the Coles Group businesses. The scenarios were developed by Grant Samuel with reference to the 2008 Budget and five year management projections for the period ending 29 July 2012 ("Projections") prepared by Coles Group management. However, the Projections were prepared by Coles Group management for the purpose of the sale process, and on the basis of actual results of Coles Group to 28 January 2007. They have not been updated to reflect the actual trading of Coles Group businesses for the second half of the 2007 financial year or to reflect the 2008 Budget. Accordingly, Grant Samuel developed its own "high level" top down financial models in order to assist in analysing value.

Grant Samuel adopted assumptions for the scenarios to reflect its judgement on certain matters. The assumptions adopted by Grant Samuel and the associated calculations of future performance in the financial models are not, and are not necessarily consistent with, the assumptions and forecasts of Coles Group. The scenarios are based on a large number of assumptions and are subject to significant uncertainty and contingencies, many of which are outside the control of Coles Group. The scenarios allow an assessment of the impact on value of various key assumptions relating to sales growth, EBITDA margin, capital expenditure and other factors. It should be recognised that the scenarios focus on assumptions regarding key value drivers, rather than detailed "bottom up" parameters. The scenarios are discussed in more detail in the following sections of this report.

The assumptions adopted for the purposes of the financial models are subject to significant uncertainties and contingencies, many of which are outside the control of Coles Group. Key assumptions regarding future operational performance are highly uncertain and there is scope for significant differences of opinion in relation to these assumptions. In particular:

- many of the assumptions are difficult to predict with any degree of reliability and are beyond the control of management. There is potential for a substantial improvement in the performance of a number of Coles Group's businesses. However, a range of different views could reasonably be held in relation to the timing, costs and extent of any turnaround. Accordingly, assumptions in relation to revenue growth and EBITDA margin are highly subjective; and

- competitor behaviour could potentially have a major impact on the future performance of the Coles Group's businesses. Future competitor behaviour is intrinsically uncertain.

Nevertheless, Grant Samuel considers that the analysis does provide some insight into value. In view of the uncertainties surrounding the future performance of Coles Group's businesses, the scenarios analysed are to some extent arbitrary. However, they reflect the range of judgements that potential buyers of the businesses could make. The scenarios analysed do not, and do not purport to, represent possible best and worst case scenarios for the future performance of the Coles Group businesses. They are simply theoretical indicators of particular sensitivities.

The scenarios do not represent Grant Samuel's forecasts of the future financial performance of Coles Group and its businesses. Grant Samuel gives no undertaking and makes no warranty regarding the future financial performance of Coles Group and its businesses. Such future performance is subject to fundamental uncertainty. Rather, the scenarios have been developed purely to allow Grant Samuel to assess the impact on calculated NPVs of alternative assumptions regarding the future financial performance of Coles Group and its businesses.

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Moreover, DCF analysis is subject to significant limitations and NPV outcomes need to be treated with considerable caution. The calculated NPVs are extremely sensitive to small change in assumptions regarding margins, revenue growth and capital expenditure for periods for many years into the future. This sensitivity to assumptions regarding future operational performance is accentuated by the fact that the terminal value (the value contributed by cash flows generated after the end of the explicit cash flow forecast period) normally contributes a high proportion of the overall value. In this respect the implied terminal value multiples become a key valuation factor.

8.3.2 DCF General Assumptions

The models for Coles Liquor and Kmart run from 30 July 2007 for five years to 31 July 2012, with a terminal value calculated as at 31 July 2012. The models for Supermarkets, Coles Express, Target and Officeworks have been extended for an additional five years to 31 July 2017 with a terminal value calculated as at 31 July 2017.

The following general assumptions have been made in the financial models prepared for each operating business for the purpose of conducting DCF analysis:

- the corporate tax rate is assumed to be 29.2% in the 2008 financial year (consistent with management forecasts). The effective rate is assumed to revert to the Australian general corporate tax rate of 30% from 2009 onwards;
- the models use as a starting point the balance sheet of Coles Group as at 29 July 2007 and project cash flows from 30 July 2007;
- cash flows occur in the middle of each period;
- projected ungeared after tax cash flows are discounted to an NPV using nominal after tax discount rates appropriate for each business. Appendix 1 sets out a detailed analysis of the discount rates used;
- foreign exchange rates are assumed to be constant for the forecast period such that no profit or loss is derived from foreign exchange movements; and
- no acquisitions or divestitures of business units occur.

8.3.3 Segmental Analysis

The valuation of the various Coles Group businesses has been based on the segmental earnings of the business units as prepared by Coles Group. While Grant Samuel considers this segmentation to be adequate for the purposes of its valuation it should be noted that:

- Coles Group incurs substantial costs on a centralised "shared services" basis, including IT costs, human resources costs and others. These costs are then allocated to operating businesses on a variety of bases; and
- certain costs are left unallocated. Grant Samuel has attributed a "negative value" to these unallocated costs, based on an estimate of the unallocated costs that would remain following the acquisition by an acquirer of all of Coles Group.

Accordingly, the values ascribed by Grant Samuel to the businesses are not necessarily representative of values that could be realised for the businesses if they were sold individually on the basis that they incurred all their own costs. Grant Samuel's valuation also does not take into account transaction costs and other costs that would be incurred in separating any of the businesses from Coles Group. Accordingly, it is not representative of a "break up" valuation.

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8.4 Supermarkets, Coles Express and Coles Liquor

8.4.1 Overview

Grant Samuel has valued the Supermarkets, Coles Express and Coles Liquor business in the range $13.5-15.2 billion.

The valuation represents the aggregate of separate valuations prepared by Grant Samuel for each of the Supermarkets, Coles Express and Coles Liquor businesses. The individual valuations, together with the associated implied earnings multiples, have not been set out in this report because Coles Group has requested that Grant Samuel not disclose earnings for the Supermarkets, Coles Express and Coles Liquor businesses on an individual basis.

The valuation represents the following multiples of earnings:

Supermarkets, Coles Express and Coles Liquor – Implied Earnings Multiples

	Variable ($ millions)	Low	High
Multiple of EBITDA			
Year ended 30 July 2006[31]	1,095.0	12.3	13.9
Year ended 29 July 2007[31]	1,095.7	12.3	13.9
Multiple of EBIT			
Year ended 30 July 2006	796.3	17.0	19.1
Year ended 29 July 2007	773.2	17.5	19.7

Grant Samuel believes that the multiples of 2006 and 2007 earnings implied by the valuation are reasonable, having regard to the performance, prospects and particular characteristics of each of the businesses. Grant Samuel has also cross-referenced its valuation against budgeted 2008 earnings, and believes that these multiples are reasonable. At Coles Group's request, Grant Samuel has not disclosed the multiples of 2008 earnings implied by its valuation of the Supermarkets, Coles Express and Coles Liquor business.

8.4.2 Valuation Commentary

The Coles Group Supermarkets business is by far the largest business within the Supermarkets, Coles Express and Coles Liquor segment. Judgements regarding the valuation of the Supermarkets business are critical to the overall valuation of Coles Group.

The valuation of the Supermarkets business is subject to considerable uncertainty. It requires a balancing of the recent poor performance of the business against the expectations for an earnings rebound for the 2008 financial year and the potential for further earnings growth over the medium to longer term. In addition, the valuation needs to reflect the strategic value inherent in the Coles brand and the extensive and essentially non-replicable store network of the Supermarkets business. Grant Samuel's valuation takes into account the following:

- after a disappointing performance in the 2006 financial year, the Supermarkets business reported a significant fall in earnings for the 2007 financial year. The fall in earnings was the result of a number of specific factors, including the poorly executed conversion of Bi-Lo stores to Coles stores and the problematic implementation of a new centrally managed range system. However, the poor business performance also appeared to reflect more general issues, including a gradual decline in the customer offer. In addition, it appears that the lengthy sale process for Coles Group has been

[31] The implied multiples for the business unit are based on Coles Group's divisional EBITDA for statutory purposes, which are understated because depreciation incurred at a corporate level is recharged as an operating expense. This results in slightly higher EBITDA multiples than would be the case if the EBITDA was adjusted to recategorise this charge.

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disruptive at a management level and that these effects will continue, at least in the short term;

- management has put in place a number of initiatives to address the consequences of the Bi-Lo store conversion and the centrally managed range implementation. More generally, management has moved to improve the overall customer offer, with a focus on improving the fresh offer and providing better value. Trading towards the end of the 2007 financial year and over the first few weeks of the 2008 financial year has shown some preliminary evidence of a sales turnaround;

- Coles Group expects that the earnings for the Supermarkets business will rebound significantly in the 2008 financial year. To some extent, this will reflect the full year benefit of Simplification program initiatives implemented during the 2007 financial year and further Simplification program benefits from 2008 initiatives, as well as the non-recurrence of one-off costs associated with the Bi-Lo conversion in 2007. In addition, the budgeted increase in earnings reflects an expectation that comparable store sales growth will accelerate and various other business initiatives will increase margins;

- there is potential for substantial earnings growth over the medium to longer term. In particular, the Transformation program is expected to generate large savings in supply chain costs by 2012, with the bulk of the savings to be delivered towards the back end of the program. Management expects that supply chain cost efficiencies will be complemented by improved in-store execution, with improved range, an expanded house brand offer, a focus on fresh, a consistent value proposition, and a more aggressive store refurbishment program all contributing to sales and margin growth;

- while management's plans for longer term earnings growth are credible, the reality is that they are subject to significant execution risk. The Supermarkets business will need to concurrently complete a complex supply chain program and substantially improve in-store execution, while also completing a business and management restructuring, including the hiring of a number of senior executives;

- the Transformation program, which is key to reducing the cost base of the Supermarket's business in the medium term, is already expected to be more costly, and to deliver its benefits later, than originally expected;

- management has prepared plans for an extensive capital program to refresh existing stores, roll-out new stores and to make improvements to the supply chain. However, it is difficult to predict with confidence the timing and effectiveness of the capital expenditure, and the extent to which it will generate the expected uplift in earnings;

- the Supermarkets business is exposed to the effects of competitive behaviour, principally from Woolworths. The Woolworths business is highly profitable. Its lead in supply chain and lower cost structure means that it can afford to trade off margin for market share. Competition from Woolworths (or from other participants such as Aldi or IGA) in terms of price, in-store execution or otherwise could have a significant effect on the earnings of the Supermarkets business;

- notwithstanding the uncertainty regarding future earnings improvement, the Supermarkets business has attractive characteristics. The Coles brand is long established and the store network, one of only two such networks in Australia, could not be replicated by a new entrant to the market. The Supermarkets business is one of two major participants in a market protected by significant barriers to entry; and

- on the other hand, the synergies available to potential acquirers of the Supermarkets business would be modest at best. Given competition regulation, the only other major supermarket operator in Australia, Woolworths, would not be able to acquire the Supermarkets business. Other potential buyers, whether a foreign trade buyer, a

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financial buyer (i.e. private equity firm) or a new entrant to the industry (such as Wesfarmers) could not realise any significant operational synergies (except perhaps some minor head office/listed company cost reductions).

Grant Samuel's valuation of the Supermarkets business reflects a view that, while earnings are likely to improve materially for 2008, there remain risks associated with management's expectations of sales and margin growth for 2008. The opportunities for longer term earnings growth are substantial, but the execution and competitive risks mean that this potential upside requires discounting. A buyer of the Supermarkets business would not pay for all the potential upside, given the risks that the buyer would assume. A wide range of views could reasonably be taken on the likely timing, costs and extent of the expected business turnaround. Accordingly, a range of credible conclusions regarding the value of the Supermarkets business could reasonably be reached.

The Coles Express business has recorded strong profit growth in 2007, notwithstanding a marginal decline in sales due to falling petrol prices. Earnings for 2008 are budgeted to continue the strong growth, based on solid comparable store sale growth, extension of the store network and margin improvements. Sales and margin improvements are expected to be supported by the ongoing store refurbishment program, the availability of "You'll Love Coles" products and an improved customer value proposition. Grant Samuel's valuation of the Coles Express business takes into account its position as the largest petrol retailer in Australia, its extensive store network, its competitive value position in the convenience sector, its strong track record and the prospects for further earnings growth.

The Coles Liquor business is in the early stages of a growth and restructuring program, which aims to rationalise brands and store formats, reinvigorate the current network and build a competitive business in the "big box" liquor store format. The business has grown rapidly through acquisition and roll-out of the 1st Choice large format store network, and the brand and store portfolio has been successfully integrated and rationalised into the three businesses - 1st Choice, Liquorland and Vintage Cellars.

Earnings from the Coles Liquor business grew substantially during the 2007 financial year, largely reflecting the benefits of acquisitions and the expansion of the 1st Choice store network. Earnings are budgeted to continue to grow in the 2008 financial year, although at a moderated rate. While Coles Liquor is expected to continue to deliver earnings growth, the challenge for the business is to produce acceptable returns on capital. Actual returns on net assets invested in the business for 2006 and 2007, and budgeted returns on capital for 2008, are all below Coles Group's overall cost of capital. The low returns are the result of the elevated values of pubs and hotels, and the consequent high acquisition costs that Coles Group has had to incur in building the Coles Liquor business, and the start-up nature of the 1st Choice business, which has yet to achieve the efficiencies and low cost base of a mature business.

Grant Samuel's valuation of Coles Liquor reflects:

- the strong market position of Coles Liquor, which is the second largest participant in the Australian retail liquor market;
- its extensive national network of stores;
- the significant opportunities for growth through expansion of the store network, particularly the 1st Choice network;
- the ability to target a broad range of consumers and shopping preferences through the three differentiated retail brands;
- the high barriers to entry as a result of the liquor licensing requirements; and

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- the potential for margin improvement through product differentiation, particularly through growth of sales of private label products.

On the other hand, the multiples also take into account:

- the low returns on capital currently earned by the business, and the additional capital investment and risks associated with growing the business to the point where it will generate improved returns;
- the considerable capital expenditure required to refurbish hotels and gaming facilities, make new acquisitions, roll-out the 1st Choice network, and refurbish the Liquorland network, to take the business to the point where it is at an optimum size;
- the strong competition for greenfields sites and hotels. As a result, the eventual cost of the anticipated roll-out of new stores and the hotel acquisition strategy is uncertain; and
- the competitive nature of the liquor retailing, hotels and gaming markets.

Essentially, Coles Liquor is a "work in progress". Grant Samuel's valuation reflects both the potential upside and the risks associated with the development of the business.

The valuation of the Supermarkets, Coles Express and Coles Liquor business also takes into account the Coles Online and Pharmacy Direct businesses, and the SuperCentres opportunity. Coles Online and Pharmacy Direct are start-up businesses generating either losses or modest profits. Coles Group plans to launch the SuperCentres initiative in 2009. While the superstore combined grocery and general merchandise format has been successful in many other countries, the format has not recently been tested in Australia, and its impact on the existing Supermarkets business is uncertain. Grant Samuel has attributed limited value to the Coles Online and Pharmacy Direct businesses and the SuperCentres opportunity given the early stages of their development and current earnings profile.

8.4.3 Discounted Cash Flow Analysis

Grant Samuel's valuation of the Supermarkets, Coles Express and Coles Liquor business takes into account DCF analysis of the business. Grant Samuel has undertaken DCF analysis of each of the Supermarkets, Coles Express and Coles Liquor businesses on an individual basis. However, as a result of Coles Group's request that Grant Samuel not publish financial information for these businesses on an individual basis for competitive reasons, the key inputs and results of the DCF analysis are presented on a consolidated basis for the overall Supermarkets, Coles Express and Coles Liquor business.

Separate assumptions were developed by Grant Samuel for each of the Supermarkets, Coles Express and Coles Liquor businesses. Two scenarios were developed for the Supermarkets business, to examine a range of potential outcomes for that business. The scenarios described below represent the aggregate of the scenarios for the Supermarkets, Coles Express and Coles Liquor businesses.

Scenario A is based on a gradual but nonetheless significant improvement in the performance of the Supermarkets business. Sales are assumed to grow at rates between 5.2% and 6.2% during the period to 29 July 2012, and EBITDA margins to increase from 5.0% to 5.8%[32]. The result is an increase in EBIT margin to 4.0% by 2012, and a growth in EBIT for the combined business from $784 million[33] for the 2007 financial year to $1,397 million for the 2012 financial year. EBITDA margins are assumed to remain

[32] EBITDA includes the allocation of depreciation charged at a corporate level and is not directly comparable with segmental EBITDA as per Coles Group's statutory reporting.

[33] Excludes Coles Online and Pharmacy Direct.

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constant for the remainder of the DCF analysis period (through to 2017), with sales growth slowing as the business matures. In Grant Samuel's view such performance would represent an excellent result for the business, having regard to the issues currently facing the business and its competitive position relative to Woolworths.

Scenario B incorporates more positive assumptions than Scenario A regarding sales growth and long term EBITDA and EBIT margins. The assumptions in Scenario B reflect (in a general sense) the longer term planning analysis undertaken by Coles Group management for the purpose of the Coles Group sales process (although the assumptions adopted are those of Grant Samuel). The superior performance of the Supermarkets business in Scenario B notionally reflects some combination of positive factors such as full delivery of Transformation benefits, the ability to substantially retain these benefits rather than pass them on to customers, substantial improvements in relation to in-store execution, and a relatively benign competitive environment. Sales are assumed to grow at rates between 5.4% and 7.4% during the period to 30 July 2012, and EBITDA margins to increase from 5.0% to 6.3%. The result is an increase in EBIT margin to 4.5% by 2012, and a growth in EBIT for the combined business from $784 million[33] for the 2007 financial year to $1,596 million for the 2012 financial year. In Grant Samuel's view such an outcome would represent exceptional performance. Woolworths' supermarkets, fuel and liquor EBIT margin for the 2007 financial year was 5.0%.

Both Scenario A and Scenario B assume considerable capital expenditure continues to be incurred over the five year period, with total Supermarkets capital expenditure of around $2.5 billion over the five years, including expenditure on store refurbishment, network growth and the Transformation program. Coles Liquor capital expenditure is assumed to total around $905 million over the five year period, including capital expenditure for hotel acquisitions, roll-out of the 1st Choice network and refurbishments of hotels and Liquorland stores.

The outputs of the model up to 2012 for each scenario are presented on a consolidated basis in the following table:

Supermarkets, Coles Express and Coles Liquor DCF Analysis – Key Measures of Financial Performance ($ millions)

	Financial Year				
	2008	**2009**	**2010**	**2011**	**2012**
Scenario A					
Revenue	27,684	29,413	31,218	32,998	34,705
EBITDA[34]	1,374	1,546	1,711	1,900	2,012
EBIT	903	1,023	1,159	1,313	1,397
EBIT margin	*3.3%*	*3.5%*	*3.7%*	*4.0%*	*4.0%*
Capital expenditure	842	802	795	797	825
Scenario B					
Revenue	27,684	29,727	31,558	33,419	35,216
EBITDA[19]	1,397	1,729	1,839	2,086	2,212
EBIT	926	1,205	1,287	1,498	1,596
EBIT margin	*3.3%*	*4.1%*	*4.1%*	*4.5%*	*4.5%*
Capital expenditure	842	809	802	807	837

[34] EBITDA has been adjusted for depreciation previously allocated to Coles Group's corporate function in the 2008 to 2012 financial years.

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Other parameters used in the DCF analysis are:

- discount rates of 9.0-10.0% are applied to nominal ungeared after tax cash flows. Appendix 1 sets out a detailed analysis of the selection of these discount rates; and
- the terminal value at the end of the explicit cash flow forecast period is based on nominal terminal growth rates of free cash flows of 3.0-4.0%.

The NPV outcomes from the DCF analysis are summarised below. They represent the aggregate of the NPV outcomes from the separate DCF analysis of each of the Supermarkets, Coles Express and Coles Liquor businesses:

Supermarkets, Coles Express and Coles Liquor – NPV Outcomes ($ millions)

Discount rate	9.0%		10.0%	
Terminal value - growth rate in free cash flow	3.0%	4.0%	3.0%	4.0%
Scenario				
A	14,184	16,079	12,003	13,254
B	16,082	18,202	13,619	15,018

The EBITDA multiples implied by the terminal values for the Supermarkets business (i.e. the value of cash flows projected beyond the end of the explicit cash flow period) are set out below:

Supermarkets – Terminal Value EBITDA Multiples

Discount rate	9.0%		10.0%	
Terminal value – rate of growth in free cash flow	3.0%	4.0%	3.0%	4.0%
Scenario				
A	8.1	9.8	7.0	8.1
B	8.4	10.1	7.2	8.4

In Grant Samuel's view, these multiples are reasonable, having regard to the assumption that the Supermarkets business will have matured and will effectively be experiencing system rates of growth by the end of the explicit modelling period.

Grant Samuel's valuation range substantially reflects the values calculated under Scenario A. While there may be additional upside in the business (as modelled in Scenario B), in Grant Samuel's view an acquirer of the business would be unlikely to pay for this additional upside today. The outcomes represented by Scenario A in any event reflect substantially improved performance relative to current performance, and on that basis, the valuation of the business in the range $13.5-15.2 billion makes significant allowance for the upside potential in the business.

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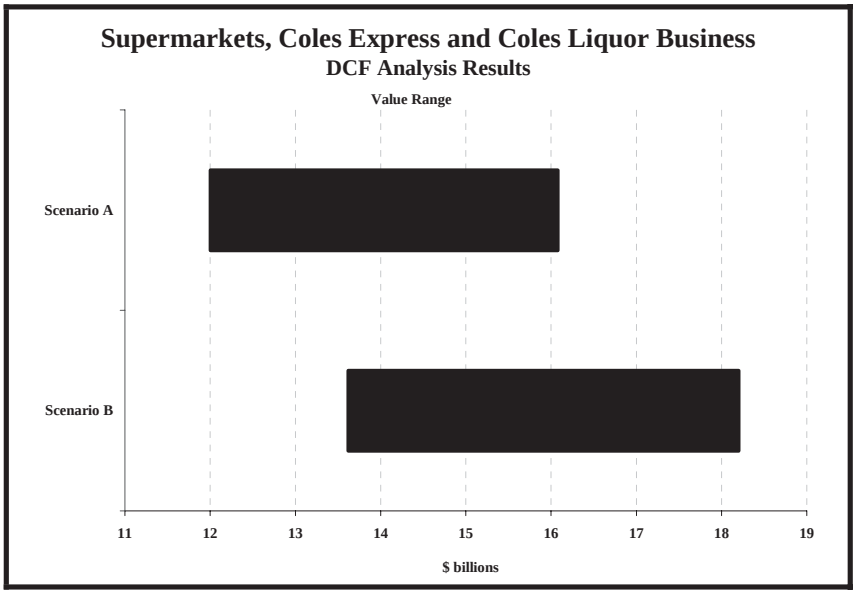
The valuation range is compared with the results of the DCF analysis in the following diagram:



8.4.4 Earnings Multiple Analysis

Grant Samuel has cross-referenced its valuations of each of the Supermarkets, Coles Express and Coles Liquor businesses on the basis of earnings multiple analysis. The analysis compares the earnings multiples implied by the valuations of each of the Supermarkets, Coles Express and Coles Liquor businesses with the earnings multiples implied by the share prices of comparable companies and by transaction values for transactions involving comparable businesses.

Transaction Evidence

There have been a large number of acquisitions of supermarket operators over the past decade as the industry has consolidated internationally. A detailed description of selected transactions is set out in Appendix 2.

The majority of comparable transactions involve international companies, with the exception of the acquisition of Foodland Associated Limited ("Foodland") by Woolworths/Metcash in November 2005. Foodland operated a major grocery wholesaler in Western Australia, the Action supermarket chain in Western Australia and Queensland, and the Progressive supermarket business in New Zealand. Woolworths acquired the Progressive supermarket chain and 22 Action stores. The estimated acquisition multiples paid by Woolworths (10.1 times historical and 9.9 times forecast EBITDA) reflected the benefits Woolworths would achieve from integrating the Action stores that it acquired into its existing Australian supermarket chain, and the supply chain and procurement cost benefits expected to be extracted from the Progressive business. The Metcash acquisition of the wholesale business and the balance of the Action chain was at significantly lower multiples (8.7 times historical and 6.9 times forecast EBITDA), reflecting the modest growth prospects for the wholesale business and Metcash's plans to resell individual Action stores to independent operators. The multiples implied by Grant Samuel's valuation of the Supermarkets, Coles Express and Coles Liquor business, while higher than the multiples for Foodland, are reasonable having regard to the upside potential in the business and the unique strategic opportunity that it presents.

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Many of the international comparable companies were involved in the retailing of general merchandise in addition to supermarket retailing. Therefore, they are not directly comparable to the Supermarkets, Coles Express and Coles Liquor businesses of Coles Group. In addition, there are significant differences in economic factors, market structures and regulatory frameworks for international supermarket operators. Nonetheless, they do give some guidance as to what potential acquirers may be willing to pay for the Coles Group's Supermarkets, Coles Express and Coles Liquor business.

The transaction evidence indicates that transactions involving supermarket operators have taken place at prices that imply a very wide range of multiples. A number of transactions took place at relatively high multiples (broadly in the range 12-14 times historical EBITDA and 10-11 times forecast year 1 EBITDA). These higher multiples generally reflected expectations of sizeable synergies or other growth opportunities. Grant Samuel's aggregate valuation of the Supermarkets, Coles Express and Coles Liquor business implies multiples in the range 12.3-13.9 times historical EBITDA and 17.5-19.7 times historical EBIT. For the Supermarkets business alone, the multiples are:

Supermarkets – Implied Earnings Multiples

	Low	High
Multiple of EBITDA		
Year ended 30 July 2006[35]	11.2	12.6
Year ended 29 July 2007[35]	12.5	14.1
Year ending 27 July 2008[36]	9.8	11.0
Multiple of EBIT		
Year ended 30 July 2006	15.2	17.2
Year ended 29 July 2007	18.2	20.5
Year ending 27 July 2008[37]	14.8	16.6

These multiples are consistent with the transaction evidence for the more highly priced transactions, which in Grant Samuel's view provides overall support for the valuation range having regard to:

- the strong earnings growth budgeted for the Supermarkets, Coles Express and Coles Liquor business for the 2008 financial year and the prospects for a substantial longer term improvement in the business;
- the unique acquisition opportunity presented by the Supermarkets, Coles Express and Coles Liquor business, given its extensive, non-replicable store network and its position as one of only two major participants in the Australian supermarket sector; and
- the fact that potential acquirers of Supermarkets, Coles Express and Coles Liquor business are unlikely to realise any significant synergies through acquiring the business.

There have also been a large number of acquisitions in the liquor and hotel sectors in Australia over the past decade, in part reflecting competition between Coles Group and Woolworths to secure liquor licences. A more detailed description of these transactions is set out in Appendix 2 of this report.

35 The implied multiples for the business unit are based on Coles Group's divisional EBITDA for statutory purposes, which are understated because depreciation incurred at a corporate level is recharged as an operating expense. This results in slightly higher EBITDA multiples than would be the case if the EBITDA was adjusted to recategorise this charge.

36 The implied multiples of 2008 EBITDA are based on the midpoint of the EBITDA in Grant Samuel's scenario outputs, which include an allocation of depreciation charged at the corporate level. The EBITDA is not on the same basis as the historical EBITDA.

37 The implied multiples of 2008 EBIT are based on the midpoint of the EBIT in Grant Samuel's scenario outputs.

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Much of the acquisition activity has been driven by the Queensland Government regulations which require that owners of liquor retail stores also hold hotel licences. Consequently, Coles Group and Woolworths have pursued, and continue to pursue, acquisitions in the hotel sector.

The most significant transaction during this period was the acquisition by Bruandwo Pty Limited ("Bruandwo") (a joint venture company owned 75% by Woolworths and 25% by Bruce Mathieson Group) of Australian Leisure & Hospitality Group Limited ("ALH") in February 2005. This highly competitive transaction involved bids from Newbridge Capital, as well as from a Coles Group/Macquarie Bank consortium. As a result, the transaction was completed at a relatively high multiple of 12.2 times historical EBITDA and 9.9 times forecast EBITDA, and 16.7 times historical EBIT and 13.1 times forecast EBIT. These multiples were significantly higher than previous multiples paid for liquor retailing businesses and ignited a period of consolidation in the sector. The acquisition provided Woolworths (through its Bruandwo joint venture) with an immediate and sizeable presence in the hotel and gaming sector and facilitated the expansion of its liquor retailing operations in the growing Queensland market. This transaction was closely followed by Bruandwo's acquisition of Taverner Hotel Group in October 2005 at a multiple of 9.2 times forecast EBITDA.

Coles Group's most recent and significant transaction in the liquor retailing industry was the February 2006 acquisition of Hedley Hotel Group. The multiple was estimated to be, based on brokers' estimates, approximately 8.5 times historical EBITDA. This acquisition was considered important strategically in strengthening the Coles Group's liquor retailing business, particularly in the fast-expanding far north Queensland market.

Internationally, transactions involving liquor retailing and hotel/gaming companies have generally been completed at multiples in the range of 9–11 times historical EBITDA, apart from the acquisition of Liquor Barn Income Fund, which was completed at significantly higher multiples reflecting the substantial synergies available from the transaction. The international transaction multiples are generally consistent with those of Australian transactions. While not directly comparable to those of Australian liquor retailing transactions because of differences in economic factors, market structures and regulatory frameworks, they do provide some guidance as to transaction multiples paid in this industry.

Sharemarket Evidence

The multiples of selected listed supermarket operators are set out in Appendix 3. The analysis covers both full service supermarkets, department stores, superstores and other retailers. The following factors are relevant to consideration of the comparable entity multiples:

- the multiples for the listed entities are based on share prices and therefore do not include a premium for control;

- none of the comparable companies is precisely comparable to the Supermarkets, Coles Express and Coles Liquor business, with differences in business mix, historical performance, outlook and other factors. The majority of supermarket operators are also retailers of general merchandise, generally through hypermarkets and/or department stores. Further, each comparable company has a different business mix, with varying interests in activities including liquor, consumer finance, online, pharmacy and property. Accordingly, it is difficult to identify trading multiples for "pure" supermarket operators;

- while Woolworths appears the most comparable (in terms of business mix and market environment), the Woolworths business has outperformed Coles Group by a significant margin. The multiples of earnings on which Woolworths is trading (13.6

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times historical EBITDA and 11.8 times year 1 forecast EBITDA and 17.4 times historical EBIT and 14.9 times year 1 forecast EBIT) reflect this outperformance and expectations of future strong growth. They are almost definitionally not relevant to the valuation of Coles Group (because Woolworths' earnings profile and market rating would almost certainly change materially if Coles Group's performance was to improve substantially);

- the selected international supermarket retailers operate in different economic conditions, market structures and regulatory frameworks. Accordingly, caution must be used in relying on the trading multiples of these companies;

- in the United Kingdom, there are a number of supermarket operators, including Tesco plc ("Tesco") (the largest grocery retailer in the United Kingdom, with interests in supermarkets, hypermarkets, convenience stores and general merchandise), and J Sainsbury plc ("Sainsbury") and Wm Morrisons Supermarkets plc. They trade at around 11-12 times historical EBITDA and 8-10 times forecast year 1 EBITDA, and a wider range of 14-25 times historical EBIT and 11-20 times year 1 forecast EBIT. The high multiples at which Tesco trades reflect its strong performance in recent years, while the high multiples for Sainsbury may reflect takeover speculation;

- Shoprite Holdings Limited and Pick 'n Pay Stores Limited in South Africa are both primarily supermarket operators with some general merchandise. They trade at around 8-9 times historical EBITDA and 7 times forecast year 1 EBITDA, and 10-12 times historical EBIT and 10 times forecast year 1 EBIT; and

- the primary listed supermarket retailers in the United States (with limited general merchandise offerings) are Safeway Inc, Supervalu Inc and Metro Inc, all of which trade at around 8 times historical EBITDA and 8 times forecast year 1 EBITDA, and 13-14 times historical EBIT and 10-15 times forecast year 1 EBIT. While Wal-Mart Stores Inc ("Wal-Mart") is the world's largest discount retailer, its business mix (which includes a sizeable general merchandise component) means that the multiples on which it is trading (8.6 times historical EBITDA and 7.7 forecast year 1 EBITDA, and 10.9 times historical EBIT and 10.2 forecast year 1 EBIT) are of less relevance to the valuation of Supermarkets.

Many of the supermarket operators considered in the above analysis have activities in liquor retailing (but often just within their supermarkets). There are also a number of liquor retailers and hotel operators that are separately listed, and provide market evidence upon which to consider the valuation of the Coles Liquor business. While there is often considerable overlap between companies involved in the hotel sector when the hotel includes a bottleshop, and liquor retailers, they tend to trade in the range 9-13 times historical EBITDA and 8-13 times forecast year 1 EBITDA, and 13-14 times historical EBIT and 12-13 times forecast EBIT (excluding Liquor Stores Income Fund and Mitchells & Butlers plc ("Mitchells & Butlers")). The Liquor Stores Income Fund acquired Liquor Barn Income Fund in May 2007, and therefore its historical multiples are not meaningful. Mitchells & Butler tends to trade on higher multiples than its peers, possibly reflecting its ownership of a significant portfolio of freehold property that it intends to sell into a property fund, thereby releasing value to shareholders.

A detailed analysis of the sharemarket trading values of listed companies primarily involved in retail liquor and hotels/gaming is set out in Appendix 3.

Coles Group has requested that Grant Samuel not disclose financial information for each of Supermarkets, Coles Express and Coles Liquor businesses on an individual basis for competitive reasons, and that Grant Samuel not disclose Coles Group's budgeted financial performance for the 2008 financial year.

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Nonetheless, Grant Samuel believes that the earnings multiples (both historical and prospective) implied by its valuations of the Supermarkets, Coles Express and Coles Liquor businesses are reasonable, taking account of the factors set out above and in the valuation commentary in Section 8.4.2 compared to listed companies in the same sector.

8.5 Kmart

8.5.1 Overview

Grant Samuel has valued Kmart in the range $1.55-1.75 billion.

The valuation represents the following multiples of earnings:

Kmart – Implied Earnings Multiples			
	Variable ($ millions)	Low	High
Multiple of EBITDA			
Year ended 30 July 2006[38]	131.2	11.8	13.3
Year ended 29 July 2007[38]	155.9	9.9	11.2
Multiple of EBIT			
Year ended 30 July 2006	76.0	20.4	23.0
Year ended 29 July 2007	96.8	16.0	18.1

Grant Samuel believes that the multiples of 2006 and 2007 earnings implied by the valuation are reasonable, having regard to the recent performance and prospects of Kmart. Grant Samuel has also cross-referenced its valuation against budgeted 2008 earnings, and believes that the multiples of budgeted 2008 earnings implied by the valuation are reasonable. At Coles Group's request, Grant Samuel has not disclosed the multiples of 2008 earnings implied by its valuation of Kmart.

8.5.2 Valuation Commentary

After a number of years of flat to declining sales and falling earnings, the Kmart business recorded significantly improved earnings in the 2007 financial year. EBIT recovered from $76.0 million for the 2006 financial year to $96.8 million for the 2007 financial year, although sales for 2007 were marginally lower than for the prior year. The turnaround in profitability followed the implementation of the Revitalisation strategy, which involved inventory reduction, a reduction and simplification in product range, a reallocation of store space to categories with better margins and more targeted promotional programs. In essence, the program has focussed the business on profitability rather than sales. The challenge for the business will be to continue to grow earnings through a return to positive sales growth.

Grant Samuel's valuation takes into account the following:

- the significant improvement in earnings achieved by Kmart in the 2007 financial year;
- the continued strong growth in earnings budgeted for the 2008 financial year, based on the resumption of sales growth and further improvement in margins. Sales are expected to strengthen based on improved product range, a more active store refurbishment program and the opening of new stores. Improvements in margins will

[38] The implied multiples for the business unit are based on Coles Group's divisional EBITDA for statutory purposes, which are understated because depreciation incurred at a corporate level is recharged as an operating expense. This results in slightly higher EBITDA multiples than would be the case if the EBITDA was adjusted to recategorise this charge.

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be supported by an increase in direct sourcing. Trading in the first few weeks of the 2008 financial year suggests that the positive trends of late 2007 are continuing;

- the opportunities for further growth in earnings in future years. Plans for longer term earnings growth are credible, based on the opportunity to substantially improve the store network (which appears to have received inadequate refurbishment expenditure in recent years), open new stores and continue the focus on profitable product appropriate to customer preferences. On the other hand, this process is not risk free. The business has yet to demonstrate the ability to revert to meaningful sales growth and the earnings improvements reflect positive trends that have only become clear in recent times. The sustainability of the recovery is still to be confirmed;

- the exposure of the business to changes in consumer confidence. Any deterioration in consumer confidence (whether through higher interest rates, weaker house prices, increased unemployment or otherwise) is likely to impact on future earnings;

- the risk of increased margin pressure from aggressive competition. Competition for market share could undermine Kmart's ability to grow sales and maintain improved margins; and

- the strategic value inherent in Kmart's extensive store network. Kmart's presence in shopping centres across Australia is a significant asset. It is possible that a potential purchaser could view the acquisition of Kmart as an opportunity to convert the store network (in part or in whole) to a more profitable format (or formats).

Kmart may have a significant strategic value to one or two specific acquirers that could realise material synergy benefits. The value of Kmart to these parties would be above Grant Samuel's range of $1.55-1.75 billion. While realisation of such value is possible, any transaction would face significant risks to completion (and could impact other Coles Group businesses).

8.5.3 Discounted Cash Flow Analysis

Grant Samuel's valuation of Kmart takes into account DCF analysis of the business.

The DCF analysis is based on two valuation scenarios. The scenarios are designed to represent the range of judgements that a potential acquirer of the business could make, having regard to the long term decline in Kmart's performance, the recent turnaround in profitability and management's expectation of further earnings growth. Given that the turnaround in the performance of the business is very recent and the absence of any meaningful track record in relation to sales growth, the scenarios are inevitably to some extent speculative.

For Scenario A, Grant Samuel has assumed modest sales growth at rates between 3.2% and 4.0% for the period to 30 July 2012. EBITDA[39] margins are assumed to increase from 4.9% in 2008 to 5.0% in 2012. The result is an increase in EBIT margin to 3.1% by 2012, and a growth in EBIT from $97 million for the 2007 financial year to $145 million for the 2012 financial year.

Scenario B incorporates more positive assumptions than Scenario A regarding sales growth and long term EBITDA and EBIT margins. Sales are assumed to grow at rates between 3.2% and 4.7% during the period to 30 July 2012, and EBITDA margins to increase from 4.9% in 2008 to 5.3% in 2012. The result is an increase in EBIT margin to 3.4% by 2012, and a growth in EBIT for the business from $97 million for the 2007 financial year to

[39] EBITDA includes the allocation of depreciation charged at a corporate level and is not directly comparable with segmental EBITDA as per Coles Group's statutory reporting.

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$162 million for the 2012 financial year. In Grant Samuel's view such an outcome would represent a strong result. Woolworths' Big W discount department store recorded an EBIT margin for the 2007 financial year of 4.0%.

Both Scenario A and Scenario B assume an increase in capital expenditure over the five year period, largely to fund store refurbishments and new store openings.

The key measures of financial performance for each scenario are presented in the following table:

Kmart DCF Analysis – Key Model Outcomes ($ millions)

	Financial Year				
	2008	**2009**	**2010**	**2011**	**2012**
Scenario A					
Revenue	4,013	4,157	4,315	4,488	4,667
EBITDA[40]	196	205	216	224	233
EBIT	120	123	130	138	145
EBIT margin	*3.0%*	*3.0%*	*3.0%*	*3.1%*	*3.1%*
Capital expenditure	92	70	70	71	72
Scenario B					
Revenue	4,013	4,187	4,350	4,556	4,742
EBITDA[20]	196	226	232	241	251
EBIT	120	144	146	155	162
EBIT margin	*3.0%*	*3.4%*	*3.4%*	*3.4%*	*3.4%*
Capital expenditure	92	71	70	72	73

Other parameters used in the DCF analysis are:

- discount rates of 9.5-10.5% are applied to nominal ungeared after tax cash flows. Appendix 1 sets out a detailed analysis of the selection of these discount rates; and
- the terminal value at the end of the explicit cash flow forecast period is based on nominal terminal growth rates of 3.0-4.0%.

The NPV outcomes from the DCF analysis are summarised below:

Kmart – NPV Outcomes ($ millions)

Discount rate	**9.5%**		**10.5%**	
Terminal value growth rate	**3.0%**	**4.0%**	**3.0%**	**4.0%**
Scenario				
A	1,403	1,596	1,212	1,348
B	1,536	1,747	1,327	1,475

[40] EBITDA includes the allocation of depreciation charged at a corporate level and is not directly comparable with segmental EBITDA as per Coles Group's statutory reporting.

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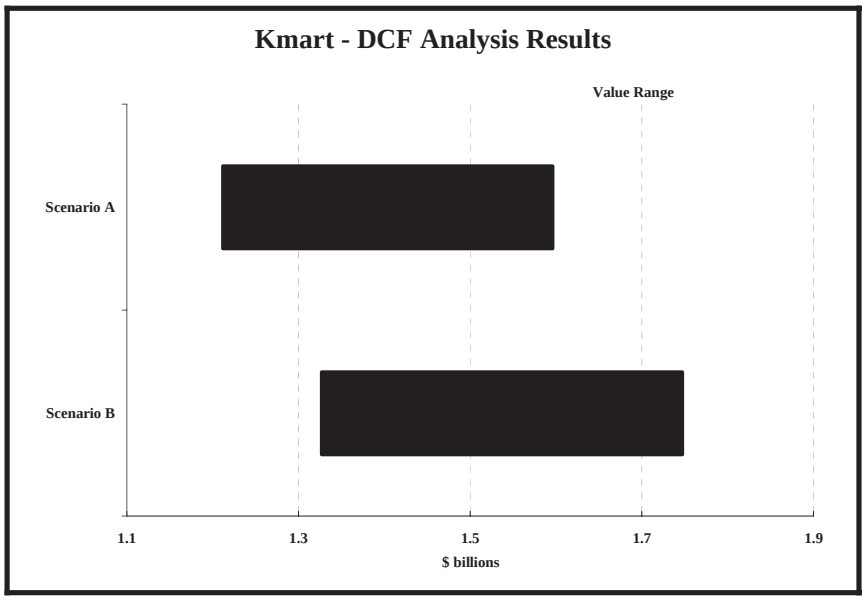
The EBITDA multiples implied by the terminal values for the Kmart business (i.e. the value of cash flows projected beyond the end of the explicit cash flow period) are set out below:

Kmart – Terminal Value EBITDA Multiples				
Discount rate	**9.5%**		**10.5%**	
Terminal value – rate of growth in free cash flow	**3.0%**	**4.0%**	**3.0%**	**4.0%**
Scenario				
A	6.9	8.2	6.0	6.9
B	7.0	8.3	6.1	7.0

Grant Samuel's valuation range is compared with the range of calculated NPV outcomes in the following chart.



Grant Samuel's valuation of Kmart in the range $1.55-1.75 billion is relatively high having regard to the results of the DCF analysis, although consistent with valuation evidence based on EBITDA multiple analysis. In Grant Samuel's view this is reasonable given the strategic value of the Kmart store network and the synergy benefits potentially available to a trade buyer, which are not fully reflected in the financial assumptions upon which the DCF analysis is based.

8.5.4 Earnings Multiple Analysis

Grant Samuel has cross-referenced its valuation of Kmart on the basis of earnings multiple analysis. The analysis compares the earnings multiples implied by the valuation of Kmart with the earnings multiples implied by the share prices of comparable companies and by transaction values for transactions involving comparable businesses. Grant Samuel believes that the earnings multiples (both historical and prospective) implied by its valuation of Kmart are reasonable, taking account of the factors set out in the valuation commentary in 8.5.2 above and having regard to the following:

- the earnings multiples for the comparable listed companies are based on sharemarket trading prices and therefore do not include a premium for control;

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- none of the comparable companies is precisely comparable to Kmart, with differences in business focus, historical performance, outlook and other factors; and

- the selected international retailers operate in different economic conditions, market structures and regulatory frameworks. Accordingly, caution must be used in relying on the trading multiples of these companies.

Transaction Evidence

There have been a large number of acquisitions in the department store sector over the past decade as the industry has consolidated. The majority of transactions have involved international companies, with few transactions in Australia. Appendix 2 summarises the historical and forecast EBITDA and EBIT multiples implied by some of the recent transactions involving global department stores. The evidence focuses on international transactions involving discount and middle market (rather than up-market) department stores.

While the transaction evidence shows that department store transactions have been completed at a wide range of earnings multiples, the evidence is generally consistent with the multiples implied by Grant Samuel's valuation of Kmart (10.3-11.5 times historical EBITDA). The following factors are relevant to consideration of the evidence:

- the selected transactions that have occurred over the past two years have all involved the acquisition of department stores by private equity groups, rather than by trade buyers. Generally, private equity buyers are not prepared to pay particularly high multiples for acquisitions, reflecting their limited ability to extract significant operational synergies. However, the evidence suggests that in recent times, private equity firms have been willing to pay higher multiples for department stores to reflect the potential for significant operational improvements at a number of the target companies. This potential is reflected in the transaction multiples for Myer, Dollar General Corporation ("Dollar General") and the Neiman Marcus Group Inc. On the other hand, the recent contraction in credit markets probably reduces the ability and willingness of private equity groups to pay high prices for these kinds of assets (except in particular circumstances);

- the only relevant transaction in Australia involving a major department store is the acquisition by Newbridge Capital of Myer. This transaction was completed at high multiples of 14.5 times historical EBITDA and 11.7 times forecast EBITDA, and 36.1 times historical EBIT and 23.4 times forecast EBIT. The high multiples reflect the underperformance of Myer prior to the acquisition, the expectation that significant cost savings could be achieved and (as subsequently became apparent) the availability of surplus assets that could be realised to materially reduce the effective purchase price;

- the (limited) transaction evidence for department stores in the United Kingdom and Europe shows that these transactions were completed on relatively low multiples of earnings (7 times historical and 6.2-6.5 times forecast EBITDA);

- the recent acquisition of Dollar General by KKR in North America was at multiples that represented a recent high water mark in terms of valuation multiples. This transaction was completed at 14.4 times historical EBITDA and 11.5 times forecast EBITDA, and 24.7 times historical EBIT and 17.4 times forecast EBIT. The multiples implied by the transaction are relatively high as Dollar General had been underperforming for a number of years and KKR expected both a turnaround in sales and cost savings to eventuate after the acquisition; and

- other recent transactions in the United States were generally concluded at multiples around the bottom end of or below the range of multiples implied by Grant Samuel's valuation of Kmart. The June 2004 acquisition of Target Corporation's Marshall

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Field's business by The May Department Stores Company at relatively high multiples may have reflected the opportunity for the realisation of significant synergies through the transaction.

Sharemarket Evidence

The earnings multiples implied by the valuation of Kmart are also generally consistent with the trading multiples for broadly comparable listed department stores (allowing for a control premium), although there is no directly comparable listed company in Australia. As noted in Section 8.4.4, the majority of international department stores also have varying interests in grocery retailing. Therefore, it is difficult to observe "pure" discount department store multiples for these companies. However, the trading multiples of these companies provide some market evidence against which to consider the valuation of Kmart.

The trading multiples for selected domestic and international listed retailers (including full service supermarkets, department stores, superstores and other retailers) are set out in Appendix 3. These multiples are based on share prices as at 29 August 2007 and do not incorporate a premium for control.

A review of sharemarket ratings of companies with significant interests in department stores indicates:

- The Warehouse Group Limited in New Zealand is one of the few "pure" listed discount department stores. It trades at significantly lower multiples than its peer companies in Australia (9.7 times historical EBITDA and 9.0 times forecast year 1 EBITDA, and 12.0 times historical EBIT and 11.3 times forecast year 1 EBIT), largely reflecting the underperformance of the business in recent years;

- David Jones is an Australian premium department store retailer. Its strong performance and premium position is reflected in the higher trading multiples of David Jones of 13.7 times historical EBITDA and 12.1 times forecast year 1 EBITDA, and 16.5 times historical EBIT and 14.5 times forecast year 1 EBIT;

- Harvey Norman is an Australian department store operator. However, it is primarily involved in the sale of furniture, electrical goods, computers, telecommunications, softline and hardline homeware and furnishings. In addition, it operates a franchise business model. Harvey Norman trades on multiples of 11.2 times historical EBITDA and 10.8 times forecast year 1 EBITDA, and 13.5 times historical EBIT and 12.8 forecast year 1 EBIT;

- all the European listed companies are involved in both grocery and department store retailing. They tend to trade at reasonably low multiples, in the range of 5–10 times historical EBITDA and 6-9 times forecast year 1 EBITDA, and 9-14 times historical and forecast year 1 EBIT;

- Marks & Spencer Group plc ("Marks & Spencer"), a pure department store operator focussed on clothing and food in the United Kingdom, trades on lower multiples of 9.1 historical EBITDA and 8.2 times forecast year 1 EBITDA, and 11.4 times historical EBIT and 10.6 times forecast year 1 EBIT. Marks & Spencer's clothing is targeted to the middle-market, and accordingly, it more akin to Target than Kmart; and

- United States companies involved in department store retailing primarily through the operation of hypermarkets generally trade in the range of 7-12 times historical EBITDA and 7-11 times forecast year 1 EBITDA, and 10-16 times historical EBITDA and 10-15 times forecast year 1 EBIT. Target Corporation is primarily involved in the department store sector, with limited grocery retailing. Target Corporation trades on multiples of 10.0 times historical EBITDA and 8.7 times forecast year 1 EBITDA, and 13.0 times historical EBIT and 11.7 times forecast year

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1 EBIT. Sears Holdings Corporation operates discount department stores and trades on multiples of 6.9 times historical EBITDA and 7.6 times forecast year 1 EBITDA, and 9.9 times historical EBIT and 11.6 times forecast year 1 EBIT. Wal-Mart is the world's largest discount retailer operating a range of store formats. Wal-Mart trades on 8.6 times historical EBITDA and 7.7 times forecast year 1 EBITDA, and 10.9 times historical EBIT and 10.2 times forecast year 1 EBIT.

8.6 Target

8.6.1 Overview

Grant Samuel has valued Target in the range $4.0-4.3 billion.

The valuation represents the following multiples of earnings:

Target – Implied Earnings Multiples

	Variable ($ millions)	Low	High
Multiple of EBITDA			
Year ended 30 July 2006[41]	294.7	13.6	14.6
Year ended 29 July 2007[41]	342.9	11.7	12.5
Multiple of EBIT			
Year ended 30 July 2006	248.3	16.1	17.3
Year ended 29 July 2007	290.0	13.8	14.8

Grant Samuel believes that the multiples of 2006 and 2007 earnings implied by the valuation are reasonable, having regard to the recent performance and prospects of Target. Grant Samuel has also cross-referenced its valuation against budgeted 2008 earnings, and believes that the multiples of budgeted 2008 earnings implied by the valuation are reasonable. At Coles Group's request, Grant Samuel has not disclosed the multiples of 2008 earnings implied by its valuation of Target.

8.6.2 Valuation Commentary

Target has delivered strong growth in earnings in recent years, based on steady sales growth and margin improvements. EBIT grew from $248 million for the 2006 financial year to $290 million for the 2007 financial year, and Target is budgeting for further EBIT growth (albeit at reduced growth rates) for the 2008 financial year. The valuation of the Target business reflects:

- the history of strong earnings growth following the successful turnaround and repositioning of Target since 2001;
- the unique middle-market position of Target in the Australian department store market. Target has developed a strong apparel business in a value fashion niche, in which it is subject to limited direct competition;
- the significant opportunities for growth via the roll-out of new stores across metropolitan and regional Australia. The number of Target stores has not increased significantly in recent years (on a net basis). Management is now planning to commence a more aggressive expansion of the store network;

[41] The implied multiples for the business unit are based on Coles Group's divisional EBITDA for statutory purposes, which are understated because depreciation incurred at a corporate level is recharged as an operating expense. This results in slightly higher EBITDA multiples than would be the case if the EBITDA was adjusted to recategorise this charge.

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- expectations of an increase in sales from the refurbishment and replacement of existing stores;
- expectations of improvements in EBIT margins through the further development of Target's direct sourcing and product development capabilities; and
- the potential to improve the sales mix, in particular by way of an increase in the proportion of higher margin apparel.

On the other hand:

- the apparel sector is subject to trends that can change quickly and are difficult to predict;
- Target's success may attract increased direct or indirect competition (e.g. an increasing focus by Myer on own branded product); and
- Target is planning for substantial growth in profitability over the medium term, underpinned by an aggressive store expansion program and ongoing cost reductions through the Coles Group Simplification program. While continued growth in profitability is credible, the magnitude of this growth is inevitably uncertain. Management plans, if realised, would effectively represent an unblemished run of sales and earnings growth over a period of almost ten years. Growth could be limited by a number of factors, including competition, external economic factors affecting consumer confidence and discretionary spending, and possible limits to the size of the market for Target's value based fashion apparel offering. As the business grows it is more likely to face increased competitive pressure.

8.6.3 Discounted Cash Flow Analysis

Grant Samuel's valuation of Target takes into account DCF analysis of the business.

Management is budgeting for moderate earnings growth in 2008 and planning for substantial growth thereafter, as the benefits of the aggressive store expansion program are realised. The planned medium term growth in earnings appears reasonable (at least in a directional sense) but a range of different views could reasonably be held in relation to future revenue and profit growth. The business has not yet demonstrated the ability to grow the store network at the rates planned.

Accordingly, the DCF analysis is based on two valuation scenarios, to examine a range of potential outcomes for the business.

In both scenarios Grant Samuel has assumed a significant expansion of the business:

- a store expansion program including greenfield sites in regional and metropolitan areas involving 12 new stores (18 new stores and 6 closed stores) in the 2008 financial year;
- the refurbishment and replacement of existing stores;
- significant capital expenditure to support the above two initiatives, totalling $101 million in the 2008 financial year, comprising new stores, replacement stores, refits and refurbishments and technology, and around $460 million over the following four years;
- a reduction in inventory by improving stock turn through improved planning and logistics processes and increased speed to market; and
- ongoing cost reductions through the Coles Group Simplification program.

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Scenario A is based on sales growth at rates between 7.0% and 8.0% during the period to 30 July 2012. EBITDA[42] margins are assumed to remain broadly constant as sales ramp up, at around 10.6%. The result is a modest decline in EBIT margin to 8.2% by 2012, and a growth in EBIT from $290 million for the 2007 financial year to $392 million for the 2012 financial year.

Scenario B assumes that the capital expenditure program, including new store builds and store refurbishments, has a more positive impact on lifting both sales and EBITDA margins than is assumed for Scenario A. Sales are assumed to grow at rates between 6.9% and 9.9% during the period to 30 July 2012, and EBITDA margins to improve from 10.6% in the 2008 financial year to 10.9% by the end of the 2012 financial year. The result is the maintenance of EBIT margins at around 8.5-8.6%, notwithstanding the strong sales growth, and a growth in EBIT for the business from $290 million for the 2007 financial year to $416 million for the 2012 financial year.

The key measures of financial performance for each scenario are presented in the following table:

Target DCF Analysis – Key Measures of Financial Performance ($ millions)

	Financial Year				
	2008	**2009**	**2010**	**2011**	**2012**
Scenario A					
Revenue	3,559	3,843	4,151	4,483	4,797
EBITDA[43]	378	408	441	476	511
EBIT	307	326	352	373	392
EBIT margin	*8.6%*	*8.5%*	*8.5%*	*8.3%*	*8.2%*
Capital expenditure	113	112	115	124	129
Scenario B					
Revenue	3,559	3,854	4,180	4,594	4,912
EBITDA[21]	378	409	445	498	535
EBIT	307	327	356	395	416
EBIT margin	*8.6%*	*8.5%*	*8.5%*	*8.6%*	*8.5%*
Capital expenditure	113	112	115	126	131

Other parameters used in the DCF analysis are:

- discount rates of 9.5-10.5% are applied to nominal ungeared after tax cash flows; and
- the terminal value at 29 July 2012 is based on nominal terminal growth rates of 3.0-4.0%.

42 EBITDA includes the allocation of depreciation charged at a corporate level and is not directly comparable with segmental EBITDA as per Coles Group's statutory reporting.

43 EBITDA includes the allocation of depreciation charged at a corporate level and is not directly comparable with segmental EBITDA as per Coles Group's statutory reporting. .

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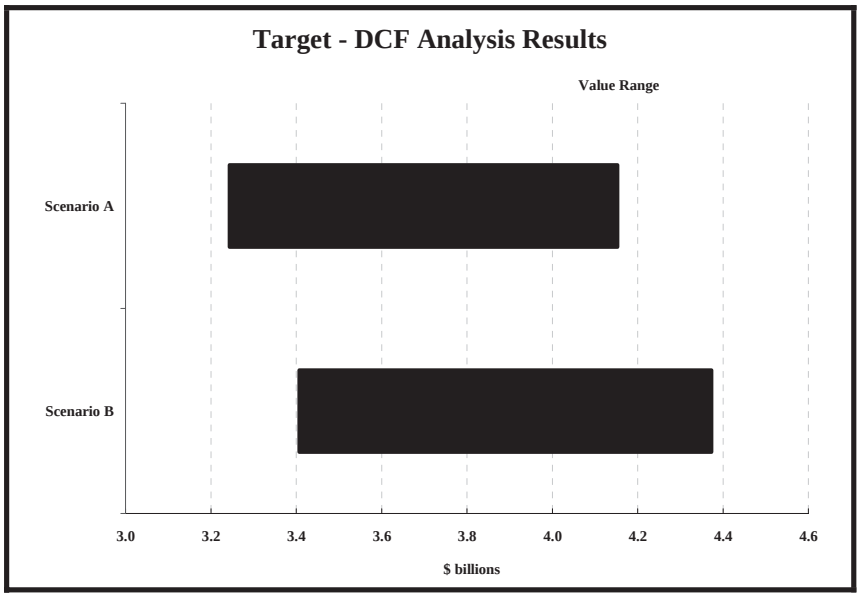
The NPV outcomes from the DCF analysis are summarised below:

Target – NPV Outcomes ($ millions)				
Discount rate	**9.5%**		**10.5%**	
Terminal value – rate of growth in free cash flow	**3.0%**	**4.0%**	**3.0%**	**4.0%**
Scenario				
A	3,762	4,153	3,243	3,505
B	3,957	4,373	3,407	3,685

The EBITDA multiples implied by the terminal values calculated in the DCF analysis are as follows:

Target – Terminal Value EBITDA Multiples				
Discount rate	**9.5%**		**10.5%**	
Terminal value – rate of growth in free cash flow	**3.0%**	**4.0%**	**3.0%**	**4.0%**
Scenario				
A	7.8	9.3	6.8	7.8
B	7.9	9.3	6.9	7.9

Grant Samuel's valuation of Target is at the high end of the range of net present values produced by the DCF analysis, reflecting the growth outlook for the business, its strong market position and the synergies that an in-market acquirer could potentially extract from the business (which are not included in the DCF analysis). A value range at the high end of the NPV outputs is also supported by the earnings multiple analysis.



8.6.4 Earnings Multiple Analysis

Grant Samuel has cross-referenced its valuation of Target on the basis of earnings multiple analysis. The analysis compares the earnings multiples implied by the valuation of Target with the earnings multiples implied by the share prices of comparable companies and by transaction values for transactions involving comparable businesses. Grant Samuel

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believes that the earnings multiples (both historical and prospective) implied by its valuation of Target are reasonable, taking account of the factors set out in Section 8.6.2 above and having regard to the following:

- the earnings multiples for the comparable listed companies are based on sharemarket trading prices and therefore do not include a premium for control;
- none of the comparable companies is precisely comparable to Target, with differences in business focus, market position, historical performance, outlook and other factors; and
- the selected international retailers operate in different economic conditions, market structures and regulatory frameworks. Accordingly, caution must be used in relying on the trading multiples of these companies.

Grant Samuel has considered the evidence as to earnings multiples from selected comparable department store transactions and sharemarket trading of comparable companies. The transaction and sharemarket trading evidence is detailed in Appendices 2 and 3. Section 8.5.4 summarises the valuation evidence from the analysis of comparable transactions and trading multiples.

Given Target's unique middle-market value fashion niche, the analysis of comparable transactions and trading multiples provides only limited evidence as to the value of Target. However, having regard to the differences between Target and the selected comparable companies, the multiples implied by Grant Samuel's valuation of Target are generally consistent with the transaction and sharemarket trading evidence.

8.7 Officeworks

8.7.1 Overview

Grant Samuel has valued Officeworks in the range $1.4-1.6 billion.

The valuation represents the following multiples of earnings:

Officeworks – Implied Earnings Multiples

	Variable ($ millions)	Low	High
Multiple of EBITDA			
Year ended 30 July 2006[44]	91.5	15.3	17.5
Year ended 29 July 2007[44]	104.4	13.4	15.3
Multiple of EBIT			
Year ended 30 July 2006	74.9	18.7	21.4
Year ended 29 July 2007	85.4	16.4	18.7

Grant Samuel believes that the multiples of 2006 and 2007 earnings implied by the valuation are reasonable. Grant Samuel has also cross-referenced its valuation against budgeted 2008 earnings, and believes that the multiples of budgeted 2008 earnings implied by the valuation are reasonable. At Coles Group's request, Grant Samuel has not disclosed the multiples of 2008 earnings implied by its valuation of Officeworks. Overall, the multiples are high. However, in Grant Samuel's view they are appropriate, given the recent performance of Officeworks, its prospects for continued earnings growth, and its unique

[44] The implied multiples for the business unit are based on Coles Group's divisional EBITDA for statutory purposes, which are understated because depreciation incurred at a corporate level is recharged as an operating expense. This results in slightly higher EBITDA multiples than would be the case if the EBITDA was adjusted to recategorise this charge.

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position in the Australian office products market as the only large store format retail operator.

8.7.2 Valuation Commentary

Officeworks has delivered steady growth in earnings in recent years, with EBIT growing 14% from $74.9 million for the 2006 financial year to $85.4 million for the 2007 financial year. Officeworks is budgeting for comparable earnings growth for 2008, underpinned by an expanded program of new store openings and store refurbishments, which is expected to support continued earnings growth in subsequent years. The valuation of the Officeworks business reflects:

- Officeworks' market leadership position in the Australia office products retail market. Officeworks has no direct competitors;
- the established store network of "big box" stores. Officeworks is the only Australian retailer using this format in the stationery/office products market. Given the extent of Officeworks' store network and the relatively limited size of the Australian market place, there are substantial barriers to entry for any potential competitor to Officeworks;
- the strong history of earnings growth and forecasts for future growth in sales and earnings, reflecting the planned refurbishment of the store network (including improvements to signage, merchandising and changes to store layout) and an accelerated roll-out of new stores;
- the potential to improve margins through changes to the product mix, increased direct sourcing and increased sale of private label products; and
- the benefits of the Officeworks Simplification program, which is expected to deliver material cost savings in the 2008 financial year.

On the other hand:

- the planned accelerated network expansion and store refurbishment program will require significant capital expenditure; and
- while Officeworks has no direct competitors, it will be continue to be subject to a range of indirect competition, including from online competitors and potential new entrants such as Harvey Norman.

8.7.3 Discounted Cash Flow Analysis

Grant Samuel's valuation of Officeworks takes into account DCF analysis of the business.

Management is budgeting for reasonable earnings growth in 2008 and planning for substantial growth thereafter, as the benefits of the aggressive store expansion program are realised and margins improved. The planned medium term growth in earnings is (at least in a directional sense) reasonable. However, the magnitude of the growth in earnings is less certain. In particular, management's plans are based on a significant lift in future margins. The extent of future margin growth is difficult to predict with any confidence. As the business grows it is more likely to face increased competitive pressure, which will tend to limit margin growth.

Accordingly, the DCF analysis is based on two valuation scenarios, to examine a range of potential outcomes for the business.

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Both scenarios are premised on a substantial capital expenditure program for Officeworks, at a cost of $36 million in 2008 and $146 million over the four subsequent years. The program is to focus on new stores, store productivity and in-store experience. In particular, the model assumes:

- an accelerated store expansion program including greenfields sites and new smaller store formats. It is assumed that 17 new Officeworks stores and 5 new Harris Technology stores are opened in the 2008 financial year, and a further net 15 stores in each of the following two years; and
- an extensive store refurbishment program targeting older and larger stores first, to improve the in-store experience.

In Scenario A, Grant Samuel has assumed sales growth at rates between 7.6% and 12.8% for the period to 30 July 2012. EBITDA[45] margins are assume to improve from 8.6% in 2008 to 9.3% in 2012, through the Simplification program and strategic initiatives including an improved merchandise mix, increased sales of housebrands and increased direct sourcing. The result is an increase in EBIT margins from 6.8% in 2008 to 7.2% by 2012, and a growth in EBIT from $85 million for the 2007 financial year to $148 million for the 2012 financial year.

Scenario B is based on the same rates of growth in sales as for Scenario A. However, Scenario B assumes that Officeworks is more successful in achieving planned margin improvements. EBITDA margins are assumed to increase from 8.6% in 2008 to 10.3% in 2012. The result is an increase in EBIT margins to 8.1% by 2012, and a growth in EBIT from $85 million for the 2007 financial year to $165 million for the 2012 financial year.

The key measures of financial performance for each scenario are presented in the following table:

Officeworks DCF Analysis – Key Measures of Financial Performance ($ millions)

	Financial Year				
	2008	**2009**	**2010**	**2011**	**2012**
Scenario A					
Revenue	1,424	1,582	1,748	1,904	2,048
EBITDA[46]	122	138	156	174	191
EBIT	97	109	121	137	148
EBIT margin	*6.8%*	*6.9%*	*6.9%*	*7.2%*	*7.2%*
Capital expenditure	41	41	38	39	39
Scenario B					
Revenue	1,424	1,582	1,748	1,904	2,048
EBITDA[22]	122	142	167	190	211
EBIT	97	111	129	148	165
EBIT margin	*6.8%*	*7.0%*	*7.4%*	*7.8%*	*8.1%*
Capital expenditure	41	41	38	39	39

45 EBITDA includes the allocation of depreciation charged at a corporate level and is not directly comparable with segmental EBITDA as per Coles Group's statutory reporting.

46 EBITDA includes the allocation of depreciation charged at a corporate level and is not directly comparable with segmental EBITDA as per Coles Group's statutory reporting.

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The discount rate and terminal value assumptions adopted for the DCF analysis are as follows:

- discount rates of 9.5-10.5% are applied to nominal ungeared after tax cash flows; and
- the terminal value at 29 July 2012 is based on nominal terminal growth rates of 3.0-4.0%.

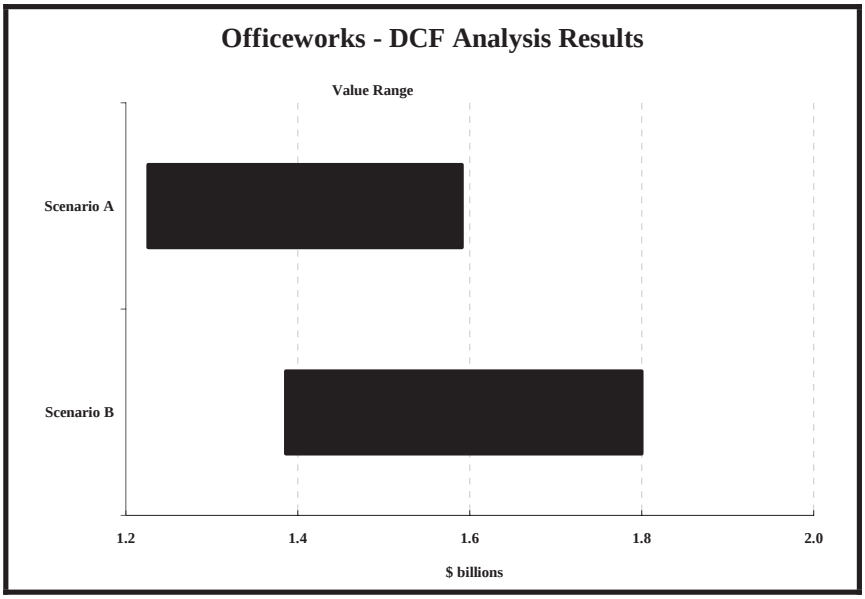
The NPV outcomes of the DCF analysis are summarised below:

Officeworks –NPV Outcomes ($ millions)				
Discount rate	**9.5%**		**10.5%**	
Terminal value growth rate	**3.0%**	**4.0%**	**3.0%**	**4.0%**
Scenario				
A	1,434	1,591	1,226	1,331
B	1,622	1,800	1,386	1,505

The EBITDA multiples implied by the terminal values calculated in the DCF analysis are as follows:

Officeworks – Terminal Value EBITDA Multiples				
Discount rate	**9.5%**		**10.5%**	
Terminal value – rate of growth in free cash flow	**3.0%**	**4.0%**	**3.0%**	**4.0%**
Scenario				
A	8.5	10.0	7.3	8.5
B	8.7	10.3	7.5	8.7

Grant Samuel's valuation of Officeworks of $1.4-1.6 billion at the top end of the range of values calculated for Scenario A. Effectively, the valuation captures substantial earnings upside, but recognises that there is greater risk associated with achieving the margin improvements assumed in Scenario B:



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8.7.4 Earnings Multiple Analysis

Grant Samuel has cross-referenced its valuation of Officeworks on the basis of earnings multiple analysis. The analysis compares the earnings multiples implied by the valuation of Officeworks with the earnings multiples implied by the share prices of comparable companies and by transaction values for transactions involving comparable businesses. The earnings multiples (both historical and prospective) implied by Grant Samuel's valuation of Officeworks are high by comparison with the evidence on earnings multiples. However, in Grant Samuel's view the multiples implied by the valuation are reasonable, taking account of the factors set out in the valuation commentary set out in Section 8.7.2 above and having regard to the following:

- the earnings multiples for the comparable listed companies are based on sharemarket trading prices and therefore do not include a premium for control;
- none of the comparable companies is precisely comparable to Officeworks, with differences in business focus, historical performance, outlook and other factors;
- the selected international retailers operate in different economic conditions, market structures and regulatory frameworks. Accordingly, caution must be used in relying on the trading multiples of these companies; and
- in particular, Officeworks is the only specialist Australian office products retailer with an extensive "big box" store network. It has the opportunity to continue to grow a category leading business in the office products market.

Transaction Evidence

Recent transaction evidence involving companies in the office supplies industry is contained in Appendix 2 to this report. The transaction evidence shows that acquirers have generally paid 9–12 times historical EBITDA and 8-10 times forecast year 1 EBITDA (except in relation to Andvord Tybring-Gjedde ASA ("Andvord") and Guilbert's Mail Order Business acquisition by Staples Inc ("Staples")). The transaction values implied a wide range of historical EBIT multiples.

Not all of the transactions analysed are directly comparable to Officeworks. A number of the target companies operated in specialist sectors of the office supply market such as electrical product supply and medical stationery. In addition, the major participants in Europe and North America are of significantly greater scale than Officeworks. On the other hand, Officeworks' status as the only "big-box" office supplies retailer in Australia means that its competitive position is more favourable than those of many participants in off-shore markets. The most relevant transactions upon which to benchmark the valuation of Officeworks are:

- the acquisition of OfficeMax by Boise Cascade Corporation in the United States. OfficeMax had nearly 1,000 superstores offering office products, business machines and office furniture. The acquisition was completed at 11.7 times historical EBITDA and 50.7 times historical EBIT, and 9.4 times forecast EBITDA and 22.6 times forecast EBIT, reflecting an expectation for considerable synergy benefits to be realised from the acquisition. Although OfficeMax is of a considerably larger scale than Officeworks, it operates a similar business and product model; and
- the acquisition of Andvord by Corporate Express N.V. (formerly Buhrmann N.V.). Andvord was a Norwegian company that offered a range of corporate supplies to the business market in the Nordic region. The acquisition was completed at 15.0 times historical EBITDA and 18.1 times historical EBIT and 10.7 times forecast EBITDA and 15.7 times forecast EBIT, reflecting an expectation for significant growth in the forecast year, and the realisation of substantial synergies.

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Sharemarket Evidence

Grant Samuel has reviewed sharemarket ratings of Australian and international listed office supplies companies. The sharemarket evidence is set out in Appendix 3. The following observations are made from the analysis:

- Corporate Express Limited ("Corporate Express Australia") is the only major listed participant in the Australian office supplies market. However, it focuses almost exclusively on servicing the corporate market and doesn't have a retail store presence. Corporate Express Australia is 59% owned by Corporate Express N.V., an international office supplies and computer retailer and wholesaler based in Amsterdam. Corporate Express N.V. trades on multiples of 6.8 times historical EBITDA and 7.4 times forecast year 1 EBITDA, and 9.1 times historical EBIT and 10.0 times forecast year 1 EBIT. Corporate Express Australia trades on multiples of 10.5 times historical EBITDA and 10.0 times forecast year 1 EBITDA, and 12.3 times historical EBIT and 11.4 times forecast year 1 EBIT; and

- North American office supplies companies currently trade on multiples of 7-9 times historical EBITDA and 6-9 times forecast year 1 EBITDA, and 8-14 times historical EBIT and 9-11 times forecast year 1 EBIT.

The following factors are relevant to consideration of the comparable entity multiples in relation to Officeworks:

- the selected North American office supply companies are significantly larger than the selected Australian office supplies companies, with extensive store networks;

- on the other hand, the selected North American office supplies companies may be subject to more direct competition than Officeworks; and

- all of the companies have a 31 December year end, except for Staples which has a 31 January year end.

8.8 Other Assets and Liabilities

Coles Group's other assets and liabilities have been valued as follows:

Coles Group – Other Assets and Liabilities ($ millions)

	Value Range	
	Low	**High**
Market value of properties as at 29 July 2007	720.0	740.0
Retirement benefit asset as at 29 July 2007	77.6	77.6
Mark-to-market value of hedge book as at 29 July 2007	(52.9)	(52.9)
Restructuring provisions as at 29 July 2007	(57.4)	(57.4)
Total other assets and liabilities	**687.3**	**707.3**

Source: Coles Group, Grant Samuel analysis

The restructuring provisions of Coles Group as at 29 July 2007 include provisions associated with redundancy, rebadgings, surplus lease space and the divestment of Myer.

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8.9 Corporate Costs

Coles Group incurs corporate overheads of approximately $65 million. These corporate overheads represent the unallocated costs of the Coles Group head office and include costs associated with:

- senior group executives (such as costs associated with the offices of the Chief Executive Officer and Chief Financial Officer) and Directors;
- being a listed company (such as annual reports and shareholder communications, share registry and listing fees and dividend processing); and
- group services costs (such as corporate affairs, finance, tax, treasury, audit and human resources).

Corporate overheads exclude costs associated with the management of the businesses of the Coles Group, which are reflected in the valuation of the business operations.

Any acquirer of Coles Group would be able to save the costs associated with being a publicly listed company, and a significant proportion of other unallocated head office costs. Grant Samuel has assumed residual corporate costs of $25 million for the purpose of the valuation (i.e. costs remaining after the savings available to an acquirer), which have been capitalised at a multiple of 10-11 times.

8.10 Net Borrowings

The valuation of Coles Group incorporates net borrowings of $1.3 billion. This is based on net borrowings at 29 July 2007, adjusted to exclude cash in tills and the cash that would be received upon the exercise of outstanding options, as follows:

Coles Group – Net Borrowings for Valuation Purposes	
	$ millions
Net borrowings as at 29 July 2007 (excluding cash in tills)	(1,312.6)
Cash received from the exercise of options	43.4
Net Borrowings for Valuation Purposes	**(1,269.2)**

Source: Coles Group

8.11 Franking Credits

No value has been attributed to Coles Group's accumulated franking credit balance of $356.7 million in the context of the value of Coles Group as a whole. Under Australia's dividend imputation system, domestic equity investors receive a taxation credit (franking credit) for tax paid by a company. The franking credit attaches to any dividends paid by a company and the franking credit offsets personal tax for Australian investors. To the extent that personal tax has been fully offset the individual will receive a refund of the balance of the franking credit.

In Grant Samuel's opinion, while acquirers are attracted by franking credits there is no clear evidence that they will actually pay extra for a company with them (at any rate the sharemarket evidence used by Grant Samuel in valuing the Coles Group businesses will already reflect the value impact of the existence of franking credits). Further, franking credits are not an asset of the company in the sense that they can be readily realised for a cash sum that is capable of being received by all shareholders. The value of franking credits can only be realised by shareholders themselves when they receive distributions. Importantly, the value of franking credits is dependent on the tax position of each individual shareholder. To many shareholders (e.g. overseas shareholders) they will have very little or no value.

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9 Value of the Consideration offered by Wesfarmers

9.1 Summary

Under the Wesfarmers Proposal, Coles Group shareholders who choose the Base Offer Consideration will receive for each Coles share:

- $4.00 in cash;
- 0.14215 Wesfarmers ordinary shares; and
- 0.14215 Wesfarmers PPS.

Shareholders can also elect to participate in the mix and match facility. For the purpose of the transfer of interests between Coles Group shareholders under the mix and match facility, Wesfarmers shares will be valued at the VWAP over the five trading days from the date on which the Scheme becomes effective.

All Coles Group shareholders will be entitled to the fully franked final dividend of 25 cents per share in relation to the year ended 29 July 2007. However, Coles Group shareholders will not participate in the final Wesfarmers dividend.

Grant Samuel has analysed the effect on the Wesfarmers share price of the commencement of trading in Wesfarmers shares on an "ex dividend" basis, having regard to interim and final dividends in recent years. The analysis suggests that it is reasonable to expect the Wesfarmers share price to fall by the amount of Wesfarmers' final dividend (i.e. without any further adjustment for the franking credit attached to the dividend). Accordingly, Grant Samuel has assumed that the Wesfarmers share price will fall by approximately $1.40 when Wesfarmers shares commence to trade ex dividend.

Grant Samuel has attributed a total value to the Base Offer Consideration of $14.87-15.44 per Coles Share, based on a Wesfarmers share price of $38.00-40.00 and a dividend drop off of $1.40. The value attributed to the Base Offer Consideration is summarised as follows:

Value of Wesfarmers Base Offer Consideration per Coles Group Share ($)

	Value Range	
	Low	**High**
Cash	4.00	4.00
Wesfarmers ordinary shares ($36.60-38.60) x 0.14215	5.20	5.49
Wesfarmers PPS ($38.10-40.10) x 0.14215	5.42	5.70
Final Coles Group dividend	0.25	0.25
Total Base Offer Consideration value per Coles Group share	**14.87**	**15.44**

The actual value of the Base Offer Consideration will vary with movements in the Wesfarmers share price. The final value of the Base Offer Consideration could ultimately exceed or be less than the range of $14.87-15.44 set out above. Significant movements could change the overall evaluation of the Wesfarmers Proposal.

The after tax value of the Base Offer Consideration will vary depending upon the particular taxation position of individual shareholders. For some shareholders, the ability to defer taxation through roll-over relief in relation to the scrip component of the consideration (including the PPS) will be attractive. The Coles Group final dividend of $0.25 per share will be fully franked and the franking credits have additional value of up to 10.7 cents per share (not included in the range $14.87-15.44) for shareholders who can make full use of them.

Given the value exchange mechanism of the mix and match facility (whereby shares are exchanged for cash at the VWAP over the five trading days from the date on which the Scheme

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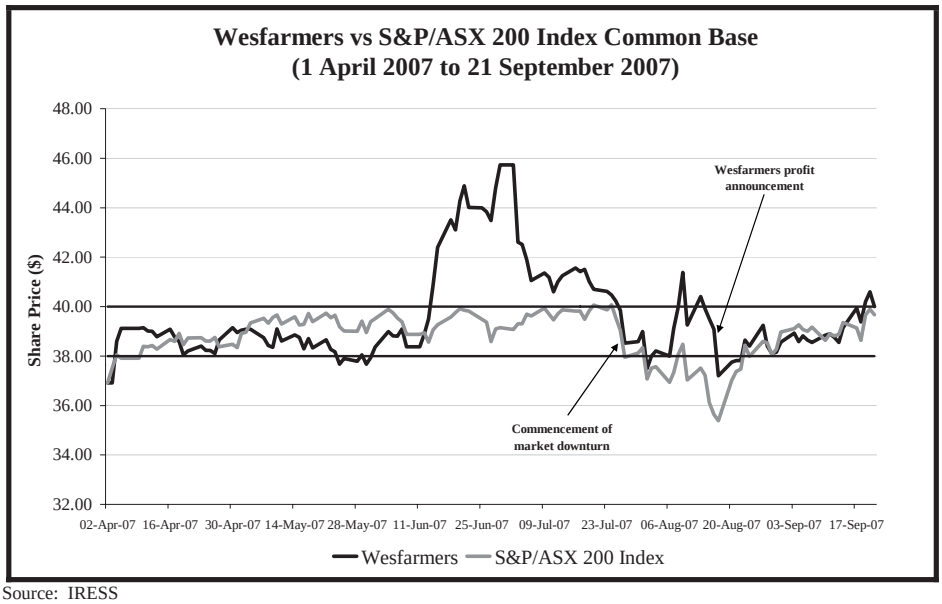
becomes effective), the outcomes for Coles Group shareholders should have similar headline values to the Base Offer Consideration. However, the effective after tax values may be different, depending upon the personal tax positions of individual shareholders. Grant Samuel makes no recommendation as to whether Coles Group shareholders should choose the Base Offer Consideration or participate in the mix and match facility. Coles Group shareholders who are in any doubt should seek their own professional advice.

9.2 Value of Wesfarmers Ordinary Shares

Assessment of the value of the Base Offer Consideration requires an estimate of the likely trading price of Wesfarmers ordinary shares at the time that the Wesfarmers Proposal becomes effective. It is normal practice to use the current market price as the starting point for estimating the value of the offer, particularly for large companies such as Wesfarmers that enjoy reasonable share liquidity and are followed by a number of analysts and other commentators (adjusted for any likely effects of the transaction not already reflected in market trading). It is usual to focus on the post announcement price as this will incorporate the market's assessment of the impact of the transaction on the offeror's business and market rating.

However, judgements regarding the likely trading price of Wesfarmers shares (or even a range of likely trading prices) are difficult. The Wesfarmers share price has fluctuated significantly in recent times (and its volatility is well above historical norms).



Source: IRESS

During April, May and the first two weeks of June 2007, Wesfarmers shares traded reasonably consistently in the range $38.00-40.00 (with a VWAP of $38.82). During the last two weeks of June 2007, the Wesfarmers share price strengthened considerably, reaching an all time closing high of $45.73 immediately before the announcement of the Initial Wesfarmers Proposal on 2 July 2007. The increase appears to have coincided with a general re-rating of stocks with exposure to coal that occurred at around this time.

Following the announcement of the Initial Wesfarmers Proposal, the Wesfarmers share price fell significantly. Wesfarmers shares generally traded in the range $40.00-42.00 for most of July, before falling further as the overall market weakened at the end of July 2007. During August 2007, Wesfarmers shares generally traded in the range $38.00-40.00, with a VWAP of $38.77.

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Following announcement of the revised Wesfarmers Proposal on 5 September 2007, (which provided greater certainty for Coles Group shareholders and appeared to increase market confidence that the Wesfarmers Proposal would proceed, the Wesfarmers share price strengthened. Wesfarmers shares have traded in the range $38.55.-40.60 since that announcement (to 21 September 2007).

There are a number of factors that suggest that the recent Wesfarmers share price may not be representative of the price at which Wesfarmers shares would trade at the time of implementation of the Wesfarmers Proposal:

- the recent Coles Group share price (which has generally been less than the "see-through" value implied by the Wesfarmers share price) indicates that the market is pricing in some risk that the Wesfarmers Proposal will not proceed. It is possible (although not certain) that the Wesfarmers share price will strengthen as the market becomes more confident that the Wesfarmers Proposal will complete;

- Coles Group's 2007 results were not released until 19 September 2007. Wesfarmers' share price prior to this date may therefore not reflect full information about Coles Group's performance and prospects. However, a review of the commentary suggests that there were, in broad terms, no major surprises;

- the market has to date had limited financial information on the merged group. The Scheme Booklet discloses a decline in pro forma earnings per share for the merged Wesfarmers/Coles Group for the 2007 financial year (relative to earnings for Wesfarmers on a standalone basis). On the other hand:

  - both companies are large enough to be closely followed by analysts and many will have been able to estimate the merged group's financials in any event; and

  - the market is focussed on prospective, rather than historical, earnings. In the case of Coles Group, the market's value judgements are also likely to reflect assessments of the medium term upside potential of the Supermarkets group;

- the market has limited visibility on 2008 earnings for either Wesfarmers or Coles Group as no internal forecasts have been released by either company. However, Grant Samuel's review of the Wesfarmers 2008 budget indicates that it is not inconsistent with market analyst forecasts;

- the Wesfarmers Proposal (if it proceeds) will fundamentally change the nature of Wesfarmers. On one view Wesfarmers will be transformed from a diversified conglomerate to a very large retailer, with a variety of much smaller businesses arguably inconsistent with the core retail focus. The implications of this transformation and the longer term structural consequences for Wesfarmers and, in particular its market rating, are not clear; and

- there have been suggestions that hedge fund and arbitrage trading in Coles Group and Wesfarmers may have depressed the Wesfarmers share price following the announcement of the Wesfarmers Proposal.

The Wesfarmers share price will also continue to be exposed to the risk of overall sharemarket volatility during the period up to implementation.

Notwithstanding these issues, in Grant Samuel's view the recent Wesfarmers share price range of $38.00-40.00 is the best current estimate of the likely Wesfarmers ordinary share price at the time of implementation of the Wesfarmers Proposal.

While an attempt could be made to estimate the post transaction market value of Wesfarmers share price using fundamental analysis (e.g. earnings multiples, DCF) , Grant Samuel does not believe this would be useful to shareholders. Grant Samuel has no better information on Wesfarmers medium term prospects than the market as a whole (it has no access to Wesfarmers internal

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medium term forecasts). In any event, the consensus view of the market is likely to be a more reliable estimate than a single observer.

In addition:

- Wesfarmers is a highly diversified conglomerate which makes valuation difficult. The aggregate value of individual businesses (even on a portfolio basis) is not necessarily the same as the way in which the market will judge the value of the company as a whole and there is no direct comparable company;
- pro forma forecasts for the combined company have not been prepared;
- while Wesfarmers has released some information on its plans and financial estimates of savings for Coles Group, Grant Samuel is not privy to Wesfarmers' detailed plans or expected synergy benefits; and
- the Coles Group businesses will represent a significant proportion of the combined group. Wesfarmers' share price will be materially impacted by perceptions about its ability to execute the turnaround.

Accordingly, Grant Samuel believes that the post announcement trading is likely to be the most reliable value benchmark for Coles Group shareholders.

Given that Coles Group shareholders will not receive the Wesfarmers final dividend of $1.40 per share, Grant Samuel has used a Wesfarmers share value in the range $36.60-38.60 for the purpose of attributing value to the Base Offer Consideration.

9.3 Value of Wesfarmers Partially Protected Shares

In valuing the PPS the uncertainty attached to the value of Wesfarmers ordinary shares is compounded by the uncertainty of the value of the PPS features. There is no existing market for PPS and they are relatively complex instruments. Valuation of the PPS requires the use of sophisticated mathematical models.

The PPS can be characterised as an ordinary Wesfarmers share but:

- with a right to receive value of $45.00 (in ordinary shares) if Wesfarmers shares are worth less than $45.00 at reclassification date or Wesfarmers choose to reclassify the PPS ahead of this date. This is akin to having a 4 ½ year put option exerciseable at $45.00;
- below a Wesfarmers share price of $36.00 the value protection is incomplete because the maximum bonus share issue per PPS remains at 0.25 of an ordinary share. Effectively, a holder of PPS is short 1.25 puts at $36.00. Notionally, a shareholder would need to acquire 1.25 put options exerciseable at $36.00 for the same period in order to ensure that the main put option was fully effective; and
- with the risk that, if the Wesfarmers share price trades above $45.00 for more than 20 days, the PPS will automatically be reclassified as ordinary shares and the downside protection will be lost. This feature means that the options described above are "barrier options" where the puts are "knocked out" when the share price breaches the $45.00 limit.

Using this approach, the theoretical value of a PPS could be assessed as being:

Value of a Wesfarmers share
\+ *value of a 4 ½ year put option at $45.00*
\- *cost of acquiring 1.25 put options at $36.00 with the same terms*
(where both the $45.00 and $36.00 puts are barrier options with knockouts at $45.00).

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Grant Samuel has calculated the incremental value of the PPS using this approach and valuing the implicit options using a Black-Scholes formula modified for the "up and out" knock out barrier features, in order to take into account the risk of an early reclassification of the PPS as ordinary shares. The key assumptions are:

- maturity of 4.5 years;
- risk free rate of 6.2%;
- volatility of 20%; and
- Wesfarmers' ordinary dividend yield is based on a dividend of $2.00 per share.

The analysis has been undertaken on two bases for the estimate of the current share price of $38.00-40.00:

- a cum dividend price; and
- an ex dividend price, allowing for the payment of the $1.40 dividend, of $36.60-38.60.

The results are summarised below:

Indicative Theoretical Incremental Value of PPS

	Wesfarmers Ordinary Share Price			
	$38.00		$40.00	
	Excluding Franking Credits	Including Franking Credits	Excluding Franking Credits	Including Franking Credits
Cum Dividend				
Put option @ $45.00	4.76	6.09	3.26	4.23
1.25 Put options @ $36.00	(3.15)	(4.22)	(2.13)	(2.89)
Incremental value of PPS	1.61	1.87	1.13	1.34
Ex Dividend				
Put option @ $45.00	5.88	7.45	4.30	5.53
1.25 Put options @ $36.00	(3.94)	(5.23)	(2.83)	(3.81)
Incremental value of PPS	1.94	2.22	1.47	1.72

Grant Samuel has also considered the value:

- using the binominal method to value the options; and
- recasting the PPS as a bond with a call option at $45.00 (and risk exposure below $36.00).

However, in Grant Samuel's view the analysis described above provides a better approach to the theoretical value of the PPS.

The table shows that as the Wesfarmers share price increases towards $45.00, the incremental value of the PPS declines. The PPS lose all incremental value if Wesfarmers shares trade above $45.00 (following which the PPS would automatically convert). It is also notable that:

- the early conversion feature has a material negative impact on value. If it was not included the net incremental value would be more than double that shown above; and
- a higher volatility factor would reduce value.

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The values shown above do not take into account some features of the PPS that would affect theoretical value:

- the PPS are automatically reclassified as ordinary shares if the Wesfarmers share price exceeds $45.00 for 20 consecutive days. However, the mathematical models used in the analysis set out above effectively assume reclassification if Wesfarmers shares trade above $45.00 on any single occasion. As this is a more demanding test, the analysis set out above understates the theoretical value of the PPS;

- the PPS can be extended for up to a further four years if the S&P/ASX 200 Industrials Index remains below 6,500 (the index is currently around 7,000). This means that if the overall market remains weak (or collapses but does not recover to current levels) PPS holders are at risk of not being able to recover their $45.00 in value for an extended period. This feature detracts from value but is not reflected in the analysis above; and

- if additional shares are issued (i.e. the price is below $45.00) there will be a dilutionary impact on the ordinary shares.

It is difficult to put a precise value on these features. For example:

- the 20 day test is extremely difficult to model. Among other things, it would be necessary to determine the probability of the share price remaining above $45.00 for 20 days if it reached it once;

- the extendibility feature is a series of four separate events each with its own probability but dependent on the previous one occurring. Grant Samuel's research indicates that for the relevant index it has never been less than it was four years previously, but the series only allows analysis from 2004. For the S&P/ASX All Ordinaries Index, the index has been less than it was four years previously on approximately 7% of occasions over the last 24 years; and

- the dilution effect on ordinary shares is variable depending on the Wesfarmers share price.

In any event, it is necessary to take a broader view of the likely market trading price. It is important not to overemphasise the outputs of the financial models which are subject to significant limitations and involve simplifying assumptions. The aggregate market value of the PPS will be approximately $7 billion. Normal turnover will see a significant supply of stock over time. It is unclear how much natural demand there will be from investors prepared to pay such a premium over the price of Wesfarmers ordinary shares. There will of course be trading opportunities for professional investors (hedge funds etc.) but it is also unclear to what extent they will be able to undertake effective arbitrage strategies (complicated by the 4 ½ year term, early conversion and extendibility features) in sufficient volume to match the supply.

In these circumstances a cautious approach to valuing the PPS is warranted. Grant Samuel has assessed value as a premium to the ordinary share price for the purposes of valuing the Base Offer Consideration:

- a premium of $1.50–2.00 at an ordinary share price of $38.00; and

- a premium of $1.00–1.50 at an ordinary share price of $40.00.

This is, to a degree, an arbitrary judgement but it is considered reasonable. The width of the range reflects the inherent uncertainty. These values are not inconsistent with the estimates of analysts that follow Coles Group or Wesfarmers.

Taking into account the Wesfarmers final dividend of $1.40 (which Coles Group shareholders will not receive), Grant Samuel has attributed a range of values of $38.10-40.10 to the Wesfarmers PPS for the purpose of valuing the Base Offer Consideration.

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10 Evaluation of the Wesfarmers Proposal

10.1 Conclusion

In Grant Samuel's view the Wesfarmers Proposal is in the best interests of Coles Group shareholders. The Wesfarmers Proposal does not deliver a full premium for control. However, unless a superior alternative proposal emerges before the Scheme meeting, Coles Group shareholders are likely to be better off voting in favour of the Wesfarmers Proposal.

Assessment of the Wesfarmers Proposal is not straightforward. Valuation of Coles Group is subject to uncertainty and a wide range of valuation conclusions could credibly be reached. This uncertainty has been exacerbated by the recent volatility in financial markets. Similarly, there is uncertainty regarding the value of the consideration (which largely consists of equity in the expanded Wesfarmers). Accordingly, valuation analysis can provide no more than partial guidance as to whether the Wesfarmers Proposal is in the best interests of Coles Group shareholders. Other considerations include the circumstances that led to the Wesfarmers Proposal, the recent trading performance of Coles Group and the alternatives available to Coles Group should the Wesfarmers Proposal be rejected. The assessment of the Wesfarmers Proposal is an overall conclusion having regard to all these considerations.

Grant Samuel has valued Coles Group in the range $19.6-22.0 billion, or $16.21-18.23 per share. The valuation reflects the estimated full underlying value of Coles Group's businesses. The valuation range exceeds the price at which Grant Samuel would expect Coles Group shares to trade in the absence of the Wesfarmers Proposal or of speculation regarding some alternative corporate transaction.

The Supermarkets, Coles Express and Coles Liquor business represents around 65% of the total enterprise value of Coles Group. The Supermarkets business has traded poorly during the year to 29 July 2007, particularly in the second half of the year. While the current performance is a factor, the valuation of the Supermarkets business also takes into account the strategic attractions of the business, its extensive and non replicable store network and the potential for a turnaround in performance over the medium term. Based on international and local comparisons, the turnaround potential is substantial and this needs to be reflected in the valuation. However, assessment of the fair value today must be tempered by the extent of the restructuring steps yet to be taken and the associated execution risks. The future performance of the Supermarkets business is also likely to be influenced, perhaps materially, by competitor behaviour. Widely differing views could reasonably be adopted in relation to the timing and magnitude of a future turnaround in the business and the capital costs and other investment required to achieve that turnaround. The valuation of Target and Officeworks reflects their ongoing strong performance.

Grant Samuel has attributed a value of $14.87-15.44 per Coles Group share to the Base Offer Consideration. This value range is based on a Wesfarmers ordinary share price in the range $38.00-40.00, adjusted for the final Wesfarmers dividend of $1.40. The PPS have been valued at a premium of $1.00-1.50 (for a $40.00 share price) and $1.50-2.00 (for a $38.00 share price) over the value of a Wesfarmers ordinary share. The Wesfarmers share price has fluctuated significantly since the announcement of the Wesfarmers Proposal, falling from a high of $45.73 immediately prior to the announcement of the Wesfarmers Proposal to lows in mid-August of $37.15. In these circumstances judgements about the value of the consideration are inevitably imprecise. The value of the consideration will fluctuate with movements in the Wesfarmers share price such that the Base Offer Consideration may ultimately be greater or less than the range of values adopted by Grant Samuel of $14.87-15.44. For some shareholders (to the extent that they receive Wesfarmers shares and PPS under the Wesfarmers Proposal), roll-over relief may increase the effective after tax value of the consideration.

The value attributed to the Base Offer Consideration of $14.87-15.44 per Coles Group share is less than Grant Samuel's estimate of the full underlying value of Coles Group of $16.21-18.23. Accordingly, the Wesfarmers Proposal is not currently in the fair value range, and this suggests that Coles Group shareholders are not receiving a full premium for control under the Wesfarmers Proposal.

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It can be argued that Coles Group shareholders need not accept an offer that is not "fair":

- alternative proposals could emerge. The value of the consideration has fallen significantly since the announcement of the Wesfarmers Proposal and this may encourage other parties, particularly those that previously participated in the Coles Group sale process, to re-enter the process (notwithstanding the current difficult credit market conditions). There is ample time for an alternative proposal to be made before the Scheme meeting. Wesfarmers' 12.1% voting power in Coles Group would not be an insurmountable impediment to an alternative offer;

- if the Wesfarmers Proposal is rejected, Wesfarmers might improve its offer; and

- while a return to the "status quo" is not realistic, Coles Group could ultimately deliver value above $16.21-18.23 per share through a successful turnaround of the Supermarkets business (possibly in conjunction with an equity partner), albeit over the medium term. Such a strategy could be undertaken in conjunction with a sale or spin off of businesses such as Target and Officeworks. The organisation does require a major revamp, including substantial management revitalisation across the Supermarkets business and other structural changes, but a turnaround under Coles Group ownership cannot be ruled out. Wesfarmers' plans for the Supermarkets business are not dramatically different to those of Coles Group and Wesfarmers will also need to recruit new management. It should be recognised that there are substantial risks associated with the turnaround of the Supermarkets business, whether under Coles Group or Wesfarmers ownership.

The offer process has coincided with a low point in the performance of the Supermarkets business, a period of negative market sentiment towards the company and adverse external market conditions. It may therefore not be a propitious time for shareholders to sell.

On the other hand:

- given the inherent uncertainty regarding valuation judgements for Coles Group, the conclusion that the Wesfarmers Proposal is not "fair" needs to be treated with some caution. The Wesfarmers Proposal was the outcome of an extensive worldwide sale process and was the only firm offer for all of Coles Group. On one view, the highest price secured through a comprehensive sale process by definition represents full underlying value. Notwithstanding the subsequent fall in the Wesfarmers share price (and consequent reduction in the value of the consideration), the Wesfarmers Proposal remains the only proposal available to Coles Group shareholders. If no superior proposal is received prior to the Scheme meeting it could be argued that the Wesfarmers Proposal still represents full value;

- having enhanced its offer through the introduction of PPS, the prospects of Wesfarmers increasing its offer are not high. In addition, the prospects of an alternative offer may be diminished because of the provisions of the (amended) Scheme Implementation Agreement;

- the Wesfarmers share price has fallen sharply from more than $45.00 on the announcement date to its current levels of $38.00-40.00. In part, this fall may be attributable to overall weakness in equity markets during this period but it is likely that the fall also reflected specific factors such as hedge fund and arbitrage activity, some adverse reaction to the proposal and Wesfarmers' results announcement. There is an argument (but no certainty) that the price has been temporarily depressed and that Wesfarmers shares would trade higher once the market settles and if the Wesfarmers Proposal is successfully implemented;

- continued ownership uncertainty is likely to be damaging for the Supermarkets business. There is an urgent need to strengthen Supermarkets' management team, but it is difficult to attract high quality candidates in the current circumstances. Further, the achievement of the full turnaround in the Supermarkets business may require such profound changes in the organisation that new ownership may be more effective than continuation of the current structure (even with management changes). Ownership changes (whether involving

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Wesfarmers or some other party) may provide the opportunity for a decisive break from the past and an accelerated transformation of the Coles Group culture; and

- Coles Group shareholders (excluding Wesfarmers) would collectively have a 44%[47] economic interest in the combined business after implementation. This gives them a substantial ongoing exposure to any upside from the Coles Group businesses if Wesfarmers successfully achieves the turnaround (but equally provides exposure to 44% of any downside).

While control clearly passes at a Board and management level, Coles Group shareholders will have a significant ongoing participation in Wesfarmers. In view of the similar sizes of the two entities and the continued involvement of Coles Group shareholders in the merged company, the transaction could be analysed as a merger. Although this analysis is also not clear cut, it suggests that, as a merger, the terms of the Wesfarmers Proposal strike a reasonable balance between the interests of Coles Group and Wesfarmers shareholders, and arguably are favourable to Coles Group shareholders (i.e. they receive some premium). However, where an acquirer is seeking Board and management control, it is usual for a control premium to be paid.

Choosing between these two perspectives is a finely balanced judgement and shareholders could validly form either view.

The Scheme process could be a catalyst for a superior offer, by establishing a clear value benchmark and a defined timetable within which any interested third party would have to act. A counterbidder does face some hurdles but it would nevertheless be sensible for shareholders to defer any voting decision until close to the Scheme meeting. Similarly, the current volatility in financial markets (and in the Wesfarmers share price) would also suggest that decisions should be left as late as practically possible.

If a superior proposal does not emerge prior to the Scheme meeting the choice is essentially between the Wesfarmers Proposal and a standalone turnaround strategy. While the Supermarkets turnaround strategy has the potential to deliver attractive returns over the medium term, it is subject to considerable execution and competitive risk. It is likely that ongoing ownership uncertainty would continue to hamper Coles Group, which would be reliant on achieving major organisational change from within. The Coles Group share price is likely to be relatively weak for a sustained period until credibility is restored through demonstration of a material improvement in performance. While the Wesfarmers Proposal is less than the fair value range, the effect of the discount is mitigated by the fact that Coles Group shareholders will have a 44% economic interest in the combined entity.

Accordingly, if no superior proposal emerges prior to the Scheme meeting, Grant Samuel's judgement is that the Wesfarmers Proposal would be in the best interests of shareholders.

10.2 Fairness

Grant Samuel has valued Coles Group in the range $16.21-18.23 per share. The value attributed to the Base Offer Consideration of $14.87-15.44 per share is less than the valuation of Coles Group shares. Accordingly, in Grant Samuel's view, the Wesfarmers Proposal is not "fair" (based on the current value of the Base Offer Consideration). Coles Group shareholders will not receive a full premium for control under the Wesfarmers Proposal.

However, the valuation analysis should be treated with some caution. The value of Coles Group is subject to significant uncertainty, given that (at least in respect of the Supermarkets business) it depends on judgements regarding the timing, cost and ultimate success of a future business turnaround. In addition, changes in external market conditions (including sharemarket prices and the availability of debt funding in credit markets) also affect underlying value. Market conditions have recently been volatile. Shareholders with different views on the future prospects for Coles

[47] The interest is potentially higher if Wesfarmers is required to issue bonus shares when the PPS are reclassified as ordinary shares. However, this would probably be in circumstances where little upside has been realised.

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Group's businesses could reasonably reach different conclusions on the value of Coles Group. Grant Samuel's valuation of Coles Group incorporates significant value for the turnaround potential of the Supermarkets business. Less positive views on the turnaround could lead to valuation judgements below Grant Samuel's valuation range.

Moreover, it must be recognised that Coles Group has run an extensive worldwide sale process. The Wesfarmers Proposal is the only offer received for all of Coles Group. In the ordinary course of events, the highest offer received following an extensive sale process by definition represents full underlying value. In the current circumstance, with the fall in the Wesfarmers share price since the announcement of its initial proposal and recent dislocations in world credit markets undermining the ability of financial buyers to compete for Coles Group, this logic is less clear. However, if no superior offer for Coles Group has emerged before the Scheme meeting, there would be grounds to argue that the overall sale process for Coles Group demonstrates that Coles Group shareholders are receiving full underlying value.

10.3 Premium for Control

Takeover transactions are commonly analysed by reference to the extent of the control premium paid by the bidder relative to the pre-bid share price. Control premium analysis is of only limited utility in the case of the Wesfarmers Proposal, because Coles Group shares have been trading on the expectation of some corporate transaction ever since Coles Group's announcement on 17 August 2006 that it had been approached in relation to a potential change of control transaction for the company.

The value attributed by Grant Samuel to the Base Offer Consideration represents the following premiums to the price at which Coles Group shares traded in the period prior to the announcement of the Wesfarmers Proposal:

Base Offer Consideration – Implied Premiums

Share Price prior to	Price/VWAP	Premium
Announcement of Wesfarmers Proposal on 5 September 2007	$14.24	4.4-8.4%
Announcement of Initial Wesfarmers Proposal on 2 July 2007	$16.12	(4.2-7.8)%
Initial approach to Coles Group on 17 August 2006	$11.70	27.1-32.0%
1 month VWAP to 17 August 2006	$11.14	32.1-37.1%
3 month VWAP to 17 August 2006	$11.31	29.9-34.8%

The premiums calculated relative to prices subsequent to 17 August 2006 are of limited relevance, given that since that date Coles Group shares have been trading in expectation of a transaction and therefore already incorporate (at least to some extent) a premium for control. The premiums relative to share prices prior to 17 August 2006 are broadly comparable with the premiums commonly paid in takeovers. Some caution needs to be applied given the overall strengthening in equity markets and changes in Coles Group's prospects since August 2006. The S&P/ASX 200 Index has risen by 25.8% since 17 August 2006 (to 21 September 2007). However, it is not appropriate to assume that Coles Group shares would have risen by the same amount as the index over that period in the absence of any takeover speculation (and indeed many companies have not), particularly having regard to the weak trading performance of the Supermarkets business.

10.4 Merger Analysis

While, in Grant Samuel's view, Coles Group shareholders will not realise a full premium for control under the Wesfarmers Proposal, they are not losing control in an absolute sense (at least not in the same way as in a 100% cash bid). At a Board and management level, control will clearly pass to Wesfarmers. However, the issue of control is less clear at a shareholder level. Coles Group shareholders will collectively hold a 44% interest in the merged Wesfarmers/Coles Group and will continue to have significant economic exposure to the upside in the Coles Group businesses. The combined company will have no controlling shareholder and a widely dispersed share register.

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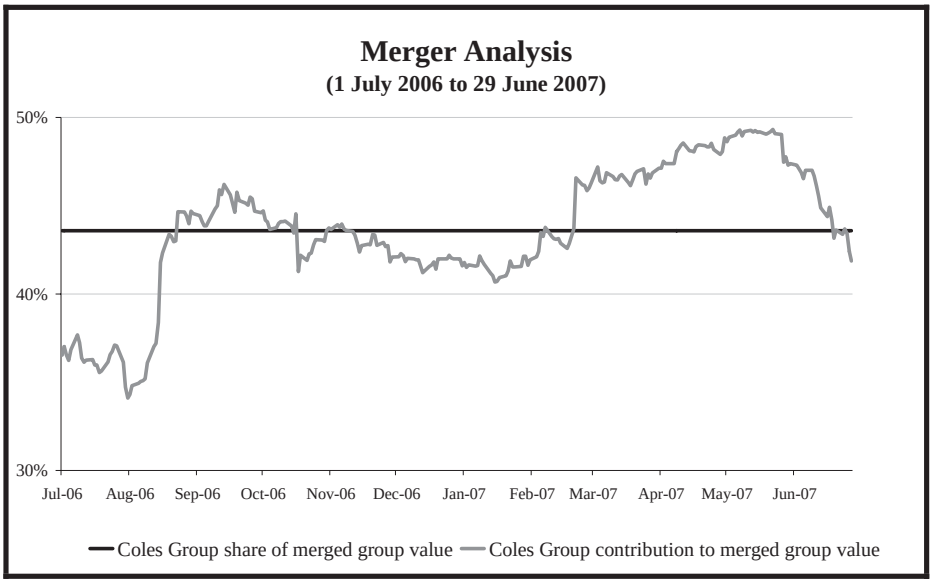
Given that Coles Group and Wesfarmers are of similar size and that Coles Group shareholders will collectively hold a major economic interest in the merged Wesfarmers/Coles Group, it is arguable that merger analysis is also relevant to assessment of the Wesfarmers Proposal.

In the absence of the information required to estimate the full underlying value of Wesfarmers, Grant Samuel has analysed the contributions of value in sharemarket terms contributed by Coles Group and Wesfarmers. In the ordinary course, particularly for large companies like Coles Group and Wesfarmers, with deeply traded shares and extensive analyst coverage, it is reasonable to assume that sharemarket values reflect an objective market consensus as to value.

The following chart compares the contribution of market values made by Coles Group shareholders, based on relative Coles Group and Wesfarmers share prices since July 2006, with the share of overall market value that Coles Group shareholders will enjoy (including the $4.00 cash per share). The analysis does not adjust for dividend payments over the period and the final Coles Group and Wesfarmers dividends still to be paid:



Source: IRESS and Grant Samuel analysis

The chart shows that for share prices prior to August 2006, the terms of the Wesfarmers Proposal are such that Coles Group shareholders hold a significantly larger share of the value of the merged company than their contribution of value to the merger. Effectively, this suggests that the Wesfarmers Proposal delivers at least a partial premium for control. For share prices from 22 August 2006 to around the end of February 2007, the share of value held by Coles Group shareholders in the merged company is generally consistent with their value contribution (notwithstanding that Coles Group shares were trading on the basis of an expectation of some corporate transaction during this period). This also suggests that the Wesfarmers Proposal delivers at least a partial premium for control. Coles Group shares traded at substantially higher prices during the period March to June 2007, as Coles Group undertook its formal sale process and market expectations of a competitive bidding process supported more optimistic views on value. For share prices during this period, the share of value held by Coles Group shareholders in the merged company is somewhat less than their value contribution (suggesting that the Wesfarmers Proposal does not deliver a full premium for control).

Although the analysis is not clear cut, given the impact of takeover speculation on the Coles Group share price, in Grant Samuel's view the analysis suggests that, if analysed as a merger, the terms of the Wesfarmers Proposal strike a reasonable balance between the interests of Coles Group and Wesfarmers shareholders, and arguably are favourable to Coles Group shareholders. Nevertheless, it is generally accepted that when an acquirer seeks Board and management control, a control

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premium should be paid (notwithstanding the share of the merged group owned by the target shareholders).

10.5 Alternatives

10.5.1 Overview

Assessment of the Wesfarmers Proposal requires evaluation of the alternatives available to Coles Group shareholders. The Wesfarmers Proposal is the only offer currently available to Coles Group shareholders. However, given the sale process that Coles Group has undertaken, there is at least some possibility of an alternative offer. In addition, the Wesfarmers Proposal needs to be assessed against the benefits, disadvantages and risks for Coles Group of continuing on some standalone basis.

10.5.2 Alternative Proposals

The Wesfarmers Proposal is the outcome of events that commenced more than twelve months ago. From February 2007, Coles Group and its advisers actively sought potential buyers for the company and its businesses. Given the high profile of the Coles Group and its businesses, it is reasonable to assume that every credible potential buyer of Coles Group (including international buyers) would have been aware of the opportunity. The Wesfarmers Proposal is the only firm offer put forward to acquire the whole company. While a private equity consortium led by Kohlberg Kravis Roberts & Co ("KKR") made indicative offers of $14.50 and $15.25 cash per Coles Group share during August and October 2006, these were subject to due diligence. During the first half of 2007, KKR and the other members of its consortium withdrew from the sale process.

It is possible that Coles Group could receive some alternative superior proposal. Given the fall in the value of the Wesfarmers Proposal since the announcement on 2 July 2007, one of the parties that has already examined a transaction with Coles Group could be encouraged to re-enter the process as they would now be more competitive.

The commitment of Coles Group to the Wesfarmers Proposal should help to establish whether there are any superior alternatives for Coles Group shareholders. The Scheme process should act as a catalyst to any genuinely interested party with a superior proposal, by establishing benchmarks for value and defining a time frame within which parties would have to act which, while limited, should be sufficient to put together such a proposal. At the same time it is necessary to recognise that:

- current conditions in financial markets (particularly credit markets) make it more difficult for financial buyers to put together competitive and fully financed proposals. Apart from Wesfarmers, the other parties that undertook due diligence with a view to acquiring all of Coles Group essentially comprised private equity funds. For these buyers the availability of substantial debt finance on reasonable margins is critical to their ability to make a fully priced offer. Credit markets may settle down at some stage to enable these buyers to return but there is little sign of that occurring quickly;

- the introduction of the PPS into the Base Offer Consideration has improved the value delivered under the Wesfarmers Proposal (albeit not substantially) and may make it more difficult for a third party to formulate an attractive counterproposal; and

- the terms of the (amended) Scheme Implementation Agreement create some impediments to a counterproposal. For example, the break fee has been increased to $150 million, there are tighter controls on the provision of information and for engagement with any counterbidder, and Wesfarmers now has a right to match any alternative proposal. However, these impediments are not insurmountable for a keen acquirer. The increased break fee represents only around 12.5 cents per Coles Group share (less than 1% of equity value).

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There is a broader argument that Coles Group shareholders would be better off deferring a sale of the company until some later date. The sale process conducted by Coles Group has coincided with a period of poor performance of some key business units, negative market sentiment towards Coles Group and unfavourable external market conditions. It is possible that shareholders could realise more value by deferring a sale of the company until more propitious circumstances emerge.

In Grant Samuel's view, however, this argument is not persuasive. Negative market sentiment towards Coles Group is unlikely to improve until Coles Group has established a track record of substantially improved business performance. There can be no guarantee that external market conditions will improve. Ongoing uncertainty regarding ownership of the business is likely to undermine the prospects for a successful turnaround of the Supermarkets business.

It is difficult to make any assessment of the likelihood of an alternative proposal before the Scheme meeting. However, given the possibility of an alternative proposal, shareholders should delay voting in relation to the Scheme as long as possible before the Scheme meeting. In the absence of a superior alternative proposal before the Scheme meeting, in Grant Samuel's opinion the Wesfarmers Proposal is in shareholders' best interests.

10.5.3 The Standalone Option

A turnaround of the Supermarkets business under Coles Group ownership could conceivably deliver more value to Coles Group shareholders than the Wesfarmers Proposal (although there can be no certainty regarding the timing and extent of a successful turnaround, and at best it would only occur over the medium term). A return to the "status quo" is probably not realistic but a viable strategy could involve:

- changes to the company's leadership; and
- the sale or spin off of some businesses outside the Supermarkets, Coles Express and Coles Liquor business, either individually or as a package. In particular, the Target and Officeworks businesses could be attractive to a number of buyers (including Wesfarmers and Woolworths) or could form the basis of a meaningful separate listed company. The effect would be some value realisation for shareholders (through a sale) or at least greater clarity of value (through a spin off).

The potential in the Supermarkets business is clear. Comparisons with international and local benchmarks demonstrate the scope for substantial profit improvement in terms of both sales and margins.

The company has already begun a major re-engineering of the business (including supply chain transformation and overhead reduction). To some extent, the weak performance for the 2007 financial year was the result of the poor execution of two major initiatives (the Bi-Lo store conversion and introduction of centrally managed range), and management has taken steps to rectify these problems. Management is focussed on improving the customer offer, particularly in fresh produce, and ensuring that the Supermarkets business delivers a compelling value proposition to customers. Trading in the last few weeks shows some sign of improved performance.

Much remains to be done to achieve a turnaround of the Supermarkets business. The organisation requires a major revamp with changes in structure and new management. The Transformation program requires considerable further capital expenditure and the implementation of major programs such as automated stock replenishment, with the bulk of the benefits only realised in the medium term. The Supermarkets business needs to maintain an improved customer offer (including through an aggressive program of store refurbishments) while dealing with the disruptions of supply chain transformation.

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Notwithstanding these challenges, the turnaround of the Supermarkets business could be achieved under Coles Group ownership. Wesfarmers plans for the Supermarkets business are not dramatically different to those of Coles Group and Wesfarmers will also need to recruit new management.

On the other hand:

- there are significant risks associated with the turnaround of the Supermarkets business. While there is a reasonably clear program that needs to be achieved, the turnaround is inevitably subject to execution risk. Moreover, the turnaround will need to be achieved in the context of what may be vigorous competition. Woolworths has a substantial cost advantage and business momentum. Competitive activity may limit the extent to which Coles Group shareholders benefit from improvements in the Supermarkets business, if the business is forced to pass on a major part of the benefits to customers. These turnaround risks will apply whether the Supermarkets business is in Coles Group or Wesfarmers ownership;

- continued ownership uncertainty is likely to be damaging for the Supermarkets business. The protracted sale process appears to have undermined management morale and business performance. There is an urgent need to strengthen the Supermarkets management team, but it is difficult to attract high quality candidates in the current circumstances and this problem may continue under a standalone model (at least to some extent) as ownership of the business is not really resolved. The Wesfarmers Proposal provides an opportunity to move quickly to put an end to the uncertainty about ownership of the Coles Group and promote a turnaround of the Supermarkets business;

- new leadership has to be identified and attracted to Coles Group. This may take some time and the outcome is uncertain. Selection of the right people will be a critically important judgement;

- the culture of the organisation (in particular the Supermarkets business) needs significant change. Profound organisational changes of this nature are often difficult to achieve "from within" (even with new management). In contrast, ownership changes (whether Wesfarmers or some other party) may provide the opportunity for a decisive break from the past and an accelerated transformation of the Coles Group culture; and

- the turnaround will only be achieved over time (say 3 years). The Coles Group share price is likely to be relatively weak for a sustained period until credibility is restored through demonstration of a consistent improvement in performance. Coles Group shares were trading at levels around $11.50 in August 2006, immediately before Coles Group announced that it had been approached in relation to a potential change of control transaction. The overall market has strengthened considerably since then. On the other hand, Coles Group's overall business performance since then has disappointed, with the Supermarkets business recording a significant decline in earnings for the 2007 financial year. In the absence of the Wesfarmers Proposal or speculation regarding some alternative transaction, it is likely that Coles Group shares would trade at prices below the range of values of $14.87-15.44 attributed to the Wesfarmers Base Offer Consideration.

In Grant Samuel's view, the risks and disadvantages of the standalone alternative outweigh the uncertain prospect of realising some higher value in the future. The Wesfarmers Proposal is also not without risk, given that Coles Group shareholders will retain a 44% economic interest in Wesfarmers and that Wesfarmers will face the same business turnaround challenges currently faced by Coles Group. However, the Wesfarmers Proposal does provide some risk mitigation, while also delivering near term value uplift. The discount from the bottom end of Grant Samuel's estimate of full underlying value is in the order of 5-9%. While this is not insignificant, the impact on Coles Group shareholders is

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substantially mitigated by the fact they will have a 44% economic interest in the enlarged group.

In Grant Samuel's view, Coles Group shareholders are likely to be better off if the Wesfarmers Proposal proceeds than if Coles Group was to pursue some standalone option.

10.6 Other Advantages and Disadvantages

There are a number of other advantages and disadvantages that need to be considered in assessing the Wesfarmers Proposal. In particular:

- Coles Group shareholders are likely to receive an enhanced dividend stream. Wesfarmers has announced that it expects to pay fully franked dividends of at least $2.00 per share for the 2008 financial year, which translates into dividends of at least $0.57 per Coles Group share. By comparison, Coles Group's total dividend for the 2007 financial year was $0.45. While the dividend outlook should already be reflected in the Wesfarmers share price, some Coles Group shareholders may find the higher dividend yield attractive;

- in the short term, the earnings and cash flows of Wesfarmers' existing businesses should tend to support the Wesfarmers share price and underpin the funding of the turnaround of the Coles Group businesses (particularly Supermarkets);

- Coles Group shareholders will have exposure to the performance of a more diversified portfolio of businesses, and a reduced direct exposure (44% economic interest) to the turnaround risks associated with the Coles Group's businesses. While this will (arguably) provide some risk reduction for Coles Group shareholders, they could also achieve this through their own direct investment/divestment activity; and

- capital gains tax roll-over relief (see Section 10.7 below) may be attractive to some shareholders (albeit that it only defers rather than eliminates the ultimate tax liability).

Disadvantages and risks arising from the Wesfarmers Proposal include the following:

- while the bulk of Wesfarmers' earnings and value will be generated by its retail businesses, Wesfarmers will not be a pure retail play. Coles Group shareholders who hold Coles Group shares for the pure retail investment exposure may find Wesfarmers shares less attractive.

  In particular, Coles Group shareholders who retain Wesfarmers shares received under the Wesfarmers Proposal will be exposed to such factors as coal price risk and commodity market risk (through Wesfarmers' explosives activities); and

- Wesfarmers does not have in-house supermarket management skills and will need to recruit senior management to progress the turnaround. To some extent Coles Group shareholders are being asked to approve a proposal based on the turnaround of the Supermarkets business in circumstances where there is little detail about precisely how the turnaround is to be achieved. There is a significant "trust us" element in the Wesfarmers Proposal (as there would be in a standalone strategy).

In Grant Samuel's view none of these advantages and disadvantages is significant enough to impact Grant Samuel's conclusion that the Wesfarmers Proposal is in the best interests of Coles Group shareholders, in the absence of a superior alternative offer. In general sense, they should already be reflected in the Wesfarmers share price.

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10.7 Taxation

Under the Scheme, Coles Group shareholders will receive consideration for the sale of Coles Group shares to Wesfarmers in the form of cash and new Wesfarmers ordinary shares and new Wesfarmers PPS. The capital gains tax ("CGT") implications of the sale of Coles Group shares to Wesfarmers will depend upon a number of factors including the tax position of the individual shareholder and the date on which the Coles Group shares were acquired.

Coles Group shareholders will make a capital gain to the extent that the consideration is greater than the cost base of the Coles Group shares, subject to roll-over relief in respect to the scrip component of the consideration. Coles Group shareholders will make a capital loss to the extent the consideration received is less than the cost base of their Coles Group shares.

Roll-over relief is expected to be available in respect to the scrip component of the capital gain. If Coles Group shareholders elect to receive roll-over relief the capital gain that would otherwise be generated will be delayed to the extent they receive new Wesfarmers ordinary shares and PPS. Roll-over relief is not available to the extent the consideration received is cash.

Eligible Coles Group shareholders (individuals who have held the shares for more than 12 months) will be able to treat the capital gain as a "discount" capital gain for CGT purposes. There will be no CGT consequences for shareholders that acquired Coles Group shares before 20 September 1985 (pre-CGT).

10.8 Shareholder Decision

The decision of each shareholder as to whether to vote in favour of the Wesfarmers Proposal is a matter for individual shareholders based on each shareholder's views as to value and future market conditions, risk profile, liquidity preference, investment strategy, portfolio structure and tax position. In particular, taxation consequences may vary from shareholder to shareholder. If in any doubt, shareholders should consult an independent professional adviser.

This report does not purport to consider the investment merits of the merged entity. Whether to buy, hold or sell shares or PPS in the merged entity is a separate investment decision upon which Grant Samuel does not offer an opinion. Shareholders should consult their own professional adviser in this regard.

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11 Qualifications, Declarations and Consents

11.1 Qualifications

The Grant Samuel group of companies provide corporate advisory services (in relation to mergers and acquisitions, capital raisings, debt raisings, corporate restructurings and financial matters generally), property advisory services and manages specialist funds. The primary activity of Grant Samuel & Associates Pty Limited is the preparation of corporate and business valuations and the provision of independent advice and expert's reports in connection with mergers and acquisitions, takeovers and capital reconstructions. Since inception in 1988, Grant Samuel and its related companies have prepared more than 380 public independent expert and appraisal reports.

The persons responsible for preparing this report on behalf of Grant Samuel are Stephen Wilson MCom (Hons) CA (NZ) SF Fin, Stephen Cooper BCom (Hons) CA (SA) ACMA and Hannah Crawford BCom LLB CA F Fin. Each has a significant number of years of experience in relevant corporate advisory matters. Caleena Stilwell BBus CA F Fin, Warwick Earl BCom LLB, Tina Fendl BCom CFA, Bo Briedis BCom CA, Anne Foster BSc and Michael Creswell BCom LLB assisted in the preparation of the report. Each of the above persons is an authorised representative of Grant Samuel pursuant to its Australian Financial Services Licence under Part 7.6 of the Corporations Act.

11.2 Disclaimers

It is not intended that this report should be used or relied upon for any purpose other than as an expression of Grant Samuel's opinion as to whether the Wesfarmers Proposal is in the best interests of shareholders. Grant Samuel expressly disclaims any liability to any Coles Group shareholder who relies or purports to rely on the report for any other purpose and to any other party who relies or purports to rely on the report for any purpose whatsoever.

This report has been prepared by Grant Samuel with care and diligence and the statements and opinions given by Grant Samuel in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading. However, no responsibility is accepted by Grant Samuel or any of its officers or employees for errors or omissions however arising in the preparation of this report, provided that this shall not absolve Grant Samuel from liability arising from an opinion expressed recklessly or in bad faith.

Grant Samuel has had no involvement in the preparation of the Scheme Booklet issued by Coles Group and has not verified or approved any of the contents of the Scheme Booklet. Grant Samuel does not accept any responsibility for the contents of the Scheme Booklet (except for this report).

Grant Samuel has had no involvement in Coles Group's due diligence investigation in relation to the Scheme Booklet and does not accept any responsibility for the completeness or reliability of the process which is the responsibility of Coles Group.

11.3 Independence

Grant Samuel and its related entities do not have at the date of this report, and have not had within the previous two years, any shareholding in or other relationship with Coles Group or Wesfarmers that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Wesfarmers Proposal. Grant Samuel advises that:

- six Grant Samuel group executives hold parcels of less than 25,000 shares in Coles Group;
- four Grant Samuel group executives hold parcels of less than 10,000 shares in Wesfarmers; and
- in November 2006, Grant Samuel Property Pty Limited was engaged by Wesfarmers to undertake a sale and leaseback of certain property assets (selected Bunnings stores). The transaction was completed in June 2007. There is no ongoing engagement.

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Grant Samuel commenced analysis for the purposes of this report in June 2007 prior to the announcement of the Wesfarmers Proposal. This work did not involve Grant Samuel participating in the setting the terms of, or any negotiations leading to, the Wesfarmers Proposal. Grant Samuel had no part in the formulation of the Wesfarmers Proposal. Its only role has been the preparation of this report.

Grant Samuel will receive a fixed fee of $3,500,000 for the preparation of this report. This fee is not contingent on the outcome of the Wesfarmers Proposal. Grant Samuel's out of pocket expenses in relation to the preparation of the report will be reimbursed. Grant Samuel will receive no other benefit for the preparation of this report.

Grant Samuel considers itself to be independent in terms of Regulatory Guideline 42 issued by the ASIC (previously known as Australian Securities Commission) on 8 December 1993.

11.4 Declarations

Coles Group has agreed that it will indemnify Grant Samuel and its employees and officers in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity will not apply in respect of the proportion of any liability found by a court to be primarily caused by any conduct involving gross negligence or wilful misconduct by Grant Samuel. Coles Group has also agreed to indemnify Grant Samuel and its employees and officers for time spent and reasonable legal costs and expenses incurred in relation to any inquiry or proceeding initiated by any person. Where Grant Samuel or its employees and officers are found to have been grossly negligent or engaged in wilful misconduct Grant Samuel shall bear the proportion of such costs caused by its action. Any claims by Coles Group are limited to an amount equal to the fees paid to Grant Samuel.

Advance drafts of this report were provided to Coles Group and its advisers. Advance drafts of Sections 6 and 7 of this report were also provided to Wesfarmers. Certain changes were made to the drafting of the report as a result of the circulation of the draft report. Subsequent to providing a draft of the report an error was discovered in the capital expenditure forecasts used in the DCF analysis. As a result of correcting this error the value of Coles Group was reduced by 4 cents per share. However, there was no alteration to the methodology, evaluation or conclusions.

11.5 Consents

Grant Samuel consents to the issuing of this report in the form and context in which it is to be included in the Scheme Booklet to be sent to shareholders of Coles Group. Neither the whole nor any part of this report nor any reference thereto may be included in any other document without the prior written consent of Grant Samuel as to the form and context in which it appears.

11.6 Other

The accompanying letter dated 21 September 2007 and the Appendices form part of this report.

Grant Samuel has prepared a Financial Services Guide as required by the Corporations Act. The Financial Services Guide is set out at the beginning of this report.

GRANT SAMUEL & ASSOCIATES PTY LIMITED
21 September 2007

Grant Samuel & Associates

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Appendix 1

Selection of Discount Rates

1 Overview

The following discount rates have been selected by Grant Samuel to apply to the forecast nominal ungeared after tax cash flows for Coles Group's major businesses:

- Supermarkets, Coles Express and Coles Liquor 9.0-10.0%
- Kmart 9.5-10.5%
- Target 9.5-10.5%
- Officeworks 9.5-10.5%

Selection of the appropriate discount rate to apply to the forecast cash flows of any business enterprise is fundamentally a matter of judgement. The valuation of an asset or business involves judgements about the discount rates that may be utilised by potential acquirers of that asset. There is a body of theory which can be used to support that judgement. However, a mechanistic application of formulae derived from that theory can obscure the reality that there is no "correct" discount rate. Despite the growing acceptance and application of various theoretical models, it is Grant Samuel's experience that many companies rely on less sophisticated approaches. Many businesses use relatively arbitrary "hurdle rates" which do not vary significantly from investment to investment or change significantly over time despite interest rate movements. Valuation is an estimate of what real world buyers and sellers of assets would pay and must therefore reflect criteria that will be applied in practice even if they are not theoretically correct. Grant Samuel considers the rates adopted to be reasonable discount rates that acquirers would use irrespective of the outcome or shortcomings of applying any particular theoretical model.

The discount rate that Grant Samuel has adopted is reasonable relative to the rates derived from theoretical models. The discount rate represents an estimate of the weighted average cost of capital ("WACC") appropriate for these assets. Grant Samuel has calculated a WACC based on a weighted average of the cost of equity and the cost of debt. This is the relevant rate to apply to ungeared cash flows. There are three main elements to the determination of an appropriate WACC. These are:

- cost of equity;
- cost of debt; and
- debt/equity mix.

WACC is a commonly used basis but it should be recognised that it has shortcomings in that it:

- represents a simplification of what are usually much more complex financial structures; and
- assumes a constant degree of leverage which is seldom correct.

The cost of equity has been derived from application of the Capital Asset Pricing Model ("CAPM") methodology. The CAPM is probably the most widely accepted and used methodology for determining the cost of equity capital. There are more sophisticated multivariate models which utilise additional risk factors but these models have not achieved any significant degree of usage or acceptance in practice. However, while the theory underlying the CAPM is rigorous the practical application is subject to shortcomings and limitations and the results of applying the CAPM model should only be regarded as providing a general guide. There is a tendency to regard the rates calculated using CAPM as inviolate. To do so is to misunderstand the limitations of the model. For example:

- the CAPM theory is based on expectations but uses historical data as a proxy. The future is not necessarily the same as the past;
- the measurement of historical data such as risk premia and beta factors is subject to very high levels of statistical error. Measurements vary widely depending on factors such as source, time period and sampling frequency;

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- the measurement of beta is often based on comparisons with other companies. None of these companies is likely to be directly comparable to the entity for which the discount rate is being calculated and may operate in widely varying markets;
- parameters such as the debt/equity ratio and risk premium are based on subjective judgements; and
- there is not unanimous agreement as to how the model should adjust for factors such as taxation. The CAPM was developed in the context of a "classical" tax system. Australia's system of dividend imputation has a significant impact on the measurement of net returns to investors.

The cost of debt has been determined by reference to the pricing implied by the debt markets in Australia. The cost of debt represents an estimate of the expected future returns required by debt providers. In determining the appropriate cost of debt over this forecast period, regard was had to debt ratings of comparable companies.

Selection of an appropriate debt/equity mix is a matter of judgement. The debt/equity mix represents an appropriate level of gearing, stated in market value terms, for the business over the forecast period. The relevant proportions of debt and equity have been determined having regard to the financial gearing of the industry in general and comparable companies, and judgements as to the appropriate level of gearing considering the nature and quality of the cash flow stream.

The following sections set out the basis for Grant Samuel's determination of the discount rates for Coles Group's businesses and the factors which limit the accuracy and reliability of the estimates.

2 Definition and Limitations of the CAPM and WACC

The CAPM provides a theoretical basis for determining a discount rate that reflects the returns required by diversified investors in equities. The rate of return required by equity investors represents the cost of equity of a company and is therefore the relevant measure for estimating a company's weighted average cost of capital. CAPM is based on the assumption that investors require a premium for investing in equities rather than in risk free investments (such as Australian government bonds). The premium is commonly known as the market risk premium and notionally represents the premium required to compensate for investment in the equity market in general.

The risks relating to a company or business may be divided into specific risks and systematic risks. Specific risks are risks that are specific to a particular company or business and are unrelated to movements in equity markets generally. While specific risks will result in actual returns varying from expected returns, it is assumed that diversified investors require no additional returns to compensate for specific risk, because the net effect of specific risks across a diversified portfolio will, on average, be zero. Portfolio investors can diversify away all specific risk.

However, investors cannot diversify away the systematic risk of a particular investment or business operation. Systematic risk is the risk that the return from an investment or business operation will vary with the market return in general. If the return on an investment was expected to be completely correlated with the return from the market in general, then the return required on the investment would be equal to the return required from the market in general (i.e. the risk free rate plus the market risk premium).

Systematic risk is affected by the following factors:

- financial leverage: additional debt will increase the impact of changes in returns on underlying assets and therefore increase systematic risk;
- cyclicality of revenue: projects and companies with cyclical revenues will generally be subject to greater systematic risk than those with non-cyclical revenues; and
- operating leverage: projects and companies with greater proportions of fixed costs in their cost structure will generally be subject to more systematic risk than those with lesser proportions of fixed costs.

CAPM postulates that the return required on an investment or asset can be estimated by applying to the market risk premium a measure of systematic risk described as the beta factor. The beta for an

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investment reflects the covariance of the return from that investment with the return from the market as a whole. Covariance is a measure of relative volatility and correlation. The beta of an investment represents its systematic risk only. It is not a measure of the total risk of a particular investment. An investment with a beta of more than one is riskier than the market and an investment with a beta of less than one is less risky. The discount rate appropriate for an investment which involves zero systematic risk would be equal to the risk free rate.

The formula for deriving the cost of equity using CAPM is as follows:

$$Re = Rf + Beta\ (Rm - Rf)$$

Where:

Re	=	the cost of equity capital;
Rf	=	the risk free rate;
Beta	=	the beta factor;
Rm	=	the expected market return; and
Rm - Rf	=	the market risk premium.

The beta for a company or business operation is normally estimated by observing the historical relationship between returns from the company or comparable companies and returns from the market in general. The market risk premium is estimated by reference to the actual long run premium earned on equity investments by comparison with the return on risk free investments.

The formula conventionally used to calculate a WACC under a classical tax system is as follows:

$$WACC = (Re \times E/V) + (Rd \times (1-t) \times D/V)$$

Where:

E/V	=	the proportion of equity to total value (where V = D + E);
D/V	=	the proportion of debt to total value;
Re	=	the cost of equity capital;
Rd	=	the cost of debt capital; and
t	=	the corporate tax rate

The models, while simple, are based on a sophisticated and rigorous theoretical analysis. Nevertheless, application of the theory is not straightforward and the discount rate calculated should be treated as no more than a general guide. The reliability of any estimate derived from the model is limited. Some of the issues are discussed below:

- **Risk Free Rate**

  Theoretically, the risk free rate used should be an estimate of the risk free rate in each future period (i.e. the one year spot rate in that year if annual cash flows are used). There is no official "risk free" rate but rates on government securities are typically used as an acceptable substitute. More importantly, forecast rates for each future period are not readily available. In practice, the long term Commonwealth Government Bond rate is used as a substitute in Australia and medium to long term Treasury Bond rates are used in the United States. It should be recognised that the yield to maturity of a long term bond is only an average rate and where the yield curve is strongly positive (i.e. longer term rates are significantly above short term rates) the adoption of a single long term bond rate has the effect of reducing the net present value where the major positive cash flows are in the initial years. The long term bond rate is therefore only an approximation.

  The ten year bond rate is a widely used and accepted benchmark for the risk free rate. Where the forecast period exceeds ten years, an issue arises as to the appropriate bond to use. While longer term bond rates are available, the ten year bond market is the deepest long term bond market in Australia and is a widely used and recognised benchmark. There is a very limited market for bonds of more than ten years. In the United States, there are deeper markets for longer term bonds. The 30 year bond rate is a widely used benchmark. However, long term rates accentuate the distortions of the yield curve on cash flows in early years. In any event, a single long term bond rate matching

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the term of the cash flows is no more theoretically correct than using a ten year rate. More importantly, the ten year rate is the standard benchmark used in practice.

Where cash flows are less than ten years in duration the opposite issue arises. An argument could be made that shorter term, and therefore lower, bond rates should be used in determining the discount rate for there assets. While Grant Samuel believes this is a legitimate argument, an adjustment may give a misleading impression of precision for the whole methodology. In any event, the impact on valuation would usually be trivial.

In practice, Grant Samuel believes acquirers would use a common rate. The ten year bond rate can be regarded as an acceptable standard risk free rate for medium to long term cash flows, particularly given its wide use.

- **Market Risk Premium**

The market risk premium *(Rm - Rf)* represents the "extra" return that investors require to invest in equity securities as a whole over risk free investments. This is an "ex-ante" concept. It is the expected premium and as such it is not an observable phenomenon. The historical premium is therefore used as a proxy measure. The premium earned historically by equity investments is calculated over a time period of many years, typically at least 30 years. This long time frame is used on the basis that short term numbers are highly volatile and that a long term average return would be a fair indication of what most investors would expect to earn in the future from an investment in equities with a 5-10 year time frame.

In the United States it is generally believed that the premium is in the range of 5-6% but there are widely varying assessments (from 3% to 9%). Australian studies have been more limited but indicate that the long run average premium has been in the order of 6% using a geometric average (and is in the order of 8% using an arithmetic average) measured over more than 100 years of data[1]. Even an estimate based over a very long period such as 100 years is subject to significant statistical error. Given the volatility of equity market returns it is only possible to state that the "true" figure lies within a range of approximately 2-10% at a 95% confidence level (using the geometric average).

In addition, the market risk premium is not constant and changes over time. At various stages of the market cycle investors perceive that equities are more risky than at other times and will increase or decrease their expected premium. Indeed, there are arguments being put forward at the present time that the risk premium is now lower than it has been historically. This view is reflected in the recent update of the Officer Study[2] which indicates that (based on the addition of 17 years of data to 2004) the long term arithmetic average has declined to 7.17% from 7.94%.

In practice, market risk premiums of 5-7% are typically adopted in Australia.

- **Beta Factor**

The beta factor is a measure of the expected covariance (i.e. volatility and correlation of returns) between the return on an investment and the return from the market as a whole. The expected beta factor cannot be observed. The conventional practice is to calculate an historical beta from past share price data and use it as a proxy for the future but it must be recognised that the expected beta is not necessarily the same as the historical beta. A company's relative risk does change over time.

The appropriate beta is the beta of the company being acquired rather than the beta of the acquirer (which may be in a different business with different risks). Betas for the particular subject company may be utilised. However, it is also appropriate (and may be necessary if the investment is not

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1 See, for example, R.R. Officer in Ball, R., Brown, P., Finn, F. J. & Officer, R. R., "Share Market and Portfolio Theory: Readings and Australian Evidence" (second edition), University of Queensland Press, 1989 ("Officer Study") which was based on data for the period 1883 to 1987 and therefore was undertaken prior to the introduction of dividend imputation in Australia.

2 Gray, S. and Officer, R.R., "A Review of the Market Risk Premium and Commentary on Two Recent Papers: A Report prepared for the Energy Networks Association", August 2005.

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listed) to utilise betas for comparable companies and sector averages (particularly as those may be more reliable).

However, there are very significant measurement issues with betas which mean that only limited reliance can be placed on such statistics. There is no "correct" beta. For example:

- over the last three years Coles Group's beta as measured by the Australian Graduate School of Management ("AGSM") has varied between 0.65 and 1.04; and
- the standard error of the AGSM's estimate of the Coles Group beta has generally been in the order of 0.47 to 0.65 meaning that for a beta of, say, 0.65 there is only a confidence level of approximately 70% that it falls somewhere in a range of roughly zero to 1.65.

- **Debt/Equity Mix**

The tax deductibility of the cost of debt means that the higher the proportion of debt the lower the WACC, although this would be offset, at least in part, by an increase in the beta factor as leverage increases.

The debt/equity mix assumed in calculating the discount rate should be consistent with the level implicit in the measurement of the beta factor. Typically, the debt/equity mix changes over time and there is significant diversity in the levels of leverage across companies in a sector. There is a tendency to calculate leverage at a point in time whereas the leverage should represent the average over the period the beta was measured. This can be difficult to assess with a meaningful degree of accuracy.

The measured beta factors for listed companies are "equity" betas and reflect the financial leverage of the individual companies. It is possible to unleverage beta factors to derive asset betas and releverage betas to reflect a more appropriate or comparable financial structure. In Grant Samuel's view this technique is subject to considerable estimation error. Deleveraging and releveraging betas exacerbates the estimation errors in the original beta calculation and gives a misleading impression as to the precision of the methodology. Deleveraging and releveraging is also incorrectly calculated based on debt levels at a single point in time.

In addition, the actual debt and equity structures of most companies are typically relatively complex. It is necessary to simplify this for practical purposes in this kind of analysis.

Finally, it should be noted that, for this purpose, the relevant measure of the debt/equity mix is based on market values not book values.

- **Specific Risk**

The WACC is designed to be applied to "expected cash flows" which are effectively a weighted average of the likely scenarios. To the extent that a business is perceived as being particularly risky, this specific risk should be dealt with by adjusting the cash flow scenarios. This avoids the need to make arbitrary adjustments to the discount rate which can dramatically affect estimated values, particularly when the cash flows are of extended duration or much of the business value reflects future growth in cash flows. In addition, risk adjusting the cash flows requires a more disciplined analysis of the risks that the valuer is trying to reflect in the valuation.

However, it is also common in practice to allow for certain classes of specific risk (particularly sovereign and other country specific risks) in a different way by adjusting the discount rate applied to forecast cash flows.

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3 Calculation of WACC for Coles Group

3.1 Cost of Equity Capital

The cost of equity capital has been estimated by reference to the CAPM. Grant Samuel has adopted a cost of equity capital in the as follows:

- Supermarkets, Coles Express and Coles Liquor 10.2-11.4%
- Kmart 10.8-12.0%
- Target 10.8-12.0%
- Officeworks 10.8-12.0%

- **Risk-Free Rate**

  Grant Samuel has adopted a risk free rate of 6.0%. The risk free rate approximates the current yield to maturity on ten year Australian Government bonds.

- **Market Risk Premium**

  Grant Samuel has consistently adopted a market risk premium of 6% and believes that, particularly in view of the general uncertainty, this continues to be a reasonable estimate. It is:

  - not statistically significantly different to the premium suggested by the historical data;
  - similar to that used by a wide variety of analysts and practitioners; and
  - the same as that adopted by most regulatory authorities in Australia.

- **Beta Factor**

  For the purposes of valuing Coles Group's business operations, Grant Samuel has adopted the following beta factors:

  - Supermarket, Coles Express and Coles Liquor 0.7-0.9
  - Kmart 0.8-1.0
  - Target 0.8-1.0
  - Officeworks 0.8-1.0

  Grant Samuel has considered the beta factors for a wide range of retailing companies in determining an appropriate beta for the respective Coles Group businesses. The betas have been calculated on two bases relative to each company's home exchange index and relative to the Morgan Stanley Capital International Developed World Index ("MSCI"), an international equities market index that is widely used as a proxy for the global stockmarket as a whole. Where a company is extensively traded by global investors it can be argued that the regression against the MSCI is more relevant but:

  - this depends on who the "price setting" investors are; and
  - it raises a related issue as to whether a global risk premium is also appropriate and, if so, what that global premium is.

  Put alternatively, there is no simple, universal answer.

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A summary of betas for selected comparable listed companies is set out in the table below:

Equity Beta Factors for Selected Listed Companies

Company	Market Capital-isation[3] (millions)	Monthly Observations over 4 years			Weekly Observations over 2 years	
		AGSM / Barra / Ibbotson / LBS[4]	Bloomberg[5]		Bloomberg	
			Local Index	MSCI[6]	Local Index	MSCI
Coles Group	**A$16,639**	**0.65**	**0.87**	**0.69**	**0.87**	**0.82**
Grocery and Discount Retailing						
Australia and New Zealand						
Woolworths Limited	A$34,504	0.51	0.68	0.48	0.72	0.64
Harvey Norman Holdings	A$5,261	1.23	1.04	0.77	0.75	0.63
Metcash Limited	A$3,576	0.79	0.94	0.93	0.77	0.59
David Jones Limited	A$2,334	0.93	0.72	0.36	0.92	0.79
The Warehouse Group	NZ$1,733	(0.10)	0.26	0.20	0.24	0.28
South Africa						
Shoprite Holdings Limited	R16,486	0.50	0.60	0.97	0.75	1.14
Pick 'n Pay Stores Limited	R14,888	0.60	0.80	1.13	0.74	0.88
Europe						
Group Carrefour S.A.	€35,548	0.78	0.66	0.47	0.69	0.74
Metro AG	€19,520	0.18	0.72	0.91	0.76	0.98
Koninklijke Ahold N.V.	€14,372	1.38	1.08	0.88	0.90	0.86
Casino Guichard-Perrachon	€7,098	0.58	0.75	0.90	0.66	0.83
Delhaize Group	€6,887	na[7]	1.41	1.49	0.81	0.87
Etn. Fr. Colruyt N.V.	€5,052	na	0.78	0.63	0.71	0.73
United Kingdom						
Tesco plc	£33,056	0.74	0.71	0.59	0.69	0.70
Marks and Spencer Group	£10,335	0.81	0.59	0.61	0.83	0.83
J Sainsbury plc	£9,196	1.05	0.92	0.98	0.70	0.78
Wm Morrisons Supermarkets	£7,301	0.75	0.68	0.55	0.91	0.89
North America						
Wal-Mart Stores Inc	US$181,567	0.61	0.52	0.49	0.87	0.81
Target Corporation	US$55,336	1.27	0.99	0.97	0.97	0.91
Costco Wholesale	US$28,261	0.84	0.88	0.83	0.84	0.82
Sears Holdings	US$22,219	na	0.60	0.54	1.06	0.91
The Kroger Co.	US$19,516	1.12	1.06	1.19	0.88	0.86
Safeway Inc	US$15,085	0.66	0.86	1.03	1.05	0.97
Supervalu Inc	US$9,667	1.60	1.42	1.25	0.92	0.86
Loblaw Companies	C$12,442	0.37	0.51	0.62	0.42	0.50
Metro Inc	C$4,113	0.62	0.65	0.77	0.51	0.49
Minimum		*(0.10)*	*0.26*	*0.26*	*0.24*	*0.28*
Maximum		*1.60*	*1.42*	*1.49*	*1.06*	*1.14*
Median		*0.75*	*0.74*	*0.80*	*0.76*	*0.83*

3 Based on share prices as at 29 August 2007.

4 The Australian and New Zealand beta factors calculated by the AGSM as at 30 June 2007 over a period of 48 months using ordinary least squares regression or the Scholes-Williams technique where the stock is thinly traded. United States beta factors are calculated by Ibbotson Associates ("Ibbotson") as at 31 July 2007 over a period of 60 months using ordinary least squares regression or the Scholes-Williams technique (including lag) where the stock is thinly traded. United Kingdom beta factors calculated by London Business School ("LBS") as at 30 June 2007 over a period of 60 months using ordinary least squares regression or the Scholes-Williams technique (including lag) where the stock us thinly traded. Canadian and European beta factors are calculated by Barra Inc as at 30 June 2007 over a period of 60 months using ordinary least squares regression.

5 Bloomberg betas have been calculated at 29 August 2007. Grant Samuel understands that betas estimated by Bloomberg are not calculated strictly in conformity with accepted theoretical approaches to the estimation of betas (i.e. they are based on regressing total returns rather than the excess return over the risk free rate). However, in Grant Samuel's view the Bloomberg beta estimates can still provide a useful insight into the systematic risks associated with companies and industries. The figures used are the Bloomberg "adjusted" betas.

6 MSCI is calculated using local currency so that there is no impact of currency changes in the performance of the index.

7 na = not available

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Equity Beta Factors for Selected Listed Companies

Company	Market Capital-isation (millions)	Monthly Observations over 4 years			Weekly Observations over 2 years	
		AGSM / Barra / Ibbotson / LBS	Bloomberg		Bloomberg	
			Local Index	MSCI	Local Index	MSCI
Liquor Retailing						
Australia						
National Leisure & Gaming[8]	A$91	na	na	na	na	na
Europe						
Hawesko Holding AG	€221	0.65	0.15	0.07	0.46	0.58
United Kingdom						
Enterprise Inns plc	£3,175	0.81	0.92	1.02	1.03	1.05
Mitchells & Butlers plc	£2,834	0.99	1.09	1.21	1.11	1.14
Punch Taverns plc	£2,789	0.90	1.35	1.52	1.13	1.31
Greene King plc	£1,394	0.59	0.74	0.88	1.23	1.22
Marston's plc	£988	0.69	1.03	1.13	1.00	1.11
J.D. Wetherspoon plc	£802	0.83	0.79	1.13	1.04	1.15
Majestic Wine plc	£223	0.81	0.80	0.78	0.49	0.47
North America						
Liquor Stores Income Fund[9]	C$358	na	na	na	0.64	0.69
Andrew Peller Limited	C$164	0.46	0.61	0.93	0.39	0.38
Minimum		*0.46*	*0.15*	*0.07*	*0.39*	*0.38*
Maximum		*0.99*	*1.35*	*1.52*	*1.23*	*1.31*
Median		*0.76*	*0.81*	*0.97*	*1.02*	*1.08*
Office Products						
Australia						
Corporate Express Australia	A$1,124	0.66	0.67	0.44	0.71	0.65
Europe						
Corporate Express N.V.	€1,545	1.86	1.97	2.41	1.19	1.51
North America						
Staples Inc	US$17,354	1.39	1.23	1.26	1.01	0.99
Office Depot Inc	US$6,354	1.68	1.58	1.79	1.18	1.13
OfficeMax Inc	US$2,691	1.14	1.13	1.06	0.93	0.90
United Stationers Inc	US$1,700	1.55	1.10	1.21	1.26	1.26
Minimum		*0.66*	*0.67*	*0.44*	*0.71*	*0.65*
Maximum		*1.86*	*1.97*	*2.41*	*1.19*	*1.51*
Median		*1.47*	*1.18*	*1.16*	*0.97*	*0.95*

Source: AGSM, Ibbotson, London Business School, Barra, Bloomberg

The table shows outcomes that suggest it is extremely difficult to determine a reliable beta for Coles Group:

- Coles Group's beta varies significantly depending on the measurement source (AGSM, Bloomberg etc) and, as discussed earlier, has varied significantly over time;
- individual company betas (for the same source/period) fall in a very wide range;
- some individual company betas vary significantly depending on which market index is utilised (Local or MSCI); and
- gearing levels vary significantly but this is not always consistent with beta factors.

[8] National Leisure & Gaming was listed in December 2005 and its beta is not reliable due to insufficient observations.

[9] Liquor Stores Income Fund was listed in September 2004 and therefore no beta is able to be calculated over a four year period.

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Finally, intuitively, it would be expected that the businesses of Coles Group would have a beta below 1.0 in view of the lower systematic risk of these businesses compared to the overall market.

3.2 Cost of Debt

A cost of debt of 7.0% has been adopted (a margin of 1.0% over the risk free rate). This figure represents the expected further cost of borrowing over the duration of the cash flow model. Grant Samuel believes that this would be a reasonable estimate of an average interest rate, including margin, that would match the duration of the cash flows assuming that the operations were funded with a mixture of short term and long term debt.

3.3 Debt/Equity Mix

The selection of the appropriate debt/equity ratio involves perhaps the most subjectivity of discount rate selection analysis. In determining an appropriate debt/equity mix, regard was had to gearing levels of Coles Group and the peer group companies used in the beta analysis.

Gearing levels for these companies for the past five years are set out below:

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Gearing Levels for Selected Listed Companies						
Company	Net Debt/(Net Debt + Market Capitalisation)					
	Financial Year Ended				Current[10]	Average Last 4 Years
	2003	2004	2005	2006		
Coles Group	**2.8%**	**(1.0%)**	**7.7%**	**3.6%**	**3.3%**	**3.3%**
Grocery and Discount Retailing						
Australia and New Zealand						
Woolworths Limited	6.8%	5.9%	12.4%	14.4%	6.6%	9.9%
Harvey Norman Holdings	12.6%	13.0%	19.1%	14.8%	11.0%	14.9%
Metcash Limited	2.8%	2.2%	28.2%	13.5%	10.8%	11.7%
David Jones Limited	(2.7%)	(14.1%)	19.8%	14.1%	19.9%	4.3%
The Warehouse Group	15.2%	18.8%	18.8%	7.4%	4.3%	15.0%
South Africa						
Shoprite Holdings Limited	(31.0%)	(31.3%)	(6.3%)	(5.6%)	(11.8%)	(18.5%)
Pick 'n Pay Stores Limited	(11.4%)	(16.2%)	(11.4%)	(5.3%)	(3.3%)	(11.1%)
Europe						
Group Carrefour S.A.	20.4%	21.5%	19.6%	16.3%	22.3%	19.4%
Metro AG	35.1%	29.9%	30.5%	25.1%	30.5%	30.2%
Koninklijke Ahold N.V.	43.3%	39.2%	31.6%	28.6%	(6.8%)	35.7%
Casino Guichard-Perrachon	29.4%	47.5%	47.6%	37.0%	45.9%	40.4%
Delhaize Group	45.1%	34.2%	37.1%	31.3%	26.5%	36.9%
Etn. Fr. Colruyt N.V.	(22.5%)	(11.7%)	(10.0%)	(9.2%)	(8.6%)	(13.3%)
United Kingdom						
Tesco plc	28.0%	17.1%	14.0%	13.3%	12.1%	18.1%
Marks and Spencer Group	21.1%	22.9%	24.9%	14.2%	12.7%	20.8%
J Sainsbury plc	24.3%	29.1%	21.3%	19.3%	12.0%	23.5%
Wm Morrisons Supermarkets	(7.2%)	(6.3%)	18.2%	19.0%	9.7%	5.9%
North America						
Wal-Mart Stores Inc	9.7%	8.4%	10.3%	14.4%	16.9%	10.7%
Target Corporation	28.8%	23.0%	14.2%	14.8%	16.1%	20.2%
Costco Wholesale Corporation	(1.4%)	(10.3%)	(15.2%)	(11.6%)	(9.6%)	(9.6%)
Sears Holdings Corporation	(43.3%)	(60.3%)	(2.2%)	(1.5%)	0.3%	(26.8%)
The Kroger Co.	38.0%	36.2%	39.5%	38.5%	20.6%	38.1%
Safeway Inc	44.4%	42.4%	30.4%	27.1%	25.5%	36.1%
Supervalu Inc	51.6%	30.2%	21.8%	16.0%	46.7%	29.9%
Loblaw Companies Limited	17.3%	16.2%	19.4%	18.0%	24.3%	17.7%
Metro Inc.	3.7%	(1.6%)	22.7%	19.9%	17.5%	11.2%
Minimum	*(43.3%)*	*(60.3%)*	*(15.2%)*	*(11.6%)*	*(11.8%)*	*(26.8%)*
Maximum	*51.6%*	*47.5%*	*47.6%*	*38.5%*	*46.7%*	*40.4%*
Median	*17.3%*	*17.1%*	*19.4%*	*14.8%*	*12.4%*	*17.7%*
Liquor Retailing						
Australia						
National Leisure & Gaming[11]	na	na	na	26.6%	64.9%	26.6%
Europe						
Hawesko Holding AG	18.1%	17.5%	7.6%	8.2%	11.0%	12.9%
United Kingdom						
Enterprise Inns plc	46.9%	63.0%	52.7%	48.2%	53.3%	52.7%
Mitchells & Butlers plc	42.1%	54.6%	46.9%	41.6%	47.2%	46.3%
Punch Taverns plc	65.6%	70.9%	58.9%	66.5%	64.8%	65.5%
Greene King plc	45.6%	38.9%	54.2%	52.9%	50.7%	47.9%
Marston's plc	47.5%	46.4%	48.8%	45.2%	53.7%	47.0%
J.D. Wetherspoon plc	38.9%	41.3%	40.6%	33.7%	31.8%	38.6%
Majestic Wine plc	(0.4%)	(3.4%)	(4.9%)	(2.8%)	(2.1%)	(2.9%)

10 Current gearing levels are based on the most recent balance sheet information and on share market prices as at 29 August 2007.

11 National Leisure & Gaming was listed in December 2005.

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Gearing Levels for Selected Listed Companies

Company	Net Debt/(Net Debt + Market Capitalisation)					
	Financial Year Ended				Current	Average Last 4 Years
	2003	2004	2005	2006		
Liquor Retailing (continued)						
North America						
Liquor Stores Income Fund[12]	na	na	18.7%	12.5%	8.4%	15.6%
Andrew Peller Limited	32.8%	29.2%	26.7%	41.4%	39.1%	32.5%
Minimum	*(0.4%)*	*(3.4%)*	*(4.9%)*	*(2.8%)*	*(2.1%)*	(2.9%)
Maximum	*65.6%*	*70.9%*	*58.9%*	*66.5%*	*69.6%*	65.5%
Median	*42.1%*	*41.3%*	*43.8%*	*41.4%*	*48.6%*	42.1%
Office Products						
Australia						
Corporate Express Australia	(0.8%)	(1.1%)	1.8%	3.5%	10.5%	0.8%
Europe						
Corporate Express N.V.	47.1%	53.2%	32.7%	38.9%	44.0%	43.0%
North America						
Staples Inc	(5.0%)	(6.1%)	(6.4%)	(5.3%)	(7.5%)	(5.7%)
Office Depot Inc	(1.0%)	(7.1%)	(0.9%)	4.1%	6.1%	(1.2%)
OfficeMax Inc	42.9%	(32.2%)	12.5%	(1.0%)	0.3%	5.6%
United Stationers Inc	0.5%	0.1%	0.2%	6.8%	7.2%	1.9%
Minimum	*(0.5%)*	*(32.2%)*	*(6.4%)*	*(5.3%)*	*(7.5%)*	*(5.7%)*
Maximum	*47.1%*	*53.2%*	*32.7%*	*38.9%*	*44.0%*	*43.0%*
Median	*(0.1%)*	*(3.6%)*	*1.0%*	*3.8%*	*6.7%*	*1.4%*

Source: Annual Reports, Quarterly Reports, IRESS, Bloomberg, Grant Samuel analysis

The selection of gearing levels is highly judgemental. The table shows a very wide range of gearing levels. The debt levels should actually be the weighted average measured over the same period as the beta factor rather than just at the current point in time. Moreover, these do not always bear any relationship to the betas of the individual companies.

Having regard to the above, the debt/equity mix has been estimated as 7.5% equity and 2.5% debt. This is regarded as being broadly consistent with the selected beta factors.

3.4 WACC

On the basis of the parameters outlined and assuming a corporate tax rate of 30%, the nominal WACC is calculated to be in the following ranges:

- Supermarkets, Coles Express and Coles Liquor 8.9-9.8%
- Kmart 9.3-10.2%
- Target 9.3-10.2%
- Officeworks 9.3-10.2%

This is an after tax discount rate to be applied to nominal ungeared after tax cash flows. However, it must be recognised that this is a very crude calculation based on statistics of limited reliability and involving a multitude of assumptions.

Having regard to these matters and the calculations and data set out above, the following ranges of discount rates have been selected for application in the discounted cash flow analysis:

[12] Liquor Stores Income Fund was listed in September 2004.

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▪ Supermarkets, Coles Express and Coles Liquor	9.0-10.0%
▪ Kmart	9.5-10.5%
▪ Target	9.5-10.5%
▪ Officeworks	9.5-10.5%

4 Dividend Imputation

The conventional WACC formula set out above was formulated under a "classical" tax system. The CAPM model is constructed to derive returns to investors after corporate taxes but before personal taxes. Under a classical tax system, interest expense is deductible to a company but dividends are not. Investors are also taxed on dividends received. Accordingly, there is a benefit to equity investors from increased gearing.

Under Australia's dividend imputation system, domestic equity investors now receive a taxation credit (franking credit) for any tax paid by a company. The franking credit attaches to any dividends paid out by a company and the franking credit offsets personal tax. To the extent the investor can utilise the franking credit to offset personal tax, then the corporate tax is not a real impost. It is best considered as a withholding tax for personal taxes. It can therefore be argued that the benefit of dividend imputation should be added into any analysis of value.

There is no generally accepted method of allowing for dividend imputation. In fact, there is considerable debate within the academic community as to the appropriate adjustment or even whether any adjustment is required at all. Some suggest that it is now appropriate to discount pre tax cash flows, with an increase in the discount rate to "gross up" the market risk premium for the benefit of franking credits that are on average received by shareholders. On this basis, the discount rate might increase by approximately 2% but it would be applied to pre tax cash flows. However, not all of the necessary conditions for this approach exist in practice:

- not all shareholders can use franking credits. In particular, foreign investors gain no benefit from franking credits. If foreign investors are the marginal price setters in the Australian market there should be no adjustment for dividend imputation. In this context, foreign investors represent less than 2% of Coles Group's share register;
- not all franking credits are distributed to shareholders; and
- capital gains tax operates on a different basis to income tax. Investors with high marginal personal tax rates will prefer cash to be retained and returns to be generated by way of a capital gain.

Others have proposed a different approach involving an adjustment to the tax rate in the discount rate by a factor reflecting the effective use or value of franking credits. If the credits can be used, the tax rate is reduced towards zero. The proponents of this approach have in the past suggested a factor of up to 50% as representing the appropriate adjustment (gamma). Alternatively, the tax charge in the forecast cash flows can be decreased to incorporate the expected value of franking credits distributed.

There is undoubtedly merit in the proposition that dividend imputation affects value. Over time dividend imputation will become factored into the determination of discount rates by corporations and investors. In Grant Samuel's view, however, the evidence gathered to date as to the value the market attributes to franking credits is insufficient to rely on for valuation purposes. More importantly, Grant Samuel does not believe that such adjustments are widely used by acquirers of assets at present. While acquirers are undoubtedly attracted by franking credits there is no clear evidence that they will actually pay extra for them or build it into values based on long term cash flows. The studies that measure the value attributed to franking credits are based on the immediate value of franking credits distributed and do not address the risk and other issues associated with the ability to utilise them over the longer term. Accordingly, it is Grant Samuel's opinion that it is not appropriate to make any such adjustments in the valuation methodology. This is a conservative approach.

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Appendix 2

Market Evidence - Transactions

In the last five years there have been a number of transactions in Australia and internationally involving the acquisition of supermarket operators, liquor retailing, department store retailers (discount and up-market) and office product retailers. In addition, in the prior period there were a number of major supermarkets transactions (e.g. acquisition of Progressive Enterprises, ASDA Group, Delhaize America) which are useful comparisons to Coles Group's activities. All of the transactions provided evidence of prices that acquirers are willing to pay and provide some support for the multiples implied by the valuation of the Coles Group's everyday needs, discount retail and office supplies businesses.

Recent Transaction Evidence

Date	Target	Transaction	Consideration[1] (millions)	Revenue Multiple[2]		EBITDA Multiple[3]		EBIT Multiple[4]	
				historical[5]	forecast	historical	forecast	historical	forecast
Supermarkets – Australia and New Zealand									
May 05	Foodland Associated Limited	Acquisition by Woolworths/Metcash	A$3,014	0.5	0.5	9.7	9.0	12.8	12.3
Dec 04	Metcash Trading Limited	Selective capital reduction of Metoz's 60% shareholding	A$1,866	0.3	0.3	9.2	9.0	10.0	10.3
Jun 02	Woolworths New Zealand	Acquisition by Foodland Associated Limited	NZ$690	0.4	0.4	7.3	na	13.8	na
Jun 99	Progressive Enterprises Limited	Acquisition by Foodland Associated Limited	NZ$558	0.3	0.3	7.4	7.0	12.2	10.8
Supermarkets – United Kingdom and Europe									
Jun 07	J Sainsbury plc	Acquisition of 7.07% to increase the interest of Delta Two Limited to 24.99%	£10,481	0.7	0.7	12.7	11.4	27.6	22.1
Dec 05	Hyparlo SA	Acquisition of 51.1% by Carrefour SA	€612	0.5	0.5	13.0	12.4	22.8	22.6
Oct 05	Somerfield plc	Acquisition by Violet Acquisitions Limited	£1,080	0.3	0.2	7.6	7.4	19.6	16.3
Dec 04	Big Food Group plc	Acquisition by Bauger Group consortium	£326	0.1	0.1	4.0	4.4	7.9	9.0
Oct 04	Ahold Supermercados Spain	Acquisition by Permira Advisors LLP	€685	0.3	na	13.4	na	na	na
May 04	Centros Comerciales Carrefour SA	Acquisition of remaining 2.82% by Carrefour SA	€5,064	0.4	na	6.1	na	10.2	na
Dec 03	Safeway plc	Acquisition by Wm Morrison Supermarkets plc	£3,000	0.5	0.5	7.2	7.4	10.5	11.5
Oct 02	T&S Stores plc	Acquisition by Tesco plc	£377	0.6	na	8.9	na	11.3	na
Jun 02	Budgens plc	Acquisition of 72% by Musgrave Group	£274	0.6	na	9.5	na	14.6	na
Jun 99	ASDA Group	Acquisition by Wal-Mart Stores Inc	£6,987	0.9	0.8	12.9	12.1	17.0	16.9

1 Implied equity value if 100% of the company or business had been acquired.

2 Represents gross consideration divided by revenue. The gross consideration is the sum of the equity and/or cash consideration plus borrowings net of cash.

3 Represents gross consideration divided by EBITDA. EBITDA is earnings before net interest, tax, depreciation, amortisation, investment income and significant and non-recurring items.

4 Represents gross consideration divided by EBIT. EBIT is earnings before net interest, tax, investment income and significant and non-recurring items.

5 Historical multiples are based on the most recent publicly available full year earnings prior to the transaction date. Forecast multiples are based on earnings forecasts from a range of brokers' reports available at transaction announcement date.

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Recent Transaction Evidence

Date	Target	Transaction	Consideration (millions)	Revenue Multiple		EBITDA Multiple		EBIT Multiple	
				historical	forecast	historical	forecast	historical	forecast
Supermarkets – North America									
Apr 07	Sobeys Inc	Acquisition of 27.9% by Empire Company Limited	C$3,801	0.3	0.3	7.8	7.8	12.5	13.1
Mar 07 pending	Pathmark Stores, Inc	Acquisition by Atlantic & Pacific Tea Company Inc	US$679	0.3	0.3	13.8	10.6	na	50.7
Feb 07 pending	Wild Oats Markets Inc	Acquisition by Whole Foods Markets Inc	US$567	0.6	0.5	15.8	10.3	38.5	22.0
Feb 07	Smart & Final Inc	Acquisition by Apollo Management	US$773	0.4	0.4	10.5	8.8	19.6	14.2
Apr 06	Marsh Supermarkets Inc	Acquisition by Sun Capital Partners Inc	US$93	0.2	na	10.0	na	48.4	na
Jan 06	Albertson's Inc	Acquisition by Supervalu Inc, CVS Corporation and an investor group	US$10,938	0.4	0.4	7.5	7.3	14.2	14.0
Jul 05	A&P Canada	Acquisition by Metro Inc	US$1,696	0.4	0.4	10.6	9.9	na	na
Dec 04	Bi-Lo Holdings and Bruno's Supermarkets	Acquisition by Lone Star Funds	US$524	0.2	0.2	5.5	na	23.1	na
Mar 04	Shaw's Supermarkets Inc	Acquisition by Albertson's LLC	US$2,107	0.5	0.5	6.9	6.0	11.0	9.3
Sep 01	Bruno's Supermarkets Inc	Acquisition by Ahold	US$543	0.4	0.3	10.4	8.3	18.8	15.1
Sep 00	Delhaize America	Acquisition of 55% by Delhaize Group	US$3,658	0.4	0.4	5.4	4.9	7.6	7.5
Aug 99	Hannaford Bros	Acquisition by Delhaize Group	US$3,267	1.1	1.0	13.0	11.9	19.5	18.0
Liquor Retailing – Australia and New Zealand									
Jun 2007	Pub operations of Iris Hotel Group	Acquisition by National Leisure & Gaming Limited	A$85	na	na	8.0	na	na	na
Apr 07	Pub operations of Gaming Asset Management Pty Limited	Acquisition by National Leisure & Gaming Limited	A$64	1.9	na	10.0	na	na	na
Apr 07	Pub operations of Grant Samuel Laundy Pub Fund	Acquisition by National Leisure & Gaming Limited	A$80	1.8	na	12.9	na	na	na
Feb 06	Hedley Hotel Group	Acquisition by Coles Myer Limited	A$321	1.0	na	8.5	na	na	na
Oct 05	Taverner Hotel Group	Acquisition by Bruandwo Pty Limited	A$377	na	1.4	na	9.2	na	na
Jul 05	26 hotels and 8 club management contracts of Bruce Mathieson Group	Acquisition by Woolworths Limited	A$199	na	1.8	na	na	na	na
Oct 04	Australian Leisure and Hospitality Group	Acquisition by Bruandwo Pty Limited	A$1,325	1.5	1.4	12.2	9.9	16.7	13.1
Dec 02	Theo's Liquor	Acquisition by Coles Myer Limited	A$232	1.3	na	na	na	na	na
Apr 01	Australian Liquor Group Limited	Acquisition by Coles Myer Limited	A$52	0.5	0.4	5.7	4.3	7.0	5.2
Liquor Retailing – United Kingdom									
May 07	279 tenanted pubs of Marston's plc	Acquisition by aAIM Group plc	£83	na	na	11.0	na	na	na
Apr 07	869 leased and tenanted pubs of Punch Taverns plc	Acquisition by Admiral Taverns Limited	£326	na	na	10.8	na	na	na
Jul 06	239 pubs of Whitbread plc	Acquisition by Mitchells & Butlers plc	£497	2.6	na	11.0	na	13.4	na
Jun 06	Orchid Group	Acquisition by GI Partners	£571	2.5	na	9.4	na	na	na
Dec 05	Spirit Group Limited	Acquisition by Punch Taverns plc	£423	na	2.2	9.6	9.5	na	12.4

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Recent Transaction Evidence									
Date	Target	Transaction	Consideration (millions)	Revenue Multiple		EBITDA Multiple		EBIT Multiple	
				historical	forecast	historical	forecast	historical	forecast
Liquor Retailing – North America									
May 07	Liquor Barn Income Fund	Acquisition by Liquor Stores Income Fund	C$174	1.8	1.3	24.3	17.4	41.4	26.4
Mar 07	Beverages & More Inc	Acquisition by Towerbrook Capital Partners LP	US$205	0.6	na	9.7	na	na	na
Department Stores – Australia and New Zealand									
Mar 06	Myer Department Stores	Acquisition by Newbridge Capital	A$1,409	0.5	0.5	14.5	11.7	36.1	23.4
Department Stores – United Kingdom and Europe									
Apr 04	Koninklijke Vendex KBB NV	Acquisition by VDXK Acquisition BV	€1,397	0.5	0.5	7.0	6.5	13.7	11.4
Sep 03	Debenhams plc	Acquisition by PE Consortium	£1,770	1.0	1.0	7.0	6.2	10.2	9.4
Department Stores – North America									
Mar 07	Dollar General Corporation	Acquisition by KKR	US$7,300	0.8	0.7	14.4	11.5	24.7	17.4
Oct 05	Shopko Stores, Inc	Acquisition by Sun Capital Partners	US$948	0.4	0.4	6.3	6.2	11.6	11.1
May 05	The Neiman Marcus Group, Inc	Acquisition by Private Equity Consortium	US$5,200	1.5	1.3	12.0	10.0	15.4	12.5
Mar 05	Toys R Us, Inc	Acquisition by Private Equity Consortium	US$6,621	0.6	0.5	9.3	6.8	20.1	na
Feb 05	The May Department Stores Company	Acquisition by Federated Department Stores	US$11,567	1.2	1.1	9.3	8.5	14.1	11.9
Nov 04	Sears, Roebuck and Co.	Merger of Sears Roebuck and Kmart	US$11,542	0.4	0.5	4.1	9.3	5.3	19.8
Nov 04	Barneys New York, Inc	Acquisition by Jones Apparel Group Inc	US$307	0.9	na	10.5	8.2	15.8	11.0
Jul 04	Mervyns LLC	Acquisition by Investor Group	US$1,650	0.5	na	5.6	na	8.5	na
Jun 04	Marshall Field's	Acquisition by May Department Stores	US$3,200	1.2	1.1	12.1	13.9	21.9	na
Office Supplies – Australia and New Zealand									
Dec 02	Viking Office Products Pty Limited	Acquisition by Coles Myer Limited	A$68-90	0.5-0.6	na	9.6-12.0	na	12.9-17.1	na
Office Supplies – North America									
Jul 03	OfficeMax Inc	Acquisition by Boise Cascade	US$1,377	0.3	0.3	11.7	9.4	50.7	22.6
Jul 02	Medical Arts Press Inc	Acquisition by Staples Inc	US$385	2.3	2.1	8.6	8.3	na	na
Office Supplies – Europe									
Aug 06	Andvord Tybring-Gjedde ASA	Acquisition by Buhrmann NV	NOK1,995	0.9	0.9	15.0	10.7	18.1	15.7
Dec 04	Rexel SA	Acquisition of 73.5% by private equity consortium	€2,608	0.6	0.6	11.9	10.3	15.0	12.6
Apr 03	Guilbert's Contract Business	Acquisition by Office Depot	€855	0.6	na	10.4	na	13.2	na
Aug 02	Guilbert's Mail Order Business	Acquisition by Staples Inc	€825	1.9	1.8	na	15.0	na	na

Source: Grant Samuel analysis[6]

[6] Grant Samuel analysis based on data obtained from IRESS, company announcements, transaction documentation and, in the absence of company published financial forecasts, brokers' reports. Where company financial forecasts are not available, the median of the financial forecasts prepared by a range of brokers has generally been used to derive relevant forecast value parameters. The source, date and number of broker reports utilised for each transaction depends on analyst coverage, availability and corporate activity.

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A brief summary of each transaction is set out below:

Supermarkets

Foodland Associated Limited / Woolworths Limited and Metcash Trading Limited

In May 2005, Woolworths Limited ("Woolworths") and Metcash Trading Limited ("Metcash") announced an agreement with Foodland Associated Limited ("Foodland") to purchase all of its assets. Woolworths acquired the Progressive supermarket business in New Zealand and 20 Action stores and two development sites in Australia. Metcash acquired Foodland's Western Australian grocery wholesaling business and the remainder of the Action supermarket chain. The total consideration paid for Foodland by Woolworths and Metcash was approximately A$3 billion.

Woolworths paid approximately A$2.5 billion for its component of the acquisition. Based on an apportionment of the EBITDA for the 22 Action sites that Woolworths acquired, historical and forecast EBITDA multiples for the acquisition were 10.1 and 9.9 times respectively. The acquisition provided Woolworths with a footprint in New Zealand and additional operations in Western Australia.

Metcash paid A$711 million for the businesses that it acquired. Based on an apportionment of the EBITDA for the 60 Action sites that Metcash acquired, historical and forecast EBITDA multiples for the acquisition were 8.7 and 6.9 times respectively. The purchase expanded Metcash's IGA business to over 400 SUPA IGA retail stores.

Metcash Trading Limited / Newco (wholly owned subsidiary of Metcash Trading Limited)

On 6 December 2004, Metcash announced a capital reorganisation under which, Newco, a wholly owned subsidiary, acquired all of the shares in Metoz Holdings Limited ("Metoz"). Metoz's major asset was a 52% shareholding in Metcash. The acquisition was effectively a buyout by Metcash minority shareholders of the majority shareholder, Metoz. The acquisition was implemented via a scheme of arrangement where Metoz shareholders received cash consideration of R2.65 per Metoz share and valued Metoz at R4.8 billion. The transaction implied an equity value for Metcash of A$2.92 per share, or A$1.87 billion for 100%.

Woolworths New Zealand / Foodland Associated Limited

In June 2002, Dairy Farm International Holdings Limited ("Dairy Farm") announced an agreement to sell Woolworths New Zealand to Foodland. At the time of the acquisition, Woolworths was the third largest participant in the New Zealand grocery retailing market with 85 supermarkets, 26 mini-marts and three warehouses.

Foodland Associated Limited / Progressive Enterprises Limited

In June 1999 Foodland Associated Limited ("Foodland") launched a bid to acquire all shares held by minority shareholders of Progressive Enterprises for cash consideration of NZ$2.90 per share, later increased to NZ$3.00 per share. The offer was successful, with Foodland moving to compulsory acquisition of all remaining shares on 23 August 1999.

J. Sainsbury plc / Delta Two Limited

On 2 February 2007, a consortium of CVC Capital Partners, Texas Pacific Group and The Blackstone Group International Limited announced that they were at the preliminary stages of assessing whether to proceed with an offer for J. Sainsbury plc ("Sainsbury"). Over the next few months the consortium held discussions with the Sainsbury board but in April 2007 decided to cease discussions. During this period, property investor Robert Tchenguiz built a 5.1% in Sainsbury. The other major shareholder is the Sainsbury family with 18%. In late April 2007, Delta Two Limited ("Delta Two"), a fund backed by the state of Qatar, acquired a stake of approximately 18% in Sainsbury. On 15 June 2007, Delta Two acquired a further 7.07% of the issued capital of Sainsbury for £732 million to take its interest to 24.99%. Delta Two's intentions in relation to its interest are not known but are believed to involve the creation of a property trust structure for Sainsbury's freehold or long-leasehold property. Sainsbury's board has stated that it is not its intention to undertake such a strategy.

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Hyparlo SA / Carrefour SA

On 21 December 2005, Carrefour SA ("Carrefour") made a bid to acquire the 51.1% in Hyparlo SA ("Hyparlo") that it did not already own. Hyparlo retails food and non-food products and distributes consumer services under the Carrefour brand operating 16 hypermarket franchises; 12 in France and four in Romania. It also operates auto centres in France under the 'Feu Vert' franchise. The bid followed a transaction whereby Carrefour increased its stake in Hyparlo from 20% to 48.7% by acquiring an indirect 28.7% interest in a way that did not require it to make a bid for the remaining capital. However, in September 2005 the Court of Appeal in Paris ruled that a full bid should be made. The multiples implied by the eventual transaction are relatively high reflecting the synergies available to Carrefour as well as the growth opportunities represented by the business footprint in Romania.

Somerfield plc / Violet Acquisitions Limited

On 14 October 2005, Violet Acquisitions Limited, a consortium consisting of Apax Partners Worldwide LLP, Barclays Capital and the Tchenguiz Family Trust, announced that it had agreed to purchase all of the shares in Somerfield plc ("Somerfield") for £1.97 per share. A number of approaches to Somerfield had been made in the preceding month. The total value of the acquisition (including assumed debt) was £1.3 billion. Somerfield's aim was to be the leading small-format retailer in the United Kingdom. The group consisted of 814 Somerfield stores and 494 Kwik Save stores as at 30 April 2005.

Big Food Group / Baugur Group

On 30 November 2004, Baugur Group, Iceland's largest retail company, offered £0.95 per share for Big Food Group, owner of United Kingdom frozen food retail chain "Iceland". The bid represented an acquisition price of £326 million. In December 2004 the offer price was scaled back from an initial acquisition price of £1.10 per share following concerns over deteriorating trading results during the offer period and the size of the target's pension liability.

Ahold Supermercados Spain / Permira Advisors LLP

In October 2004, Permira Advisors LLP ("Permira") announced that it had agreed to purchase Ahold's Spanish food retail business for €685 million. Ahold's Spanish business operated almost 600 stores in mainland Spain and the Canary Islands with net sales in 2003 of approximately €2 billion. It traded under a number of brands including SuperSol, HiperSol, HiperDino, Netto and CashDiplo. The sale of the business was part of Ahold's strategy to optimize its portfolio and to strengthen its financial position. The purchase was Permira's first acquisition in Spain.

Centros Comerciales Carrefour SA / Carrefour SA

On 31 May 2004 Carrefour launched a tender offer for the 2.82% of Centros Comerciales Carrefour SA ("Centros") that it did not already own. Centros was a Spanish company operating 1,471 supermarkets, 3,510 hard discount stores and 336 other format stores in Europe, Latin America and Asia. Centros was formed by the merger of Carrefour's two majority owned Spanish grocery retailers in 2000. Subsequently, in 2002, Carrefour had attempted to acquire the remaining 20.3% of Centros but had been left holding only 97.18%. The multiples implied by the transaction are relatively low as there were no material synergy benefits that would accrue to Carrefour.

Safeway Plc / Wm Morrison Supermarkets plc

On 15 December 2003, Wm Morrison Supermarkets plc ("Morrison") announced a takeover offer for all shares in Safeway plc ("Safeway") for consideration of 1 Morrison share plus £0.60 for each Safeway share. At the prior closing share price of Morrison, this valued the equity in Safeway at exactly £3 billion. At the time of acquisition, Safeway was the fourth largest food retailer by market share in the United States with 479 stores, 194 petrol stations and 59 petrol station/convenience stores operated under a joint venture with BP.

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T&S Stores Plc / Tesco plc

In October 2002, Tesco plc ("Tesco") offered £377 million for 100% of convenience store operator T&S Stores plc ("T&S Stores"). The deal, settled in January 2003, saw Tesco acquire 862 convenience stores. The acquisition price was settled through the issue of Tesco ordinary shares. Tesco acquired £153 million of T&S Stores' debt in addition to the acquisition price.

Budgens plc / Musgrave Group plc

In August 2000, the Musgrave Group plc ("Musgrave") acquired 28% of British supermarket chain Budgens plc ("Budgens"). In September 2002, Musgrave subsequently acquired the remaining shares in the company. At that time, Budgens operated 234 supermarkets and convenience stores in the South East of England.

ASDA Group / Wal-Mart Stores Inc

In June 1999 Wal-Mart Stores Inc ("Wal-Mart") acquired all of the stock of ASDA Group ("ASDA"), the third largest retailer in the United Kingdom, for a purchase price of approximately £7 billion. ASDA had 229 stores at the time of the acquisition. The acquisition of ASDA was a strategic move marking Wal-Mart's entry into the United Kingdom which is indicated by the multiples implied by the transaction.

Sobeys Inc / Empire Company Limited

On 26 April 2007 Sobeys Inc ("Sobeys") announced that it had entered into an arrangement whereby Empire Company Limited ("Empire") would acquire the 27.9% of Sobeys that it did not already own. Sobeys operates 1,317 grocery stores and distribution centres across Canada. Corporate and franchised stores are operated under the banners IGA extra, IGA, Price Chopper, Foodland, Needs, Lawtons, Bonichoix, Food Town, Commisso's and Sobeys Express. Sobeys recent trading has been impacted by Wal-Mart's entry into the Canadian market, resulting in competitive pressure on grocery margins. Empire is a diversified Canadian company with activities in food retailing, real estate, theatre operations and corporate investment. The offer was found to be fair from a financial point of view to the minority shareholders by RBC Dominion Securities Inc ("RBC"). In particular, RBC found that there were no material synergies that would accrue to Empire as a consequence of the transaction. The minority shareholders approved the transaction in June 2007.

Pathmark Stores Inc / The Great Atlantic & Pacific Tea Company Inc

On 5 March 2007, The Great Atlantic & Pacific Tea Company Inc ("A&P") announced that it had entered into an agreement to acquire Pathmark Stores Inc ("Pathmark") for US$1.24 billion. Each holder of a Pathmark share received US$9.00 in cash and 0.129630 of an A&P share. A&P management predicted annual integration synergies of approximately US$150 million within two years, through cost reductions in overheads, greater efficiencies, increased utilisation of support facilities and the adoption of mutual best practices between the two companies. As a consequence, the historical EBITDA multiples implied by the transaction would decrease to around 5 times.

Wild Oats Markets Inc / Whole Foods Market Inc

On 21 February 2007, Whole Foods Market Inc ("Whole Foods Market") announced that it would acquire Wild Oats Markets Inc, a chain of natural and organic food markets in the United States and Canada for US$697 million. All of Whole Foods Market's 11 operating regions gained stores, with three of its smallest regions gaining critical mass. Whole Foods Market also gained immediate access to a number of new markets. Whole Foods Market expected to recognise significant synergies through goodwill and amortisation cost reductions, greater purchasing power, increased utilisation of support facilities and new team member talent. As a consequence, the historical EBITDA multiple implied by the transaction could decrease to around 7 times. The transaction was completed on 28 August 2007.

Smart & Final Inc / Apollo Management, LP

On 20 February 2007, Smart & Final Inc ("Smart & Final") announced that it had entered into an agreement to be acquired by Apollo Management, LP for a price of US$22 per share. Including debt, total consideration paid by Apollo was approximately US$827 million. Smart & Final operated 254 non-membership warehouse stores

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for food and food-service supplies in California, Oregon, Washington, Arizona, Nevada, Idaho and northern Mexico.

Marsh Supermarkets Inc / Sun Capital Partners IV, LP. and Sun Capital Partners Inc

On 27 September 2006, Sun Capital Partners announced that it had completed the acquisition of Marsh Supermarkets Inc ("Marsh Supermarkets") for the purchase price of US$11.125 per share. The bid represented an acquisition price of approximately US$334 million, including around US$204 million in assumed debt. Marsh Supermarkets operated 68 Marsh supermarkets, 38 LoBill Foods stores, eight O'Malia food markets, 154 Village Pantry convenience stores and two Arthur's Fresh Market stores in Indiana and western Ohio.

Albertson's Inc / Supervalu Inc, CVS Corporation and an Investor Group

On 23 January 2006, Supervalu Inc ("Supervalu"), CVS Corporation ("CVS") and an investment group led by Cerberus Capital Management (including Kimco Realty, Schottenstein Stores Corporation, Lubert-Adler Partners and Klaff Realty), announced an agreement to acquire Albertson's Inc ("Albertsons") for US$17.4 billion in cash, stock and debt assumption. Albertsons' stockholders received US$20.35 in cash and 0.182 shares of Supervalu stock for each of their Albertsons' shares. The Albertsons business was to be split between parties as follows:

- Supervalu acquired approximately 1,124 of Albertsons' food and food/drug combination stores. The acquisition made Supervalu the second largest supermarket chain in the United States, tripling its retail operations. Pre-tax synergies of US$150 million to US$175 million were forecast by the end of the third full year. The planned synergies were primarily related to better economies of scale across the new retail footprint, optimisation of the supply chain network and elimination of redundant costs;
- CVS acquired approximately 700 standalone Sav-On and Osco drugstores in southern California, the southwest and Midwest, as well as a distribution centre in La Habra, California. CVS also acquired Albertsons' ownership interests in the drugstore real estate. The acquisition provided immediate market leadership and scale for CVS in the Southern California Drugstore Market and considerably boosted CVS market share in other key markets. CVS expected the acquisition to be accretive to earnings and cash flow in 2007 and beyond; and
- the Cerberus-led group acquired stores in Dallas/Fort Worth, Northern California, Florida, the Rocky Mountains and the Southwest.

A&P Canada / Metro Inc

On 19 July 2005, A&P Canada ("A&P") entered into an agreement where Metro Inc ("Metro") would purchase all of the outstanding shares in A&P, for US$1.46 billion (including cash, stock, and assumed debt). The deal allowed the Montreal-based Metro to expand its operations in Ontario, where A&P was operating 234 stores and 5 distribution centres at the time of the acquisition. A&P would retain 15% of Metro by virtue of the stock issue.

Bi-Lo Holdings and Bruno's Supermarkets / Lone Star Funds

On 23 December 2004, Koninklijke Ahold NV ("Ahold") announced that it had entered into an agreement so sell its United States retail subsidiaries BI-LO and Bruno's to Lone Star Funds ("Lone Star") for total cash proceeds of €524 million. Lone Star assumed debt obligations of €400 million including capitalised lease obligations, although Ahold guaranteed a "significant portion" of the capitalised lease obligations. BI-LO operated 287 stores in South Carolina, North Carolina, Georgia and Tennessee. Bruno's operated 168 stores in Alabama, Florida, Georgia and Mississippi.

Shaw's Supermarkets / Albertson's Inc

In April 2004, Albertsons completed the acquisition of all of the outstanding capital stock of JS USA Holdings Inc ("Shaw's") from J Sainsbury plc. Shaw's operated approximately 200 Shaw's Supermarkets and Star Markets in New England. The purchase price for Shaw's was US$2.475 billion which included the assumption of approximately US$368 million in capital lease obligations. At the time Shaw's was the 11th largest supermarket operator in the United States. The acquisition expanded Albertsons presence into Northeastern America.

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Bruno's Supermarkets / Koninklijke Ahold NV

In September 2001, Ahold announced its intention to acquire United States food retailer Bruno's Supermarkets. Bruno's operated a chain of 185 stores under the banners of Bruno's (superstores), Food World and Food Max (supermarkets) and Food Fair (convenience stores) located in Alabama, Florida, Mississippi and Georgia.

Delhaize America Inc / Delhaize Group

In September 2000, the boards of Delhaize Group (Brussels listed) and Delhaize America Inc. ("Delhaize America") announced a merger of the companies to be implemented by way of an exchange of all outstanding shares in Delhaize America for ordinary shares of Delhaize Group. The proposed conversion ratio of Delhaize America shares into Delhaize Group shares represented a premium of 32% over the pre-offer 20-day average closing price of Delhaize America shares. The conversion ratio was later increased from 0.35:1 to 0.4:1 to take account of a reduction in Delhaize Group's share price during the offer period. As the transaction was structured as a merger, the exchange ratio did not reflect a premium above a full enterprise value for Delhaize America. The transaction resulted in Delhaize Group increasing its ownership in Delhaize America from 45% to 100%, expanding its shareholder base, simplifying its ownership structure and commencing dual listing on the Brussels and New York stock exchanges. At the time of the acquisition, Delhaize America was the fifth largest supermarket company in the US, operating 1,420 supermarkets in 16 states and employing 116,000 people.

Hannaford Brothers / Delhaize America

On 18 August 1999, Delhaize America agreed to acquire Hannaford Brothers Co ("Hannaford Brothers") for US$3,267 million. Hannaford Brothers had 150 supermarkets in Maine, New Hampshire, Vermont, New York, Massachusetts, Virginia, North Carolina and South Carolina operating under the names Shop 'n Save and Hannaford. The acquisition was strategic allowingd Delhaize America to expand into the northeastern United States.

Liquor Retailing

Pub operations of Iris Hotel Group / National Leisure & Gaming Limited

On 25 June 2007, National Leisure & Gaming Limited ("NLG") announced the acquisition of the leasehold hotel operations of the Iris Hotel Group ("Iris") for A$85 million (A$91 million including transaction costs and government fees and taxes). The Iris portfolio comprised nine hotels in Western Sydney operating 240 gaming machines.

Pub operations of Gaming Asset Management Pty Limited / National Leisure & Gaming Limited

On 11 April 2007, NLG announced the acquisition of seven hotel leasehold businesses held by Gaming Asset Management Pty Limited ("GAM") for A$63.5 million. The GAM portfolio consisted of seven gaming orientated hotels in Western Sydney operating 180 gaming machines. Some of the hotels have drive through bottle shops.

Pub operations of the Grant Samuel Laundy Pub Fund / National Leisure & Gaming Limited

On 3 April 2007, NLG announced a merger with the ten hotel leasehold businesses held by the GSL Pub Operations Trust (part of the Grant Samuel Laundy Pub Fund) for A$80 million. The portfolio of hotels are located in New South Wales, four on Sydney's North Shore, five regional hotels and a Sydney city hotel, a number with bottle shops. The historical multiples implied by the transaction are overstated as the historical earnings only reflect full year contributions from eight of the ten hotels.

Hedley Hotel Group / Coles Myer Limited

On 24 February 2006, Coles Myer Limited announced the acquisition of the Hedley Hotel Group for A$321 million (including inventory and transaction costs). The Hedley Hotel Group incorporated 36 hotels, 103 bottle shops and sites for an additional 17 1st Choice Liquor Superstores in Queensland. This acquisition was considered important strategically in strengthening Coles Myer's liquor business.

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Taverner Hotel Group / Bruandwo Pty Limited

On 26 October 2005, Bruandwo Pty Limited ("Bruandwo") (a joint venture company owned 75% by Woolworths Limited and 25% by Bruce Mathieson Group) announced the acquisition of the Taverner Hotel Group for A$377 million (including transaction costs). The Taverner Hotel Group comprised 33 leasehold hotels located in Victoria (18), South Australia (12) and New South Wales (3) and approximately 2,000 gaming machines. It was a strategic fit for Bruandwo's existing hotel business providing an additional 27 retail liquor locations.

26 hotels and 8 club management contracts of Bruce Mathieson Group / Bruandwo Pty Limited

On 1 July 2005, Bruandwo acquired 26 hotels and 8 club management contracts previously owned by interests associated with Bruce Mathieson for A$199 million. This acquisition occurred as part of the formation of the joint venture between Woolworths and Bruce Mathieson Group.

Australian Leisure& Hospitality Group Limited / Bruandwo Pty Limited

On 2 July 2004, Bruandwo announced that it had acquired a 16% interest in Australian Leisure & Hospitality Group Limited ("ALH") on-market at an average price of A$2.62. Bruandwo sought discussions with ALH which could lead to a takeover. ALH operated gaming, on-premise and retail liquor operations and had been spun out of Foster's Group Limited ("Foster's") in 2003. ALH did not own any of the properties underlying its operations but leased them on a long term basis from ALE Property Group ("ALE"), Foster's or third parties. In addition, ALH retained the right to develop the 105 pub venues leased from ALE and Foster's. At the date of the transaction, ALH operated 133 pub venues (including 620 two and three star hotel rooms), 261 retail outlets (including 111 detached bottle shops, 103 drive-through bottle shops, 18 walk-in and 29 liquor barns) and 5,910 gaming machines.

On 8 July 2004, Bruandwo announced a takeover offer at A$2.75 per ALH share. ALH rejected the offer and applied to the Takeovers Panel alleging unacceptable circumstances. A stalemate developed and on 28 September 2004, ALH announced a recommended offer of A$3.05 per share from Newbridge Capital. On 30 September 2004, Bruandwo increased its offer to A$3.15 per share (ex-dividend) and ALH recommended the increased offer. On 13 October 2004, Coles Myer Limited and Macquarie Bank Limited ("Coles/Macquarie") announced a recommended proposal to acquire ALH by way of a scheme of arrangement at A$3.35 per share. Bruandwo announced its intention to vote against the scheme and on 19 October 2004 increased its offer to A$3.40, provided it received acceptances to increase its interest to in excess of 20% or A$3.50 if in excess of 50%. On 22 October 2004, the Coles/Macquarie consortium increased their offer by way of a scheme of arrangement to A$3.75 per share. Bruandwo announced an increase to its unconditional offer to A$3.76 per share once its interest exceeded 20%. By February 2005, Bruandwo's interest exceeded 90% and it proceeded to compulsorily acquire the remaining shares in ALH. The multiples which resulted from the competitive bidding process exceeded previous multiples paid for liquor retailing businesses and indicated a period of consolidation in the sector as the large retailers increased their participation.

Theo's Liquor / Coles Myer Limited

On 17 December 2002, Coles Myer Limited ("Coles Myer") announced the acquisition of Theo's Liquor chain which comprised 49 liquor stores and 4 hotels operating under the "Theo's" and "Crown of the Hill" banners in New South Wales and the Australian Capital Territory and had sales of more than A$175 million. It was a strategic purchase increasing Coles Myer's liquor outlets to 591.

Australian Liquor Group Limited / Coles Myer Limited

Coles Myer acquired an 18% interest in Australian Liquor Group Limited ("ALG") in April 2001 and announced its intention to make an offer for the company at A$1.20 per share. ALG was formed by the amalgamation of independent liquor store retailers and listed in June 2000 with 42 stores across Australia (11 in Victoria, 21 in Western Australia and 3 in New South Wales). The amalgamation occurred to increase the competitiveness of independent retailers against the two large players, Coles Myer and Woolworths. The multiples shown in the table are based on ALG's pro forma prospectus financial information however, the market understood that ALG was unlikely to meet its forecast (and therefore the multiples may be understated). ALG's directors recommended acceptance of the offer.

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279 tenanted pubs of Marston's plc / aAIM Group

On 10 May 2007, Marston's plc ("Marston's") announced the sale of 279 tenanted pubs to Piccadilly Licensed Properties Limited, a company owned and controlled by aAIM Group for £82.5 million. Marston's engages in brewing beer and operating pubs in the United Kingdom.

869 leased and tenanted pubs of Punch Taverns plc

On 19 April 2007, Punch Taverns plc ("Punch") announced the sale of 869 leased and tenanted pubs in England and Wales to Admiral Taverns Limited ("Admiral") for £326 million. Admiral is the largest independently owned pub company in the United Kingdom. Following this acquisition Admiral's portfolio comprised approximately 2,700 pubs and Admiral became the third largest owner and operator of tenanted and leased pubs in the United Kingdom.

239 pub-restaurants of Whitbread plc / Mitchells & Butlers plc

On 21 July 2006, Mitchells & Butlers ("Mitchells & Butlers") plc acquired 239 pub restaurants in the United Kingdom (including 4 under development) for £497 million from Whitbread plc. The price paid was considered to be high, but there was expectation of significant synergies and trading improvements from conversion to banners of Mitchells & Butlers.

Orchid Group / GI Partners

On 8 June 2006, GI Partners (a private equity group focussed on businesses and properties in the United States and Western Europe) announced the acquisition of the Orchid Group from Spirit Group plc ("Spirit") for £571 million. Orchid Group operated 290 pub bars and restaurants across the United Kingdom.

Spirit Group Limited / Punch Taverns plc

On 1 December 2005, Punch acquired Spirit from a private equity consortium for £439.6 million. Spirit was the owner and operator of 1,832 pubs in the United Kingdom. Punch had identified that 41% of the pubs purchased had potential to be converted to the leased/tenanted model and a further 4% sold for alternative uses. The remaining pubs were expected to continue to be operated as managed assets.

Liquor Barn Income Fund / Liquor Stores Income Fund

On 10 April 2007, Liquor Stores Income Fund ("Liquor Stores") (an unincorporated open ended Canadian Trust) announced an offer to acquire all of the trust units outstanding of Liquor Barn Income Fund ("Liquor Barn"). Liquor Barn operates 81 liquor stores (62 in Alberta and 19 in British Columbia) making it a leading operator of private liquor stores in Western Canada. Liquor Stores participates in the retail liquor industry in Alberta and British Columbia through its 75.6% interest in Liquor Stores Limited Partnership which operates 107 private liquor stores in Canada. The offer was 0.53 of a trust unit in Liquor Stores in exchange for each Liquor Barn trust unit and valued Liquor Barns are approximately C$158 million. The offer was rejected. On 26 May 2007, Liquor Stores and Liquor Barn agreed an enhanced offer of 0.57 Liquor Stores unit per Liquor Barn unit, valuing Liquor Barns at C$174 million based on the most recent price for Liquor Stores. The multiples implied by the transaction are high, reflecting the substantial synergies available from merging the businesses.

Beverages & More Inc / TowerBrook Capital Partners LP

On 1 March 2007, TowerBrook Capital Partners LP acquired Beverages & More Inc from Madison Dearborn Partners LLC (a principal investment firm) for US$205 million. Beverages & More Inc operates wine, spirits and beer stores in the United States. It was founded in 1994 and distributes product through the internet and retail stores.

Department Stores

Myer Department Stores / Newbridge Capital

On 13 March 2006, Coles Myer announced that it had reached an agreement to sell its Myer department store business to Newbridge Capital and The Myer Family for A$1.4 billion. Myer had 61 stores operating at the time

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of the sale, achieving sales of close to A$3 billion in 2004-5. Myer had been underperforming for a number of years and Newbridge Capital expected to derive significant cost savings post acquisition. The multiples implied by the transaction reflects the expectations of synergies.

Koninklijke Vendex KBB NV / VDXK Acquisition BV

On 26 April 2004, VDXK Acquisition BV ("VDXK"), a holding company incorporated in the Netherlands controlled by a consortium comprising Kohlberg Kravis Roberts & Co LP ("KKR"), Change Capital Partners LLP and AlpInvest Partners NV, made an amended bid of €15.40 for all of the shares in Koninklijke Vendex KBB NV ("Vendex KBB"), the largest non-food retailer in the Netherlands. The bid was reduced from €16.00 to reflect Vendex KBB's poorer than expected financial results. At the end of 2003 Vendex was approached by a number of large international private equity houses regarding a possible public offer for the company. In reaction, the board of Vendex KBB decided to undertake a preliminary sale process. Proposals of around €14 per share were received, and two parties were allowed to participate in a more extensive due diligence process, leading to an initial bid of €16 from VDXK. The total consideration paid by VDXK was €2.2 billion.

Debenhams plc / Private Equity Consortium

In September 2003, a consortium comprising CVC Partners, Texas Pacific Group and Merrill Lynch Private Equity announced an offer of £4.55 per share for all of the shares in Debenhams plc ("Debenhams"), a chain of 144 department stores predominantly based in the United Kingdom. The total cash paid for the company was £1.78 billion.

Dollar General Corporation / Kohlberg Kravis Roberts & Co. L.P.

On 12 March 2007, Dollar General Corporation ("Dollar General") announced that it had entered into an agreement to be acquired by KKR for approximately US$7.3 billion. Under the terms of the agreement, Dollar General shareholders received US$22 in cash for each of their shares. Dollar General was a discount retailer of general merchandise in the United States with 8,260 neighbourhood stores carrying food, snacks, health aids and cleaning supplies, as well as basic apparel and houseware. The multiples implied by the transaction are relatively high as Dollar General had been underperforming for a number of years and KKR expected both a turnaround in sales and cost savings to eventuate post acquisition.

Shopko Stores Inc / Sun Capital Partners

In December 2005, Shopko Stores Inc ("Shopko") agreed to be purchased by Sun Capital Partners ("Sun Capital") for a price of US$29 a share or US$921 million. Shopko operated 137 Shopko stores and 216 Pamida stores throughout the Midwest United States. The ShopKo retail segment consisted of a multi-department retailer located primarily in mid to large size communities. Pamida Retail was a general merchandise retailer serving smaller and more rural communities, offering a one-stop shopping format. Sun Capital has now separated the two businesses.

Neiman Marcus Group Inc / Private Equity Consortium

In May 2005, a consortium made up of Texas Pacific Group and Warburg Pincus LLC announced that it had signed an agreement with Neiman Marcus Group Inc ("Neiman Marcus") to purchase all of its shares for US$5.2 billion. The Neiman Marcus operations consisted of Neiman Marcus and Bergdorf Goodman department stores, and a direct marketing division operating print catalogue and online operations.

Toys'R'Us Inc / Private Equity Consortium

On 17 March 2005, a consortium of KKR, Bain Capital Partners LLC and Vornado Realty Trust announced that they had agreed to acquire Toys'R'Us Inc ("Toys'R'Us") for a price of US$26.75 per share. The acquisition was for the entire Toys'R'Us company, including its baby goods business, and came after Toys'R'Us originally entertained bids solely for its toys division. Toys'R'Us sold merchandise through over 1,500 stores, including 677 toy stores in the United States and 620 international toy stores, including licensed and franchise stores as well as through its Internet sites at www.toysrus.com, www.imaginarium.com and www.sportsrus.com. Babies "R" Us was the largest baby product specialty store chain in the world, selling merchandise through 220 stores in the United States as well as on the Internet at www.babiesrus.com.

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The May Department Stores Company / Federated Department Stores

On 28 February 2005, Federated Department Stores ("Federated") announced the acquisition of The May Department Stores Company ("May") for US$17.5 billion. Each May Department Store shareholder received US$17.75 per share in cash and 0.3115 shares of Federated stock. At the end of fiscal 2004, May operated 491 department stores in 46 states in the United States, the District of Columbia and Puerto Rico. As a result of the acquisition Federated increased its retail footprint and expected to realise approximately US$450 million in cost synergies by 2007 from the consolidation of central functions, division integrations, national advertising and economies of scale.

Sears, Roebuck and Company / Kmart Holding Corporation

In November 2004, Kmart Holding Corporation ("Kmart") and Sears, Roebuck and Company ("Sears") entered an agreement to merge under the new name "Sears Holdings Corporation". The combined entity had almost 3,500 retail stores. Kmart shareholders received one share in Sears Holdings whilst Sears' shareholders received US$50 in cash or 0.5 of a Sears Holdings share, prorated so that in the aggregate 55% of Sears' shares would be converted into Sears Holdings shares and 45% would be converted into cash. The deal had a value of approximately US$11 billion to Sears' shareholders and came less than 18 months after Kmart emerged from bankruptcy. The combination of the two companies was estimated to generate US$500 million of annualised cost and revenue synergies from cross-selling opportunities, improved purchasing scale and other efficiencies. Due to the sale of Sears' credit card business in the year preceding the transaction, the historical multiples shown for Sears are not meaningful.

Barneys New York, Inc / Jones Apparel Group, Inc

In November 2004, Barneys New York Inc ("Barneys") and Jones Apparel Group Inc ("Jones Apparel") entered into a merger agreement whereby Jones Apparel would acquire Barneys by paying US$19 per share to each Barneys' stockholder. Barneys was a luxury retailer of men's and women's fashion, accessories, cosmetics and home furnishings, operating flagship stores in New York City, Beverly Hills and Chicago as well as three regional full price stores, four CO-OP Barneys New York stores and eleven outlet stores. The acquisition of the luxury retailer significantly diversified the brand portfolio of Jones Apparel.

Marshall Field's business / The May Department Stores Company
Mervyns LLC / Investor Group

In June 2004, Target Corporation ("Target") announced that it would be selling its Marshall Field's business to May for US$3.2 billion. The assets sold by Target included 62 Marshall Field's locations, 3 distribution centres related to Marshall Field's, US$600m of credit card receivables and 9 Mervyn' Stores locations. The sale of Marshall Field's by Target allowed them to concentrate on their core discount business. Marshall Field's accounted for 5.4% of Target's total revenue in 2003. May's expected to realise pre–tax synergies of US$85 million in fiscal year 2005, US$140 million in fiscal year 2006, and US$180 million per year thereafter.

The second part of Target's department store divestment, the sale of Mervyns LLC ("Mervyns"), was announced on 29 July 2004. An investor group consisting of Sun Capital, Cerberus Capital Management LP and Lubert-Adler and Klaff Partners LP paid US$1.65 billion in cash for 257 Mervyns' stores and four distribution centres. US$475 million in credit card receivables attributable to Mervyns were sold to GE Consumer Finance. It was likely that underperforming stores would be developed or sold for their realty by Lubert-Adler and Klaff Realty.

The prices paid for both Marshall Fields and Mervyns far exceeded the price that brokers were estimating prior to the sale. The multiples for Marshall Field's and Mervyns include an apportionment of Mervyns' revenue and EBITDA to account for the 9 Mervyns stores acquired by May.

Office Supplies

Viking Office Products Pty Limited / Coles Myer Limited

On 2 December 2002, Coles Myer announced that Officeworks would acquire Viking Office Products Pty Limited ("Viking Office Products") for an undisclosed amount. Brokers estimated an acquisition price of between A$60-90 million. At the time of the acquisition Viking Office Products was Australia's largest direct

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marketer of office supplies and Officeworks was Australia's largest retailer of office supplies, with 62 stores around Australia.

OfficeMax Inc / Boise Cascade Corporation

On 14 July 2003, Boise Cascade Corporation ("Boise Cascade") acquired OfficeMax Inc ("Office Max") for US$1.336 billion in cash and stock. The acquisition more than doubled the size of Boise Cascade's office distribution business, allowing them to provide an integrated solution to clients, when combined with their existing business. Boise Cascade expected synergy benefits to reach approximately US$160 million when fully implemented, from purchasing leverage due to increased scale, logistics, marketing, paper sales and administration. OfficeMax had nearly 1,000 superstores in North America offering office products, business machines and office furniture.

Medical Arts Press Inc / Staples Inc

In July 2002, office supplier Staples Inc ("Staples") acquired Medical Arts Press Inc ("Medical Arts Press Inc") for a price of US$385 million. Medical Arts sold medical stationary and office products through multiple catalogues, including marketing materials and gifts to give to children visiting medical practices.

Andvord Tybring-Gjedde ASA / Buhrmann NV

In August 2006, Buhrmann NV made a takeover offer for all of the issued capital in Andvord Tybring-Gjeddes ASA ("ATG"), a Norwegian company which offered a range of corporate supplies to the business market in the Nordic region. The Andvord family and senior management which owned 39.9% and 0.22% of the issued capital respectively had accepted the offer. The purchase price was NOK1,995 million (or approximately €271 million) and synergies were expected from merging with Buhrmann's Swedish operations.

Rexel SA / Private Equity Consortium

In March 2005, a consortium of investors led by Clayton Dubilier & Rice, Eurzeo and Merrill Lynch Global Private Equity ("the consortium") acquired Pinault Printemps Redoute (PPR) Group's 73.45% controlling stake in Rexel SA ("Rexel") for €38.5 cash per share. Rexel is the world leader in professional distribution of electrical equipment. At the time of the transaction, Rexel was located in 29 countries with a network of 1,700 branches and was listed on Euronext Paris. In accordance with French stock market regulation, the consortium offered Rexel's minority shareholders the same guaranteed price of €38.5 per share through a mandatory tender offer. By April 2005, the consortium held 100% of the share capital and voting rights of Rexel.

Guilbert's Contract Business / Office Depot Inc

In June 2003, Office Depot acquired all the common shares of Guilbert SA ("Guilbert") from Pinault-Printemps-Redoute. The purchase price was €815 million in cash, subject to an upward adjustment of €40 million in cash or Office Depot's common stock if the price per share of Office Depot common stock closes at or above US$20 per share for any five consecutive trading days during the 18-month period following 2 June 2003. Guilbert was a leading contract stationer in the United Kingdom, Ireland and Continental Europe. The multiples calculated assume the contingency payment was made.

Guilbert's Mail Order Business / Staples Inc

In October 2002, Staples acquired the European mail order business of Guilbert SA, a subsidiary of Pinault-Printemps-Redoute, for approximately €825 million. The business acquired is a leading direct mail office products reseller to small businesses in France, Spain, Belgium, the United Kingdom and Italy. Staples is a retailer of office supplies, business services, furniture and technology to consumers and businesses.

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Australia – Other Retailing

In the last two years, there have also been transactions in Australia involving major specialist retailers which provide some guidance of the value parameters that acquirers are willing to pay for retail businesses in Australia:

Recent Transaction Evidence – Other Retailing (Australia)

Date	Target	Transaction	Consideration (millions)	Revenue Multiple		EBITDA Multiple		EBIT Multiple	
				historical	forecast	historical	forecast	historical	forecast
May 07 pending	Colorado Group Limited	Acquisition of 16.5% by ARH Investments Pty Limited	A$600	1.3	1.2	11.3	9.7	15.1	12.1
Dec 06	Repco Corporation Limited	Acquisition by CCMP Capital Asia	A$336	0.6	0.6	8.2	8.9	10.5	11.8
Nov 06	Rebel Sport Limited	Acquisition by Archer Capital Pty Limited	A$374	1.2	1.1	11.5	10.6	15.6	14.2
Nov 06	Brazin Limited	Acquisition by BB Retails Capital Pty Limited	A$219	0.5	0.5	7.9	7.6	15.1	14.4
Sep 06	Colorado Group Limited	Acquisition of 81.5% interest by ARH Investments Pty Limited	A$451	1.0	0.9	8.1	7.6	10.3	9.7

Colorado Group Limited / ARH Investments Pty Limited

On 8 May 2007, ARH Investments Pty Limited ("ARH") (part of private equity group Affinity Equity Partners) made a takeover offer for the 16.4% of Colorado Group Limited ("Colorado") that it did not already own. Colorado is an Australian footwear and apparel retailer and wholesaler with more than 440 stores in Australia and New Zealand. Divisions include Colorado, Mathers, Williams the Shoeman, JAG, Diana Ferrari and Pairs. ARH had acquired 83.5% of the issued shares of Colorado in a takeover bid initially made in July 2006. After control passed in that transaction, the company was geared up to pay a special dividend of 52 cents per share (approximately A$50 million).

Repco Corporation Limited / CCMP Capital Asia

On 11 December 2006, CCMP Capital Asia announced that it had offered A$1.75 per share to acquire all of the shares in Repco Corporation Limited ("Repco") for A$336 million in cash. Repco operated over 450 locations in Australia and New Zealand and was the largest distributor of automotive aftermarket parts, tools and accessories in those countries.

Rebel Sport Limited / Archer Capital Pty Limited

In November 2006, Archer Capital Pty Limited ("Archer Capital") and Rebel Sport Limited ("Rebel") announced that they had signed an agreement to implement a scheme of arrangement where Archer Capital would acquire all of the shares in Rebel for A$4.60 per share. Rebel is a retailer of sporting and leisure goods including footwear, clothing and equipment. A-mart All Sports, also a discounted sports retailer, is owned by Archer Capital. It is proposed that the two brands will continue to operate as separate businesses although some back office synergies were expected to accrue.

Brazin Limited / BB Retail Capital Pty Limited

On 3 November 2006, BB Retail Capital Pty Limited ("BB Retail") made an offer of A$1.81 cash per share to acquire all of the shares of Brazin Limited ("Brazin"). BB Retail held a 62.4% relevant interest in Brazin at the time of the offer. Brazin was an Australian speciality retailer and owner of a range of fashion, entertainment and homewares businesses.

Colorado Group Limited / ARH Investments Pty Limited

In September 2006, ARH made a revised offer of $4.70 per share for all the shares in Colorado. ARH's original unsolicited offer of A$4.50 per share had been rejected by Colorado's board of directors. The revised offer was unconditional and ARH acquired 83.5% of the issued shares.

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Appendix 3

Market Evidence – Listed Companies

The valuation of Coles Group has been considered in the context of the sharemarket ratings of Australian and international companies with activities primarily in grocery retailing, liquor retailing, discount department store retailing and the supply of office products.

Grocery and Discount Retailing

Grocery and discount retailers provide a wide range of day-to-day consumables including perishable groceries, homewares, electronics, fuel, apparel, pharmaceuticals and financial services. Discount retailers are distinguished by operating primarily in the sale of hard or soft goods (not grocery items) while hypermarkets and supermarkets usually derive earnings from a wide range of general consumable goods, fresh groceries and financial services. Companies operate through several retail formats including neighbourhood stores, traditional supermarkets, large-scale 'hypermarkets' and online ordering or home delivery services. Convenience stores only represent a minor business segment for the companies selected for this analysis.

While none of the grocery and discount retailing companies is precisely comparable to the Coles Group Supermarkets, Coles Express, Kmart and Target businesses, the sharemarket data provides a framework within which to assess their valuation.

Sharemarket Ratings of Selected Comparable Companies– Grocery and Discount Retailing[1]

Company	Category[2]	Market Capital-isation[3] (million)	EBITDA Multiple[4] (times)			EBIT Multiple[5] (times)			Price Earning Multiple[6] (times)		
			Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2
Australia and New Zealand											
Woolworths Limited	S/DD	A$34,504	13.6	11.8	10.7	17.4	14.9	13.4	26.5	21.7	19.3
Harvey Norman Holdings[7]	D	A$5,261	11.2	10.8	9.8	13.5	12.8	11.5	19.0	18.7	16.1
Metcash Limited	S/W	A$3,576	11.2	10.2	9.3	13.0	11.6	10.6	20.4	17.7	15.3
David Jones Limited[7]	D	A$2,334	13.7	12.1	11.1	16.5	14.5	13.2	21.3	18.6	17.0
The Warehouse Group7	DD	NZ$1,733	9.7	9.0	8.5	12.0	11.3	10.8	17.9	16.2	15.4
Minimum			*9.7*	*9.0*	*8.5*	*12.0*	*11.3*	*10.6*	*17.9*	*16.2*	*15.3*
Maximum			*13.7*	*12.1*	*11.1*	*17.4*	*14.9*	*13.4*	*26.5*	*21.7*	*19.3*
Median			*11.2*	*10.8*	*9.8*	*13.5*	*12.8*	*11.5*	*20.4*	*18.6*	*16.1*
South Africa											
Shoprite Holdings Limited	S/DD	R16,486	7.8	7.3	6.3	10.2	9.9	8.5	18.4	16.7	14.1
Pick 'n Pay Stores Limited	S/DD	R14,888	9.0	7.3	6.4	12.2	10.3	8.8	22.0	15.8	13.6
Europe											
Group Carrefour S.A.	S/DD	€35,548	9.3	9.0	8.4	13.6	13.6	12.6	18.5	18.6	16.7
Metro AG	S/D/DD	€19,520	8.9	8.4	7.7	14.4	13.7	12.3	21.4	20.8	17.6
Koninklijke Ahold N.V.	S/D/W	€14,372	5.3	6.3	5.8	9.2	10.3	9.9	17.4	19.0	17.8
Casino Guichard-Perrachon	S/DD	€7,098	7.5	6.7	6.2	11.2	10.2	9.4	16.3	13.5	12.6
Delhaize Group	S/DD	€6,887	6.3	6.2	6.0	9.6	9.3	8.7	15.8	15.3	13.0
Etn. Fr. Colruyt N.V.	S/DD	€5,052	9.9	9.0	8.5	12.4	11.4	10.6	19.2	17.7	16.5
Minimum			*5.3*	*6.2*	*5.8*	*9.2*	*9.3*	*8.7*	*15.8*	*13.5*	*12.6*
Maximum			*9.9*	*9.0*	*8.5*	*14.4*	*13.7*	*12.6*	*21.4*	*20.8*	*17.8*
Median			*8.2*	*7.6*	*7.0*	*11.8*	*10.8*	*10.2*	*17.9*	*18.2*	*16.6*

1 The companies have a variety of year ends and report annual results based on 52 or 53 weeks. The data presented for each company is for the most recent historical results and the subsequent two forecast years.

2 S = Supermarkets; D = Department Stores; DD = Discount Department Stores; W = Wholesaling

3 Market capitalisation based on sharemarket prices as at 29 August 2007.

4 Represents gross capitalisation (that is, the sum of the market capitalisation adjusted for minorities, plus borrowings less cash as at the latest balance date) divided by EBITDA. EBITDA is earnings before net interest, tax, depreciation, amortisation and non-recurring items.

5 Represents gross capitalisation divided by EBIT. EBIT is earnings before net interest, tax and non-recurring items.

6 Represents the market capitalisation divided by net profit after tax before non-recurring items.

7 Harvey Norman Holdings Limited, David Jones Limited and The Warehouse Group Limited are due to report their 2007 results in September 2007. For the purposes of this table the historical multiples for these companies are based on brokers' forecasts for the 2007 year and the forecast multiples are based on the subsequent two forecast years.

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Sharemarket Ratings of Selected Comparable Companies– Grocery and Discount Retailing

Company	Category	Market Capital-isation (million)	EBITDA Multiple (times)			EBIT Multiple (times)			Price Earning Multiple (times)		
			Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2
United Kingdom											
Tesco plc	S/DD	£33,056	10.7	10.1	9.0	14.3	13.6	12.0	17.7	17.1	15.1
Marks and Spencer Group	D	£10,335	9.1	8.2	7.6	11.4	10.6	9.9	15.2	13.6	12.2
J Sainsbury plc	S	£9,196	11.3	10.0	9.0	24.6	19.6	16.5	35.3	28.8	23.4
Wm Morrisons Supermarkets	S	£7,301	12.0	10.1	8.7	20.8	16.1	13.7	33.0	23.8	18.8
Minimum			*9.1*	*8.2*	*7.6*	*11.4*	*10.6*	*9.9*	*15.2*	*13.6*	*12.2*
Maximum			*12.0*	*10.1*	*9.0*	*24.6*	*19.6*	*16.5*	*35.3*	*28.8*	*23.4*
Median			*11.0*	*10.1*	*8.8*	*17.6*	*14.9*	*12.9*	*25.3*	*20.4*	*17.0*
North America											
Wal-Mart Stores Inc	S/D/DD	US$181,567	8.6	7.7	7.3	10.9	10.2	9.3	14.9	14.2	13.3
Target Corporation	D/DD	US$55,336	10.0	8.7	7.7	13.0	11.7	10.4	19.6	17.6	15.6
Costco Wholesale	S/DD	US$28,261	12.1	11.2	9.9	15.9	14.8	12.8	25.0	24.5	21.6
Sears Holdings Corporation	DD	US$22,219	6.9	7.6	6.8	9.9	11.6	10.1	14.2	17.6	15.2
The Kroger Company	S/D/DD	US$19,516	6.9	6.5	6.2	10.9	10.4	9.5	17.1	16.4	14.6
Safeway Inc	S	US$15,085	7.7	7.2	6.7	12.5	11.5	10.6	16.9	16.6	15.2
Supervalu Inc	S	US$9,667	8.4	6.6	6.2	14.0	10.6	9.7	20.5	15.5	13.3
Loblaw Companies Limited	S/DD	C$12,442	9.7	9.4	8.7	14.8	13.5	12.4	36.9	18.1	16.4
Metro Inc	S	C$4,113	7.9	7.3	7.2	11.2	10.2	9.9	16.1	13.3	13.0
Minimum			*6.9*	*6.5*	*6.2*	*9.9*	*10.2*	*9.3*	*14.2*	*14.2*	*13.3*
Maximum			*12.1*	*11.2*	*9.9*	*15.9*	*14.8*	*12.8*	*36.9*	*24.5*	*21.6*
Median			*8.5*	*7.8*	*7.2*	*12.8*	*11.5*	*10.2*	*18.4*	*17.1*	*15.2*

Source: Grant Samuel analysis[8]

The multiples shown above are based on sharemarket prices as at 29 August 2007 and do not reflect a premium for control.

The companies have a variety of year ends although there is some consistency by geographical region:

- Australia and New Zealand: all have a 30 June year end with the exception of Metcash Limited ("Metcash") which has a 30 April year end and David Jones Limited ("David Jones") and The Warehouse Group Limited ("Warehouse Group") which have 31 July year ends;
- Europe: all have a 31 December year end except Etn. Fr. Colruyt N.V. ("Colruyt") which has a 31 March year end;
- United Kingdom: J. Sainsbury plc ("Sainsbury") and Marks and Spencer Group plc ("M&S") have a 31 March year end, Wm. Morrisons Supermarkets plc ("Wm. Morrisons") has a 31 January year end and Tesco plc ("Tesco") has a 28 February year end; and
- North America: Metro Inc. has a 30 September year end, Costco Wholesale Corporation ("Costco") has a 31 August year end, Safeway Inc. ("Safeway") and Loblaw Companies Limited ("Loblaw") have a 31 December year end and Supervalu Inc ("Supervalu") has a 28 February year end while the remaining North American companies have 31 January year ends.

The data analysed for each company included the last two years' historical results plus the subsequent two forecast years. However, the data presented above represents an alignment of the financial data for three companies (Harvey Norman Holdings Limited ("Harvey Norman"), David Jones and The Warehouse Group) which are yet to report their 2007 results. Under this alignment, the brokers' forecasts for 2007 have been treated as the actual results and the brokers' forecasts for the subsequent two years are adopted as the forecast results. While relatively crude, this alignment is arguably more useful for the purposes of analysis than leaving the data unadjusted.

[8] Grant Samuel analysis based on data obtained from IRESS, company announcements and, in the absence of company published financial forecasts, brokers' reports. Where company financial forecasts are not available, the median of the financial forecasts prepared by a range of brokers has generally been used to derive relevant forecast value parameters. The source, date and number of broker reports utilised for each company depends on analyst coverage, availability and recent corporate activity.

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A brief description for each company is set out below.

Woolworths Limited

Woolworths Limited ("Woolworths") is Australia's largest supermarket and grocery retailer operating approximately 980 supermarkets, 1,027 liquor stores, 505 petrol outlets, 142 discount retailers, 400 consumer electronics stores and 263 pubs. In Australia, Woolworths' primary businesses operate under the Woolworths and Safeway supermarket, Dan Murphy's, BWS and ALH Group liquor, Woolworths/Caltex and Woolworths petrol and Big W retailing brands. Consumer electronics retailing includes Dick Smith Electronics, Dick Smith Powerhouse and Tandy stores in Australia and Croma in India. Woolworths also operates over 200 supermarkets in New Zealand and grocery wholesaling services in Australia through Statewide Independent Wholesalers. For the year ended 30 June 2007, 82% of retail EBITA was derived from supermarkets (including New Zealand, liquor and petrol), 8% from pubs, 6% from Big W and 3% from consumer electronics. Woolworths has recently acquired a 10% stake in The Warehouse Group Limited ("The Warehouse Group") and announced its interest in increasing that stake.

Harvey Norman Holdings Limited

Harvey Norman is a holding company for integrated franchised and non-franchised retail, property and financial service groups. Over 174 franchised businesses are licensed to operate under the Harvey Norman, Domayne and Joyce Mayne brands and primarily sell furniture, electrical goods, computers, telecommunications, softline and hardline homewares and furnishings. Harvey Norman also operates wholly owned stores and joint ventures in New Zealand, Singapore, Ireland, Malaysia and Slovenia and actively trades and holds interests in related retailing and diversified Australian and international companies. It also offers some retail lending services. In the year to June 2006, Harvey Norman generated income (including from equity accounted operations and franchises) from product sales (64%), franchisee fees and rent (31%), property investment, trading and rent (4%) and joint ventures and associates (>1%). In November 2005, Harvey Norman acquired six loss-making Megamart stores from Coles Group and in March 2007 sold its interest in Rebel Sports. Earnings from Rebel Sports are included in the historical analysis. Harvey Norman is considered to have limited comparability to Coles Group's activities but is included in the analysis as a major retailing business in Australia.

David Jones Limited

David Jones operates as a premium department store retailer across Australia. It operates 37 stores and a store credit card business which represented approximately 29% of EBIT in 2006. David Jones has positioned itself as a retailer of brand products and its recent performance has benefited from changes in the industry including the sale of Myer by Coles Group.

Metcash Limited

Metcash operates primarily as a wholesale distributor servicing the Australian food, liquor and consumer goods sectors. Metcash supplies over 4,000 independent supermarkets and 13,000 liquor hotels and outlets through the IGA Distribution, Campbells Cash & Carry and Australian Liquor Marketers brands. Operating primarily as a distribution business, Metcash is not directly comparable with Coles Group, given that it derives approximately 81% of profit before tax (before unallocated items) from food distribution, 9% from liquor distribution and only 10% from Cash & Carry stores.

The Warehouse Group Limited

The Warehouse Group operates large format retailing businesses in New Zealand through its 85 Warehouse 'hypermarket' outlets (including two Warehouse Extra stores) and 43 Warehouse Stationery stores. The group derives over 90% of retail EBITA from the provision of discount goods including home and garden wares, consumer electronics, pharmaceuticals and groceries with less than 10% of retail EBITA coming from Warehouse Stationery outlets. The share market price has been affected in recent times by approaches by potential acquirers including Foodstuffs (NZ) Limited and Woolworths.

Shoprite Holdings Limited

Shoprite Holdings Limited ("Shoprite") is the largest listed supermarket operator in Africa operating over 886 retail outlets across Africa and South East Asia under the Shoprite, Checkers, Checkers Hypers, Usave grocery and hypermarket brands and general retail, electrical and furniture stores OK Furniture, OK Power Express, House and Home and Hungry Lion (fast food stores). Shoprite also earns income from financial services,

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franchising and distribution operations.

Pick 'n Pay Stores Limited

Pick 'n Pay Stores Limited ("Pick 'n Pay") operates over 730 food, clothing, liquor, pharmacy and general discount stores in Africa and Australia. 535 stores are operated in South Africa under the Pick 'n Pay, Score and Boxer retail banners, 122 Pick 'n Pay, TM and Score supermarkets are operated in other African regions and in Australia it operates 79 Franklins stores. PWK Holdings Limited, a listed South African investment company, currently holds almost 50% of Pick 'n Pay. Historical earnings were impacted by retail employee strikes, new systems integration and warehousing facilities in Australia.

Groupe Carrefour S.A.

Groupe Carrefour S.A. ("Group Carrefour") is the second largest retailer in the world, operating in 29 countries across Europe, South America and Asia and managing a range of store formats including hypermarkets, supermarkets, discount retailers, convenience stores and wholesale distributors. Carrefour derives approximately 80% of retail EBITA from its 12,000 owned and franchised hypermarkets and supermarkets and the remaining 20% balance from hard discount retailers, convenience stores and wholesale cash and carry operations. Over 50% of sales are from outside of France and the group has recently announced further intention to expand into emerging markets in Asia and Latin America (each currently contributing approximately 7% of group sales).

Metro AG

Metro AG is the German holding company for the Metro Group, a large retailer and global distributor operating over 2,200 cash and carry outlets, hypermarkets, supermarkets, consumer electronics and departments stores. While approximately half of company sales are derived from within Germany, Metro AG has a presence in over 30 European and Asian countries through its Metro Cash & Carry (global wholesale distributor), Real und Extra (supermarkets), Media Markt and Saturn (non-food and consumer electronics) and Galeria Kaufhof (department store) businesses. Metro also offers additional marketing, financial and logistics services to wholesale and retail customers and derives additional earnings from its substantial freehold property assets.

Koninklijke Ahold N.V.

Dutch based Koninklijke Ahold N.V. ("Ahold") operates supermarkets, hypermarkets, discount retailers, wholesale and internet-based distribution services in Europe, North and South America and Asia. In 2006 over 70% of earnings were derived from United States businesses: Stop & Shop supermarkets and pharmacies, Giant Landover general discount stores, Tops and Giant Carlisle supermarkets and local stores and Peapod internet distributors. The majority of earnings within Europe were earned by Albert Heijin, Albert and Hypernova supermarkets in the Netherlands and Central Europe. Through joint ventures, Ahold also operates liquor stores (Gall & Gall), health and beauty businesses (Etos) and holds interests in supermarkets in Scandinavia (ICA Group) and Portugal (Jeronimo Martins). Between 2000 and 2005, Ahold's acquisition strategy in Central Europe and fraudulent activity in the United States Food Services business negatively impacted profitability. In 2006, Ahold announced its plans to focus on its United States and European supermarkets, undertake a €3 billion share buyback and to dispose its Polish, United States Food Service, Tops and Jeronimo Martins business interests. The results of the restructuring to date have exceeded markets expectations.

Casino Guichard-Perrachon S.A.

Casino Guichard-Perrachon S.A. ("Groupe Casino") is a French food and general consumer goods retailer which operates in 14 countries through over 9,200 hypermarkets, supermarkets, discount stores, convenience stores and pharmacies. It also offers additional services such as catering, cafeterias, banking and online shopping. In 2006, French retailing generated almost 80% of retail EBITA with the remainder derived from North and South America (11%), Asia (9%) and other European countries (<1%). Brands include: Leader Price discount retailing and Franprix local supermarkets (providing 33% of group EBITA); Geant and Casino hypermarkets and supermarkets (33% EBITA); Monoprix metropolitan supermarkets and pharmacies (14%); Petit Casino, Spar and Vival convenience stores and franchises (12%); and Casino Cafeteria and other operations (7%). In 2007 Groupe Casino disposed of over €1.5 billion of non-core assets, including interests in Taiwan, Poland and the United States.

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Delhaize Group

Delhaize Brothers and Co ("The Lion") (Delhaize Group) S.A. ("Delhaize Group") is a Belgian company which operates over 2,450 supermarkets, neighbourhood/convenience stores and specialty pharmacy, health and discount retailers across Belgium, Europe, the United States and South East Asia. In the year to December 2006 75% of group operating profit was derived from sales under the United States grocery retail brands Food Lion, Bloom, Bottom Dollar, Harvey's, Hannaford, Sweetbay and Kash'n'Karry. The balance of earnings was generated by Delhaize in Belgium (20%) and Alfa-Beta in Greece (5%).

Etn. Fr. Colruyt N.V.

Colruyt is a Belgian company which operates a range of discount and specialist supermarkets, convenience stores and export distribution services across Belgium and France, as well as fuel, wholesaling and related retail technology operations. The company operates on a low discount, high turnover strategy and offers basic 'warehouse' format stores. Over 90% of sales are derived from within Belgium under retail banners including Colruyt, Collivery (home delivery), Spar, OKay, Bio-Planet (an organic supermarket) and Dreamland/Dreambaby (discount toys, baby and family goods). During 2007 Colruyt has expanded into the Netherlands (opening its first supermarket in February 2007) and announced plans to significantly expand its franchise operations in France. Colruyt trades at a premium EBITDA multiple to its European peers reflecting its higher profit margins.

Tesco plc

Tesco is the United Kingdom's largest grocery retailer and operates food and non-food discount stores across Europe, China, and South-East Asia. Its 2,300 supermarkets encompass hypermarket, supermarket, metropolitan, convenience and express store formats, providing fresh grocery and food items, consumer electronics, apparel, entertainment and homeware products. Other operations include Tesco HomePlus, a non-food homeware discount store, Tesco Personal Finance (offering credit cards, insurance and mortgage products through a joint venture with the Royal Bank of Scotland) and Tesco Fuel. In 2007 the majority of the group's retail EBITA was derived from the United Kingdom and approximately 20% from greater Europe and Asia. It has announced its expansion into Japan and has recently commenced operations in the United States.

Marks and Spencer Group plc

M&S operates over 500 diversified clothing, food and home retail stores across the United Kingdom and an additional 200 owned and franchised international stores across Europe, the United Arab Emirates and Asia. Products include clothing, home accessories, furniture, gardening supplies, electronics and entertainment products.

J Sainsbury plc

Sainsbury is the United Kingdom's third largest grocery retailer, operating 479 supermarkets, 290 convenience stores under the banners Sainsbury's Supermarkets, Sainsbury's Local, Bells Stores, Jacksons Stores and JB Beaumont. Sainsbury provides a range of fresh and packaged in-house and private label supermarket, discount general merchandise, apparel and liquor products. It also operates an online shopping service, holds a 55% interest in Sainsbury's Bank (a joint venture with HBOS plc) and holds significant freehold property. Members of the Sainsbury family currently hold an 18% interest with Delta Two Limited (a fund backed by the State of Qatar) holding a 24.99% interest.

Wm. Morrisons Supermarkets plc

Wm. Morrisons is one of the leading low cost supermarket chains in the United Kingdom, operating over 360 supermarkets under the Morrisons banner. Services include fresh and packaged grocery products, hardline and softline homewares, retail electronics, home entertainment and petrol (at 268 stores). In March 2004, Morrisons acquired Safeway plc and incurred significant costs due to the conversion of stores, employee costs, and write-offs. Management has announced plans to continue improving operational efficiencies and margins to support its 'lowest cost' strategy and investigation of a partnership for its properties (currently 92% of stores are freehold or under long-term leases).

Wal-Mart Stores Inc

Wal-Mart Stores Inc ("Wal-Mart") is the world's largest discount retailer, currently operating over 6,700 stores across the United States, Canada, South America, the United Kingdom, China and Japan. Wal-Mart outlets

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comprise various formats, including 966 supermarkets, 437 hypermarkets and supercenters, 738 general goods warehouses and 114 "SAM's Club" members-only, homeware and DIY stores. Wal-Mart's international expansion strategy has included the acquisition of local store formats and banners – including the ASDA Group and George apparel in the United Kingdom and "Neighbourhood Stores", restaurants and departments stores in China and South America. Over the past two years, Wal-Mart has expanded into the Canadian, Japanese and South American markets and divested its South Korean and German operations.

Target Corporation

Target Corporation ("Target") is a broadline retailer currently operating over 1,480 large format Target and SuperTarget stores solely in the United States. In the year ending February 2007, approximately 32% of revenue was generated by food and general commodity sales, 23% from consumer electronics, 22% from apparel and softline accessories and 23% from home furnishings and general items. Target also offers online shopping, customer credit cards and financial services (financial services directly contributing 2.7% of total revenue and over 15.4% of profit before tax in 2006/07). Target is differentiated from larger United States peers such as Wal-Mart by its limited grocery retailing. The historical multiple reflects the impact of 113 store openings and 22 store closures or relocations during the year. Target has announced its plans to invest up to $4.4 billion in 2007, primarily to expand and upgrade stores and distribution.

Costco Wholesale Corporation

Costco is one of the largest general discount retailers in North America, currently operating 513 warehouse stores across the United States and Puerto Rico (378 stores), Canada (71), Mexico (30), the United Kingdom (19), Korea (5), Japan (6) and Taiwan (4). It sells both fresh and packaged groceries, apparel, domestic goods and general home and sporting supplies, as well as commercial cleaning, office and bulk products. Costco sells exclusively to store members and currently generates approximately 2.0% of annual operating revenue from membership fees. Costco is pursuing an expansion strategy and since September 2006 has opened 46 new stores, including stores opened as part of its entry into Mexico. Costco is generally well regarded by brokers.

Sears Holdings Corporation

Sears Holdings Corporation ("Sears") operates discount retail stores, freestanding supercentre stores, mall-based discount stores and smaller regional full-line discount stores across North America and Puerto Rico under the banners Sears, Sears Canada (70% owned) and Kmart. Products include low-to-mid price apparel, hardline and softline homewares and furnishings, jewellery and accessories, auto and garden equipment and general merchandise such as toys, shoes and hardware. In November 2004, Sears merged with Kmart Holding Corporation and has since restructured the Kmart businesses. Stores currently include: 1,388 large format Kmart discount and supercentre stores (contributing 38% of historical EBIT), 2,030 Sears Grand, Full-line and Speciality stores (52%) and 373 Sears Canada stores (10%). Forecast multiples reflect the integration of Kmart and Sears and the realisation of synergies over time.

The Kroger Company Inc.

The Kroger Company Inc ("Kroger") is the second largest United States food retailer, operating over 2,500 supermarkets, discount retailers, and department stores, 579 on-site petrol stations and substantial food manufacturing operations. Additionally, it manages 791 convenience, 428 jewellery stores and financial services through subsidiaries and franchises and 42 food manufacturing plants. Store formats comprise traditional supermarkets (including the brands Kroger, Ralphs, City Market, Dillons, Owens, Gerbes and Smiths Food and Drug Store), Price-Impact fresh food grocers (Food4Less and Foods Co.), multi-department stores (Fred Meyer, Fry's, Smith's and Kroger Marketplace), convenience stores (including Turkey Hill, Kwik Shop, and Loaf'n'Jug), jewellers (Barclay, Fred Meyers and Littman) and Kroger Personal Finance. Sales in the year ended February 2007 were generated primarily by food and general merchandise sales (87%), fuel (7%) and other operations including jewellery, manufacturing and convenience stores (6%).

Safeway Inc

Safeway operates over 1,761 grocery and drug stores across Western Canada, the United States and Mexico under the banners Safeway, Vons, Dominick's, Genuardis, Randall's, Tom Thumb, Pavilions, Carrs and Casa Ley (a Mexican grocery retailer in which Safeway holds a 49% interest). Private label product manufacture, online grocery services (through a 56% interest in GroceryWorks Holdings Inc) and specialty departments are integrated into Safeway businesses. Over 23% of merchandise sales are manufactured by the company.

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Supervalu Inc

Supervalu is a leading United States operator of discount grocery and in-store and stand-alone pharmacy retail chain of over 2,500 stores and significant wholesale and logistics operations. In January 2006, Supervalu substantially increased its retail operations through the acquisition of Albertsons Inc's United States food and food/drug combination stores. Supervalu has continued to integrate these operations into its existing businesses.

Loblaw Companies Limited

Loblaw is a Canadian grocery, pharmacy and general merchandiser operating over 1,000 corporate and franchised retail stores, 451 associate stores and 26 warehouses. Loblaw operates through its four store formats: Superstore and "Great Food" (including the banners The Real Canadian Superstore, Zehrs, Atlantic Superstore, Dominion, Provigo, Loblaws, and Maxi), hard discount, wholesale outlets (under the banners Cash & Carry, The Real Canadian Wholesale Club and Presto) and associated/franchised stores (including No Frills, Supervalu, Valu-mart, Your Independent Grocer and Fortinos). Loblaws also operates financial credit card, lending and insurance services. Loblaw has reported increased competition in its markets since Wal-Mart entered the market in 2006.

Metro Inc

Metro Inc. is a Canadian food and pharmaceuticals retailer and distributor, operating primarily in the provinces of Quebec and Ontario. It operates 392 supermarkets under the banners Metro, Metro Plus, A&P, Dominion, Loeb, Drug Basics and The Barn Markets. Metro Inc. also operates 169 discount stores under the Super C and Food Basics banners and distributes pharmaceuticals and groceries to both franchised (Brunet and Clini Plus) and independent pharmacies, supermarkets, convenience stores and health-care institutions.

Liquor Retailing

The valuation of Coles Liquor has been considered in the context of the sharemarket ratings of Australian and international liquor retailers. While none of these companies is precisely comparable to Coles Liquor, the sharemarket data provides some framework by which to assess its valuation.

Sharemarket Ratings of Selected Comparable Companies – Liquor Retailing

Company	Activity[9]	Market Capital-isation (million)	EBITDA Multiple (times)			EBIT Multiple (times)			Price Earning Multiple (times)		
			Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2
Australia and New Zealand											
National Leisure & Gaming	P	A$94	9.4[10]	na	na	13.7[10]	na	na	na	na	na
Europe											
Hawesko Holding AG	R	€221	11.0	10.5	9.6	13.5	13.0	11.7	20.5	21.0	16.6
United Kingdom											
Enterprise Inns plc	P	£3,175	12.4	12.8	12.5	12.6	13.0	12.6	14.4	15.2	15.8
Mitchells & Butlers plc	P	£2,834	12.4	11.4	10.6	17.3	15.9	14.7	15.2	20.9	18.4
Punch Taverns plc	P	£2,789	13.1	12.0	11.9	14.1	13.0	12.8	13.7	13.2	12.2
Greene King plc	P/B	£1,394	10.9	10.1	9.7	13.0	12.1	11.5	13.4	13.7	13.1
Marston's plc	P/B	£988	11.0	10.2	9.9	13.8	12.8	12.5	13.5	13.5	13.6
J.D. Wetherspoon plc[11]	P	£802	8.7	8.4	8.0	13.2	12.9	12.2	18.9	18.6	17.7
Majestic Wine plc	R	£223	11.8	10.8	9.8	13.9	12.7	11.6	20.4	19.0	17.3
North America											
Liquor Stores Income Fund	R	C$358	23.5	13.8	8.9	26.8	na	na	31.1	na	na
Andrew Peller Limited	R/W	C$164	9.9	na	na	14.0	na	na	17.1	na	na
Minimum			*8.7*	*8.4*	*8.0*	*12.6*	*12.1*	*11.5*	*13.4*	*13.2*	*12.2*
Maximum			*23.5*	*13.8*	*12.5*	*26.8*	*15.9*	*14.7*	*31.1*	*21.0*	*18.6*
Median			***11.0***	***10.8***	***9.8***	***13.8***	***12.9***	***12.4***	***16.1***	***16.9***	***16.2***

9 P = Pubs; B = Brewing; R = Retailer; W = Wineries

10 Based on pro forma results for the year ended 30 June 2007.

11 J.D. Wetherspoon plc is due to report their 2007 results in September 2007. For the purposes of this table the historical multiples for this company is based on brokers' forecasts for the 2007 year and the forecast multiples are based on the subsequent two forecast years.

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The multiples shown above are based on sharemarket prices as at 29 August 2007 and do not reflect a premium for control.

The companies have a variety of year ends which should be taken into account in reviewing the above trading multiples:

- 31 March: Andrew Peller Limited ("Andrew Peller"), Majestic Wine plc ("Majestic");
- 30 April: Greene King plc ("Greene King");
- 30 June: National Leisure & Gaming Limited ("NLG");
- 31 July: J.D. Wetherspoon plc ("Wetherspoon");
- 20 August: Punch Taverns plc ("Punch Taverns");
- 30 September: Mitchells & Butlers plc ("Mitchells & Butlers"), Enterprise Inns plc ("Enterprise"), Marston's plc ("Marston's"); and
- 31 December: Liquor Stores Income Fund ("Liquor Stores") and Hawesko Holding AG ("Hawesko").

The data presented for each company is for the most recent historical results plus the subsequent two forecast years. However, the data presented above represents an alignment of the financial data for Wetherspoon which is yet to report its 2007 results. Under this alignment, the brokers' forecasts for 2007 have been treated as the actual results and the brokers' forecasts for the subsequent two years are adopted as the forecast results.

A brief description of each company is set out below:

National Leisure & Gaming Limited

NLG operates and owns hotel and gaming machines in New South Wales and Queensland. It was founded in April 2005 and listed on the ASX in December 2005. During 2007, NLG has made a number of acquisitions moving from ownership of 6 venues and 224 electronic gaming machines in June 2006 to 39 leasehold hotels and over 1,000 electronic gaming machines as of 20 July 2007. As a result, NLG is now the fourth largest pub group in Australia. The historical multiples calculated are based on pro forma results for the year ended 30 June 2007 which reflect a full year contribution from each of the acquisitions made during that year.

Enterprise Inns plc

Enterprise is one of the largest pub operators in the United Kingdom with approximately 7,700 leased and tenanted pubs. It generates profits from the sale of beer to its tenants and licencees (50%), rents (40%) and the sale of other drinks and income from amusement machines (5%). Enterprise Inns was formed in 1991 with 368 pubs and listed in 1995.

Mitchells & Butlers plc

Mitchells & Butlers primarily manages pubs and pub-restaurants in the United Kingdom and Germany. As at 30 September 2006, Mitchells & Butlers operated 2,110 sites in the United Kingdom and 42 pubs in Germany. Its pubs operate across the market spectrum from local pubs through to high street pubs and bars and can be divided between drink and entertainment-led sites and food and accommodation-led sites. 90% of its pubs are freehold and 75% are in the residential market with the remainder found in high street or city centre locations. Founded in 1898, Mitchells & Butlers listed in April 2003.

Punch Taverns plc

Punch Taverns owns, operates and supplies pubs within the United Kingdom. The company was established in 1997 and listed in 2002. It is the largest pub operator in the United Kingdom and as at March 2007 operated 8,119 pubs on a leased basis and 1,185 under direct management. These pubs range from local pubs with basic amenities through to city pubs with premium dining. Revenue earned from retail pub activities is complemented by sales to its retailers of liquor and promotional materials through mandatory supply agreements. This supply arrangement is supported through a joint venture with an independent drinks distributor. The historical multiples for Punch Tavern reflect only a 9 month contribution from the acquisition of Spirit Group Holdings Limited in January 2006.

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Greene King plc

Greene King brews, wholesales and retails beer in addition to owning managed and tenanted pubs in the United Kingdom. It commenced brewing beer in 1799 and ownership of pubs in the 1830s. By the 1960s the company owned over 900 pubs. Greene King currently owns around 889 pubs (99 in Scotland) with another 1,600 pubs tenanted and leased (200 in Scotland). In the year ended 29 April 2007 Greene King, derived approximately 10% of EBIT from brewing.

Marston's plc

Marston's brews and markets beers and operates approximately 2,360 pubs, food pubs and restaurants in the United Kingdom. It was formed as The Wolverhamptom & Dudley Breweries plc in 1890 and listed on London Stock Exchange in 1947. It changed its name in January 2007. Marston's currently operates approximately 2,535 pubs of which 568 are managed. In the six months to 31 March 2007 Marston's derived approximately 10% of EBIT from brewing.

J.D. Wetherspoon plc

Wetherspoon was formed in 1979 with one pub, listed on the stock exchange in 1992 and now owns and operates more than 660 pubs throughout the United Kingdom. It operates in the high street (or value) end of the United Kingdom pub market and is faced with aggressive pricing of alcohol by supermarkets. Wetherspoon has issued a profit warning for the full year to 31 July 2007 based on higher costs. It is generally rated lower than its United Kingdom peers.

Majestic Wine plc

Majestic is a wine, beer and spirits retailer. It was formed in 1991 via the merger of two liquor retailers, Majestic Vintners and Wizard Wine. Majestic has developed into the largest wine warehouse chain in Britain, specialising in the sale of wine by the mixed case. In 2001 Majestic purchased three stores in Northern France (which trade as Wine and Beer World) and, in 2003, Majestic commenced a fine wine operation. These retail operations are supported by both a transactional website set up in 2000, as well as a gifts solutions service (available through either the website or by phone). Majestic listed in 1996 and currently has 139 stores in the United Kingdom. It is targeting to have 200 stores in the medium term.

Hawesko Holding AG

Hawesko trades premium wines and champagne primarily through specialist wine retail shops. At 30 June 2007 it had 261 Jacques Wein-Depot shops primarily in Germany. In 2006 Hawesko decided to also offer wines in lower price brackets (the high volume market) and currently operates in five locations in Germany under the Multiwein banner. It also sells through wholesalers and department stores, mail order and online. Hawesko was founded in 1964 and listed in 1998.

Liquor Stores Income Fund

Liquor Stores is an unincorporated open-ended limited purpose trust that owns, operates and invests in the retail liquor business in Canada. It listed on the Toronto Stock Exchange in 2004 and has quadrupled in size primarily by acquisition. Its key assets include its 75.6% interest in Liquor Stores Limited Partnership and its 86.7% interest in Liquor Barn Limited Partnership. Liquor Stores currently operates 161 stores in the province of Alberta and 30 stores in British Columbia, for a total of 191 stores. Its historical multiples are not meaningful as it acquired Liquor Barn Income Fund in May 2007 for C$174 million.

Andrew Peller Limited

Andrew Peller produces, bottles and markets wines in Canada under a range of brands. It also owns and operates around 102 retail stores under the Vineyard Estate Wines and Wine Country Vintners banners. Following the acquisition of Cascadia Brands Inc in 2006, it also markets beer under the Granville Island brand.

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Office Products

The valuation of Officeworks has been considered in the context of the sharemarket ratings of Australian and international suppliers of office products. While none of these companies is precisely comparable to Officeworks, the sharemarket data provides some framework by which to assess its valuation.

Sharemarket Ratings of Selected Comparable Companies – Office Products

Company	Market Capital-isation (million)	EBITDA Multiple (times)			EBIT Multiple (times)			Price Earning Multiple (times)		
		Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2	Historical	Forecast Year 1	Forecast Year 2
Australia and New Zealand										
Corporate Express Australia	A$1,124	10.5	10.0	9.4	12.3	11.4	10.8	16.1	15.3	14.5
Europe										
Corporate Express N.V.	€1,545	6.8	7.4	6.8	9.1	10.0	9.1	10.2	13.2	11.4
North America										
Staples Inc	US$17,690	9.3	8.6	7.6	11.5	10.4	9.1	17.8	16.5	14.8
Office Depot Inc	US$6,842	7.1	7.2	6.9	9.7	9.3	8.9	13.2	12.1	11.3
OfficeMax Inc	US$2,716	8.6	6.2	5.6	13.7	8.7	7.8	24.2	15.0	13.4
United Stationers Inc	US$1,673	6.6	7.4	6.9	7.7	9.0	8.4	12.1	15.9	14.5
Minimum		*6.6*	*6.2*	*5.6*	*7.7*	*8.7*	*7.8*	*10.2*	*12.1*	*11.3*
Maximum		*10.5*	*10.0*	*9.4*	*13.7*	*11.4*	*10.8*	*24.2*	*16.5*	*14.8*
Median		***7.8***	***7.4***	***6.9***	***10.6***	***9.6***	***9.0***	***14.6***	***15.1***	***13.9***

The multiples shown above are based on sharemarket prices as at 29 August 2007 and do not reflect a premium for control. All of the companies have a 31 December year end with the exception of Staples Inc ("Staples") which has a 31 January year end.

A brief description of each company is set out below:

Corporate Express Australia Limited

Corporate Express Australia Limited ("Corporate Express Australia") is one of Australia's largest office products suppliers. It provides business-related computer and IT services, staple office products, print management services, furniture and facility supplies through 50 Australian and New Zealand locations and online distribution services. It does not operate retail outlets. In April 2007 it completed a $90 million share buyback. Corporate Express N.V. owns 58.9% of Corporate Express Australia.

Corporate Express N.V.

Corporate Express N.V. (formerly Buhrmann N.V.) is an office supplies and computer retailer and wholesaler, based in Amsterdam and operating under the Corporate Express banner in four divisions: Office Products North America, Office Products Australia, Office Products Europe and Graphic Systems. Corporate Express N.V. sells a range of traditional office products, computers, printers and software, cleaning and kitchen supplies and industrial printing equipment and also offers logistics services. It does not operate retail outlets. In 2006 North America contributed 56% of EBIT, Europe 7%, Australia 20%, ASAP Software 10% (which was sold to Dell Inc for US$340 million on 2 August 2007) and Graphic Systems 7%. In August 2006 Corporate Express N.V. acquired Andvord Tybring-Gjedde ASA, a leading corporate supplies business in the Nordic region of Europe. Corporate Express N.V. currently holds 58.9% of Corporate Express Australia.

Staples Inc

Staples is the world's largest retail office and educational products supplier, operating through its three divisions: North American Retail, North American Delivery and International Operations. Staples operates over 1,900 superstores in the United States and distributes within the United States and internationally through online sales, catalogues and associated retail businesses. Staples is currently associated with businesses in over 19 countries throughout Europe, the United Kingdom and Latin America. Products and services include a wide range of traditional office supplies, computer, music and video technologies, telecommunication products, office furniture, printing and marketing management and financial credit services.

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Office Depot Inc

Office Depot Inc ("Office Depot") comprises three divisions, North American Retail, North American Business Solutions and International Distribution. Through its 1,200 North American retail stores and online sites, Office Depot provides a range of office and educational supplies, business furniture, camera, computer and printing technologies and office support services including information technology, printing and marketing services. Internationally, Office Depot distributes to 42 countries in Asia, Europe and Latin America. International associates include a range of joint ventures, franchisees and contracted licencees, selling through a mix of online, telephone, catalogue ordering and 348 retail stores. United States banners include Office Depot, Tech Depot, Computers4Sure and Work-Life-Reward and the international businesses are run under a range of banners including Office Depot Europe and Viking Direct. In 2006 45% of sales revenue was generated through North American Retail, 30% through North American Business Solutions and 25% from International.

OfficeMax Inc

OfficeMax Inc ("OfficeMax") is a leading corporate office retailer in the United States, supplying primarily small to mid size enterprises through online distribution and 1,000 retail stores. OfficeMax provides a range of traditional office, computer, office technology and furniture products, as well as print management and financial credit card services. In 2006 50% of sales were generated by OfficeMax Contract and 50% from OfficeMax Retail. The company performance used in the above analysis may be impacted by non-recurring items incurred during 2006, including costs due to the closure of 109 underperforming retail stores, discontinuation of a company owned building materials facility and costs due to the restructure of OfficeMax Contract head office. In recent times, the OfficeMax share price has been impacted by execution issues associated with a restructuring.

United Stationers Inc

United Stationers Inc ("United Stationers") is the largest wholesale distributor of business products in North America. It distributes technology products, traditional business products, office furniture and facilities products. It has a 63 distribution centres and 80% of its net sales are made to independent re-sellers. It does not operate retail outlets. United Stationers differentiates itself by providing substantial support services to its reseller customer base. In recent years it has been focused on widening its product range while at the same time improving its profit margins by removing costs from the business.

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2 Investigating Accountant's Report

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26 September 2007

The Directors
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Dear Directors

Investigating Accountant's Report

Introduction

Ernst & Young has been engaged by Wesfarmers Limited ("Wesfarmers") to prepare this report for inclusion in the Coles Group Limited Scheme Booklet ("Scheme Booklet") to be dated on or about 27 September 2007, and to be issued by Coles Group Limited ("Coles"), in respect of the proposed acquisition of Coles by Wesfarmers.

The acquisition proposal involves the acquisition of Coles in its entirety by Wesfarmers through a cash and scrip offer of Wesfarmers ordinary and partially protected shares.

Expressions defined in the Scheme Booklet have the same meaning in this report.

Financial Information

Ernst & Young has been requested to prepare a report covering the Wesfarmers historical financial information, Wesfarmers pro forma historical financial information and Wesfarmers merged group unaudited pro forma financial information described below and disclosed in the Scheme Booklet.

Wesfarmers historical financial information

The Wesfarmers historical financial information, as set out in section 7.8 of the Scheme Booklet comprises:

- the Wesfarmers consolidated income statements for the years ended 30 June 2003, 30 June 2004, 30 June 2005, 30 June 2006 and 30 June 2007;
- the Wesfarmers consolidated Balance Sheets as at 30 June 2003, 30 June 2004, 30 June 2005, 30 June 2006 and 30 June 2007; and
- the Wesfarmers consolidated schedule of cash flows for the years ended 30 June 2003, 30 June 2004, 30 June 2005, 30 June 2006 and 30 June 2007.

The Wesfarmers historical financial information set out in section 7.8 has been extracted from the audited statutory financial statements of Wesfarmers which were audited by Ernst & Young in accordance with Australian Auditing Standards and upon which unqualified audit opinions were issued.

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Wesfarmers pro forma historical financial information

The Wesfarmers pro forma historical financial information as set out in section 7.8 of the Scheme Booklet comprises:

- the Wesfarmers pro forma consolidated income statement for the year ended 30 June 2007;
- the Wesfarmers pro forma consolidated Balance Sheet as at 30 June 2007; and
- the Wesfarmers pro forma consolidated schedule of cash flows for the year ended 30 June 2007.

The Wesfarmers pro forma historical financial information set out in section 7.8 has been derived from the audited statutory financial statements of Wesfarmers for the year ended 30 June 2007, and adjusted to exclude Wesfarmers' initial 10.6% interest in Coles acquired during the 2007 financial year. These adjustments are described in sections 7.8 (b), (c)(i), (d)(i) and (e)(i) of the Scheme Booklet.

Wesfarmers merged group unaudited pro forma financial information

The Wesfarmers merged group unaudited pro forma financial information as set out in section 8.8 of the Scheme Booklet comprises:

- the Wesfarmers merged group unaudited pro forma income statement for the illustrative period ended 30 June 2007;
- the Wesfarmers merged group unaudited pro forma balance sheet as at the end of the illustrative period to 30 June 2007; and
- the Wesfarmers merged group unaudited pro forma schedule of cash flows for the illustrative period ended 30 June 2007.

The Wesfarmers merged group unaudited pro forma financial information has been derived from the Wesfarmers pro forma historical financial information for the year ended 30 June 2007, the Coles consolidated income statement, consolidated balance sheet and consolidated schedule of cash flows for the year ended 29 July 2007 and the key assumptions and pro forma adjustments as set out in sections 8.8(a) – (d) of the Scheme Booklet.

Information in relation to Wesfarmers and Coles has been derived from differing financial periods. However, for the purposes of the Wesfarmers merged group unaudited pro forma financial information, it has been assumed that these financial periods are the same. This period is referred to as the illustrative period and relates to the notional year beginning 1 July 2006 and ending 30 June 2007.

Directors' responsibility for the Wesfarmers historical, pro forma historical and merged group unaudited pro forma financial information

The directors of Wesfarmers are responsible for the preparation and presentation of the Wesfarmers historical, pro forma historical and merged group unaudited pro forma financial information. The directors of Wesfarmers are also responsible for the determination of the pro forma transactions and adjustments.

The Wesfarmers historical, pro forma historical and merged group unaudited pro forma financial information is presented in an abbreviated form insofar as it does not include all of the disclosures required by the *Australian Accounting Standards* applicable to general purpose financial reports.

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Scope

Review of Wesfarmers historical financial information

We have reviewed the Wesfarmers historical financial information in order to report whether anything has come to our attention that would cause us to believe that the Wesfarmers historical financial information, as set out in section 7.8 of the Scheme Booklet, has not been properly extracted from:

- the historical income statements of Wesfarmers for the years ended 30 June 2003, 30 June 2004 30 June 2005, 30 June 2006 and 30 June 2007;
- the historical balance sheets of Wesfarmers as at 30 June 2003, 30 June 2004, 30 June 2005 30 June 2006 and 30 June 2007; and
- the historical cash flow statements of Wesfarmers for the years ended 30 June 2003, 30 June 2004, 30 June 2005, 30 June 2006 and 30 June 2007.

Our review has been conducted in accordance with Australian Auditing Standard AUS 902 "Review of Financial Reports". We made such enquiries and performed such procedures as we, in our professional judgement, considered reasonable in the circumstances, including:

- analytical procedures on the Wesfarmers historical financial information;
- a consideration of work papers, accounting records and other documents; and
- enquiry of directors, management and others.

These procedures do not provide all the evidence that would be required in an audit, thus the leve of assurance provided is less than that given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion on the Wesfarmers historical financial information.

Review of Wesfarmers pro forma historical financial information

We have reviewed the Wesfarmers pro forma historical financial information in order to report wheher anything has come to our attention that would cause us to believe that the Wesfarmers pro forma historical financial information, as set out in section 7.8 of the Scheme Booklet has not been properly extracted from:

- the historical income statement of Wesfarmers for the year ended 30 June 2007;
- the historical balance sheet of Wesfarmers as at 30 June 2007; and
- the historical cash flow statement of Wesfarmers for the year ended 30 June 2007

as adjusted for the pro forma adjustments set out in sections 7.8 (c)(i), (d)(i) and (e)(i) of the Scheme Booklet.

Our review has been conducted in accordance with Australian Auditing Standard AUS 902 "Review of Financial Reports". We made such enquiries and performed such procedures as we, in our professional judgement, considered reasonable in the circumstances, including:

- analytical procedures on the Wesfarmers pro forma historical financial information;
- a consideration of work papers, accounting records and other documents; and
- enquiry of directors, management and others.

These procedures do not provide all the evidence that would be required in an audit, thus the leve of assurance provided is less than that given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion on the Wesfarmers pro forma historical financial information.

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Wesfarmers merged group unaudited pro forma financial information

We have examined the compilation of the Wesfarmers merged group unaudited pro forma financial information prepared in accordance with the basis of accounting as set out in section 8.8 of the Scheme Booklet to ensure that it is properly extracted from the relevant source documentation, appropriately reflects the key assumptions set out in section 8.8(a) and the notes as set out in section 8.8(b) – (d) of the Scheme Booklet and is arithmetically correct. Our work in respect of the Wesfarmers merged group unaudited pro forma financial information has been performed in accordance with Australian Auditing Standard AUS 904 "Engagements to Perform Agreed-upon Procedures".

Our work was limited to:

- checking that the Wesfarmers pro forma consolidated income statement and schedule of cash flows for the year ended 30 June 2007 and the Wesfarmers pro forma consolidated balance sheet as at 30 June 2007 have been accurately extracted from the equivalent financial information presented in section 7.8 of this Scheme Booklet;
- checking that the Coles consolidated income statement and schedule of cash flows for the year ended 29 July 2007 and the Coles consolidated balance sheet as at 29 July 2007 have been accurately extracted from the equivalent financial information presented in section 6.8 of this Scheme Booklet;
- determining that the pro forma adjustments have been based on the key assumptions set out in section 8.8(a) and the notes as set out in section 8.8(b) - (d) of this Scheme Booklet; and
- determining that the Wesfarmers merged group unaudited pro forma financial information included in section 8.8(b) - (d) of this Scheme Booklet is arithmetically correct.

Because the above procedures do not constitute either an audit in accordance with Australian Auditing Standards or a review in accordance with Australian Auditing Standards applicable to review engagements, we do not express any assurance on the Wesfarmers merged group unaudited pro forma financial information included in section 8.8 of this Scheme Booklet. Had we performed additional procedures or had we performed an audit in accordance with Australian Auditing Standards or a review in accordance with Australian Auditing Standards applicable to review engagements, other matters might have come to our attention that would have been reported to you.

Review Statements

Wesfarmers historical financial information

Based on our review, which was not an audit, nothing has come to our attention which would cause us to believe the Wesfarmers historical financial information, as set out in section 7.8 of this Scheme Booklet has not been properly extracted from:

- the historical income statements of Wesfarmers for the years ended 30 June 2003, 30 June 2004, 30 June 2005, 30 June 2006 and 30 June 2007;
- the historical balance sheets of Wesfarmers as at 30 June 2003, 30 June 2004, 30 June 2005, 30 June 2006 and 30 June 2007; and
- the historical cash flow statements of Wesfarmers for the years ended 30 June 2003, 30 June 2004, 30 June 2005, 30 June 2006 and 30 June 2007.

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Wesfarmers pro forma historical financial information

Based on our review, which was not an audit, nothing has come to our attention which would cause us to believe the Wesfarmers pro forma historical financial information, as set out in section 7.8 of this Scheme Booklet has not been properly extracted from:

- the historical income statement of Wesfarmers for the year ended 30 June 2007;
- the historical balance sheet of Wesfarmers as at 30 June 2007;
- the historical cash flow statement of Wesfarmers for the year ended 30 June 2007

as adjusted for the pro forma adjustments set out in sections 7.8 (c)(i), (d)(i) and (e)(i) of the Scheme Booklet.

Report on Compilation Statement

Wesfarmers merged group unaudited pro forma financial information

We report that the compilation of the Wesfarmers merged group unaudited pro forma financial informaion prepared in accordance with the basis of accounting as set out in section 8.8(a) of this Scheme Booklethas been properly extracted from the relevant source documentation, appropriately reflects the key assumptions set out in section 8.8(a) and the notes as set out in section 8.8(b) - (d) of this Scheme Booklet and is arithmetically correct.

Subsequent Events

Apart from the matters dealt with in this Report and having regard to the scope of our Report, to the best of our knowledge and belief, no material transactions or events outside the ordinary business of Wesfarmers subsequent to the completion of our review have come to our attention which require comment or or adjustment to, the information referred to in our Report or that would cause such information to be misleading or deceptive.

Independence or Disclosure of Interest

Ernst & Young does not have any interest in the outcome of the proposed scheme, other than in connecion with the preparation of this report. Ernst & Young will receive a professional fee for the preparation of this report. Ernst & Young is the auditor of Wesfarmers and from time to time, Ernst & Young also provides Wesfarmers with certain other professional services for which normal professional fees are received.

Consent to the inclusion of the Investigating Accountant's Report in the Scheme Booklet in the form and context in which it appears, has been given. At the date of this Report, this consent has not been withdrawn.

Yours faithfully

Ernst & Young

Ernst & Young

C B Pavlovich
Partner
Perth
27 September 2007

CBP:KT:WFL GROUP COLES:001 Wesfarmers IAR Coles Scheme Booklet 23.07.07

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3 Scheme Implementation Agreement

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3 Scheme Implementation Agreement

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Scheme Implementation Agreement

Coles Group Limited

Wesfarmers Retail Holdings Pty Ltd (formerly known as Cobico Pty Limited)

Wesfarmers Limited

Freehills

101 Collins Street Melbourne VIC 3000 Australia
GPO Box 128A Melbourne VIC 3001 Australia

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The agreement

Scheme Implementation Agreement

Date ▸ 5 September 2007

Between the parties

Coles	**Coles Group Limited** ABN 11 004 089 936 of 800 Toorak Road, Tooronga Victoria 3146
Bidder	**Wesfarmers Retail Holdings Pty Ltd (formerly known as Cobico Pty Limited)** ACN 126 199 022 of Level 11, Wesfarmers House, 40 The Esplanade, Perth WA 6000
Wesfarmers	**Wesfarmers Limited** ABN 28 008 984 049 of Level 11, Wesfarmers House, 40 The Esplanade, Perth WA 6000

Background

Coles and Bidder have agreed that:

1. Bidder will acquire all the Coles Shares by means of a scheme of arrangement under Part 5.1 of the Corporations Act between Coles and Coles Shareholders;
2. Coles will pay a final dividend of 25 cents per share; and
3. the parties will seek to ensure that all outstanding Options and Performance Shares are cancelled.

Coles and Bidder have agreed in good faith to implement the transactions required to effect that agreement on the terms of this agreement.

Wesfarmers has agreed, on the terms of this agreement, to ensure the provision of the consideration to Coles Shareholders under the transactions.

The parties agree

As set out in the Operative part of this agreement, in consideration of, among other things, the mutual promises contained in this agreement.

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Operative part

1 Definitions and interpretation

1.1 Definitions

The meanings of the terms used in this document are set out below.

Term	Meaning
ASIC	Australian Securities and Investments Commission.
ASX	ASX Limited (ABN 98 008 624 691).
Bidder Board	the board of directors of Bidder.
Bidder Confidential Information	any commercial or technical information of Bidder, Wesfarmers or their Related Persons disclosed or supplied by or on behalf of any such entity to Coles or any of its Related Persons, whether orally or visually or in documentary or electronic form and including the notes, records or copies made by Coles or any of its Related Persons of such information but excluding information which is in the public domain (other than as a result of a breach of this agreement by Coles) or otherwise previously known to Coles.
Bidder Group	Bidder, Wesfarmers and each of their Related Bodies Corporate.
Bidder Indemnified Parties	Bidder, Wesfarmers, their Related Bodies Corporate and their respective directors, officers, employees and advisers.
Bidder Information	information regarding the Bidder, Wesfarmers and their Related Bodies Corporate provided by Bidder to Coles for inclusion in the Scheme Booklet.
Break Fee	has the meaning set out in clause 11.2.
Businesses	means the businesses carried on by the Coles Group and its related bodies corporate as at the date of this Agreement and from time to time.
Business Day	a weekday on which trading banks are open for business in Melbourne, Australia.
Cash Consideration	A$4.00 cash for each Scheme Share held by a Scheme Shareholder.
Claim	in relation to a person, means any claim, demand, action, legal proceeding or

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	judgement brought, made, or given against the person.
Coles Board	the board of directors of Coles.
Coles Confidential Information	any commercial or technical information of Coles or any member of the Coles Group disclosed or supplied by or on behalf of any such entity to Bidder, Wesfarmers or any Related Persons of Bidder or Wesfarmers, whether orally or visually or in documentary or electronic form and including the notes, records or copies made by Bidder, Wesfarmers or any Related Persons of Bidder or Wesfarmers of such information but excluding information which is in the public domain (other than as a result of a breach of this agreement by Bidder or Wesfarmers) or otherwise previously known to Bidder.
Coles Dividend	a fully franked dividend of $0.25 per Coles Share, being the final dividend in respect of the Coles financial year ending 29 July 2007.
Coles Due Diligence Information	means all information in any form relating to Coles or any member of the Coles Group which has been obtained by Bidder or Wesfarmers or any of their Related Persons before the date of this agreement, or to which Bidder or Wesfarmers or any of their Related Persons has had access before the date of this agreement, including through data rooms, virtual data rooms, site visits, management presentations, interviews and/or discussions with Related Persons of Coles in connection with the Transaction or relating to Coles' past, present or future financial position, operations, affairs, business and/or strategic plans and includes any Forward Looking information.
Coles Group	Coles and its subsidiaries.
Coles Indemnified Parties	Coles and its subsidiaries and their respective directors, officers, employees and advisers.
Coles Information	all information included in the Scheme Booklet other than the Bidder Information.
Coles Option	an option to subscribe for, or acquire, a Coles Share granted by Coles.
Coles Optionholder	means each person who is a holder of a Coles Option.
Coles Prescribed Occurrence	(other than as required by or as a consequence of this agreement, the Scheme, a Disclosed Transaction or as agreed to in writing by Bidder) the occurrence of any of the following between the date of this agreement and 6.00pm on the day before the Second Court Date: 1 Coles converting all or any of its shares into a larger or smaller number of shares; 2 Coles resolving to reduce its share capital in any way or reclassifying, combining, splitting or redeeming or repurchasing directly or indirectly any of its shares; 3 Coles:

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- entering into a buy-back agreement; or
- resolving to approve the terms of a buy-back agreement under the Corporations Act;

4 other than the Coles Dividend, Coles declaring, paying or distributing any dividend, bonus or other share of its profits or assets or agreeing to return any capital to its members;

5 other than pursuant to the exercise of a Coles Option or the vesting of a Performance Share issued before the date of this agreement, Coles or a subsidiary of Coles issuing shares (or Performance Shares), or granting an option over its shares, or agreeing to make such an issue or grant such an option, other than to a member of the Coles Group;

6 Coles or a subsidiary of Coles issuing or agreeing to issue securities convertible into shares, other than to a member of the Coles Group;

7 Coles or a subsidiary of Coles making any change to its constitution;

8 Coles or a subsidiary of Coles creating, or agreeing to create, any mortgage, charge, lien or other encumbrance over the whole, or a substantial part, of its business or property otherwise than:

- in the ordinary course of business; and
- a lien which arises by operation of law or legislation securing an obligation that is not yet due;

9 Coles or a subsidiary of Coles resolving that it be wound up or the making of an application or order for the winding up or dissolution of Coles or a subsidiary of Coles other than where the application or order (as the case may be) is set aside within 14 days;

10 a liquidator or provisional liquidator of Coles or of a subsidiary of Coles being appointed;

11 the Court making an order for the winding up of Coles or of a subsidiary of Coles;

12 an administrator of Coles or of a subsidiary of Coles being appointed under the Corporations Act;

13 Coles or a subsidiary of Coles becoming unable to pay its debts when they fall due within the meaning of the Corporations Act or otherwise being presumed to be insolvent under the Corporations Act;

14 Coles or a subsidiary of Coles executing a deed of company arrangement;

15 a receiver, or a receiver and manager, being appointed in relation to the whole, or a substantial part, of the property of Coles or of a subsidiary of Coles;

16 Coles or a subsidiary of Coles being deregistered as a company or otherwise dissolved; or

17 Coles or a subsidiary of Coles (as applicable) authorising, committing or agreeing to take any of the actions referred to in any of paragraphs 1 to 16.

Coles Share	a fully paid ordinary share of Coles.
Coles Shareholder	each person entered in the Register as a holder of Coles Shares.
Competing Transaction	a transaction or arrangement pursuant to which a person (other than Bidder, Wesfarmers and their Related Bodies Corporate) will, if the transaction or arrangement is entered into or completed: 1 acquire (whether directly or indirectly) or become the holder of all or a

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	substantial part of the business of the Coles Group; 2 acquire (whether directly or indirectly) all or a substantial part of the Coles everyday needs business or the K-mart, Target or Officeworks businesses, or acquire management rights over any of those businesses (or any part of them) or any other right to participate in the profits of any of those businesses (other than as a shareholder of Coles Group); 3 acquire control (as determined in accordance with section 50AA of the Corporations Act) of Coles; or 4 otherwise acquire or merge with Coles.
Confidentiality Deed	the confidentiality deed between Coles and Wesfarmers dated 17 May 2007.
Consolidated Group	has the same meaning as the Tax Act.
Corporations Act	*Corporations Act 2001* (Cth).
Deed Poll	the deed poll to be entered into by the Bidder and Wesfarmers in favour of the Coles Shareholders in the form in Attachment 2.
Disclosed Transaction	any transaction fairly disclosed in: 1 any ASX announcement made by Coles on or before the date of this agreement; or 2 information made available by Coles to Bidder before the date of this agreement in the Coles Due Diligence Information (other than the GE Arrangements or the NAB Arrangements).
Dispose	in relation to any property means to sell, transfer, assign, create a Security Interest over, declare oneself a trustee of or part with the benefit of or otherwise dispose of that property (or any interest in it or any part of it) including, without limitation, in relation to a share, to enter into a transaction in relation to the share (or any interest in the share) (other than a transaction permitted by this Agreement) which results in a person other than the registered holder of the share: 1 acquiring any equitable interest in the share, including, without limitation, an equitable interest arising under a declaration of trust, an agreement for sale and purchase or an option agreement or an agreement creating a charge or other Security Interest over the share; or 2 acquiring any right to receive directly or indirectly any dividends payable in respect of the share; or 3 acquiring any rights of pre-emption, first refusal or other control over the disposal of the share; or 4 acquiring any rights of control over the exercise of any voting rights or rights to appoint Directors attaching to the share; or 5 otherwise acquiring legal or equitable rights against the registered holder of the share which have the effect of placing the person in the same position as if the person had acquired a legal or equitable interest in the share itself.
Effective	when used in relation to the Scheme, the coming into effect, under section 411(10) of the Corporations Act, of the order of the Court made under section

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	411(4)(b) in relation to the Scheme.
Effective Date	the date the Scheme becomes Effective.
End Date	31 December 2007.
Excluded Shareholder	any Coles Shareholder who is the Bidder, Wesfarmers, a Related Body Corporate of the Bidder or a Related Body Corporate of Wesfarmers.
Executive Committee Meeting	means any meeting of the executive leadership team of the Coles Group.
First Court Date	the first day on which an application made to the Court for an order under section 411(1) of the Corporations Act approving the convening of the Scheme Meeting.
Forward Looking Information	means all information provided to Bidder or Wesfarmers or any of their Related Persons by or on behalf of Coles or its Related Persons which relates to the future financial position, operations, affairs, business or strategic plans of the Coles Group, including any budget for a future financial period or any forecast or estimate, received by Bidder or Wesfarmers or any of their Related Persons in writing or otherwise, as answers to any questions by any of them to Coles or any of its Related Persons or during the course of site visits, management presentations, interviews or discussions with any Related Persons of Coles.
GE Arrangements	contractual arrangements between the Coles Group and GE Money entities.
Governmental Agency	any foreign or Australian government or governmental, semi-governmental, administrative, fiscal or judicial body, department, commission, authority, tribunal, agency or entity, or any minister of the Crown in right of the Commonwealth of Australia or any state.
Implementation Date	the fifth Business Day after the Scheme Record Date.
Independent Expert	Grant Samuel & Associates Pty Limited.
Ineligible Foreign Shareholder	a Scheme Shareholder whose address shown in the Share Register is a place outside Australia and its external territories or New Zealand unless Coles and Bidder agree in writing that: 1 it is lawful and not unduly onerous or impracticable to issue that Scheme Shareholder with New Wesfarmers Shares when the Scheme becomes Effective; or 2 it is lawful for that Scheme Shareholder to participate in the Scheme by the law of the relevant place outside Australia and its external territories or New Zealand.
Listing Rules	the official Listing Rules of ASX.

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NAB Arrangements	joint venture arrangements between the Coles Group and National Australia Bank entities relating to the FlyBuys Program.
New Wesfarmers Shares	a fully paid ordinary share or a fully paid partially protected share in Wesfarmers to be issued under the Scheme on the terms set out in this agreement and, in the case of a fully paid partially protected share, on the terms set out in Attachment 3.
Performance Share	an arrangement under which a Coles Share may be provided to the holder by Coles under the Senior Executive Performance Share Plan.
Permitted Wesfarmers Dividend	a dividend which is paid by Wesfarmers as the final dividend in respect of the financial year ending 30 June 2007 and which does not exceed $1.40 per share.
Register	the register of members of Coles.
Related Bodies Corporate	has the meaning given in the Corporations Act.
Related Persons	Related Bodies Corporate of a party and officers, employees, agents, contractors, advisers and financiers of that party and of Related Bodies Corporate of that party.
Restricted Period	the period from the date of this agreement to the earlier of: 1 the termination of this agreement; and 2 the Implementation Date.
Scheme Booklet	an information memorandum containing the information described in clause 7 to be approved by the Court and despatched to the Coles Shareholders which must include the Scheme, an explanatory statement complying with the requirements of the Corporations Act, an independent expert's report, notices of meeting and proxy forms.
Scheme Consideration	the consideration to be provided to each Coles Shareholder for the transfer to Bidder of each Scheme Share, being the Cash Consideration and the Scrip Consideration.
Scheme Meeting	the meeting of Coles Shareholders ordered by the Court to be convened under section 411(1) of the Corporations Act.
Scheme Record Date	7pm on the fifth Business Day after the Effective Date or such other date as the Bidder and Coles agree in writing.
Scheme Shareholder	Coles Shareholders (other than the Excluded Shareholders) as at the Scheme Record Date.

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Scheme Share	a Coles Share held by a Scheme Shareholder as at the Scheme Record Date.
Scheme	the scheme of arrangement under Part 5.1 of the Corporations Act between Coles and Coles Shareholders, the form of which is attached as Attachment 1.
Scrip Consideration	the combination of: 1 0.14215 of a New Wesfarmers Share which is an ordinary share in Wesfarmers; plus 2 0.14215 of a New Wesfarmers Share which is a partially protected share in Wesfarmers, for each Scheme Share held by a Scheme Shareholder.
Second Court Date	the first day on which an application made to the Court for an order under section 411(4)(b) of the Corporations Act approving the Scheme is heard.
Security Interest	means an interest or power: 1 reserved in or over any interest in any asset including, without limitation, any retention of title; or 2 created or otherwise arising in or over any interest in any asset under a bill of sale, mortgage, charge, lien, pledge, trust or power by way of security for the payment of debt or any other monetary obligation or the enforcement of any other obligation and whether or not existing or agreed to be granted or created.
Superior Transaction	a Competing Transaction which in the determination of the Coles Board, acting in good faith and in accordance with its fiduciary and statutory duties, is more favourable to Coles Shareholders than the Transaction, taking into account, among other things: 1 the terms and conditions of the Competing Transaction, including the anticipated completion date, the certainty of obtaining financing, execution risk, tax leakage (both at the corporate and shareholder level), required regulatory approvals and the impact of the time value of money; and 2 all aspects of the Transaction, including the value of scrip for scrip rollover relief for Coles Shareholders and the implied value of the Scrip Consideration at the relevant time, with this determination being supported by written advice from the Coles Board's financial and legal advisers.
Tax Act	Income Tax Assessment Act 1997 (Cth).
Third Party	a person other than Bidder, Wesfarmers or any of their Related Persons.
Trading Day	has the meaning given in the ASX Listing Rules.
Transaction	the acquisition of Coles by Bidder through the implementation of the Scheme and the cancellation of Coles Options and Performance Shares in accordance with the terms of this agreement.

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Wesfarmers Group	Wesfarmers and each of its subsidiaries.
Wesfarmers Material Adverse Change	any event which, individually or when aggregated with all such events, has or is likely to have a material adverse effect on the business, assets, liabilities, financial or operating position or profitability of the Wesfarmers Group (taken as a whole and after taking into account any matters which offset the impact of the event or events giving rise to the adverse effect), other than an event: 1 resulting from changes in general economic or political conditions or the securities markets in general; 2 resulting from changes in generally accepted accounting principles or the interpretation of them; or 3 fully and fairly disclosed in an ASX filing by Wesfarmers prior to the date of this agreement.
Wesfarmers Prescribed Occurrence	(other than as required by or as a consequence of this agreement, the Scheme, or as agreed to in writing by Coles) the occurrence of any of the following between the date of this agreement and 6pm on the day before the Second Court Date: 1 Wesfarmers converting all or any of its shares into a larger or smaller number of shares; 2 Wesfarmers resolving to reduce its share capital in any way or reclassifying, combining, splitting or redeeming or repurchasing directly or indirectly any of its shares; 3 Wesfarmers: • entering into a buy-back agreement; or • resolving to approve the terms of a buy-back agreement under the Corporations Act; 4 Wesfarmers declaring, paying or distributing any dividend, bonus or other share of its profits or assets or agreeing to return any capital to its members, other than the declaration and payment by Wesfarmers of the Permitted Wesfarmers Dividend or any dividend to which a Scheme Shareholder is entitled to receive pursuant to clause 4.4(a)). 5 Wesfarmers or a subsidiary of Wesfarmers issuing shares, or granting an option over its shares, or agreeing to make such an issue or grant such an option, other than to a member of the Wesfarmers Group or in connection with a dividend reinvestment plan (including pursuant to any underwriting of that plan) or an employee incentive arrangement (including any security issued upon conversion or exercise of rights attaching to any security issued under an employee incentive arrangement); 6 Wesfarmers or a subsidiary of Wesfarmers issuing or agreeing to issue securities convertible into shares, other than to a member of the Wesfarmers Group; 7 Wesfarmers or a subsidiary of Wesfarmers making any change to its constitution; 8 Wesfarmers or a subsidiary of Wesfarmers creating, or agreeing to create, any mortgage, charge, lien or other encumbrance over the whole, or a substantial part, of its business or property otherwise than: • in the ordinary course of business; and • a lien which arises by operation of law or legislation securing an obligation that is not yet due; 9 Wesfarmers or a subsidiary of Wesfarmers resolving that it be wound up or the making of an application or order for the winding up or dissolution of

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	Wesfarmers or a subsidiary of Wesfarmers other than where the application or order (as the case may be) is set aside within 14 days; 10 a liquidator or provisional liquidator of Wesfarmers or of a subsidiary of Wesfarmers being appointed; 11 the Court making an order for the winding up of Wesfarmers or of a subsidiary of Wesfarmers; 12 an administrator of Wesfarmers or of a subsidiary of Wesfarmers being appointed under the Corporations Act; 13 Wesfarmers or a subsidiary of Wesfarmers is or becomes unable to pay its debts when they fall due within the meaning of the Corporations Act or is otherwise presumed to be insolvent under the Corporations Act; 14 Wesfarmers or a subsidiary of Wesfarmers executing a deed of company arrangement; 15 a receiver, or a receiver and manager, being appointed in relation to the whole, or a substantial part, of the property of Wesfarmers or of a subsidiary of Wesfarmers; 16 Wesfarmers or a subsidiary of Wesfarmers being deregistered as a company or otherwise dissolved; or 17 Wesfarmers or a subsidiary of Wesfarmers (as applicable) authorising, committing or agreeing to take any of the actions referred to in any of paragraphs 1 to 16.
Wesfarmers Share	a fully paid ordinary share in Wesfarmers.
Wesfarmers VWAP	the volume weighted average price of Wesfarmers Shares or Wesfarmers partially protected shares (as applicable) (calculated to 2 decimal places of one cent) traded on ASX "On-market" (as that term is defined in the ASX Market Rules) on the relevant day or period, excluding: 1 special crossings, overseas trades, trades pursuant to the exercise of options or overnight trades; and 2 any trade which Wesfarmers and Coles reasonably agree to exclude on the basis that they are not representative of the general price at which Wesfarmers Shares or Wesfarmers partially protected shares (as applicable) traded on ASX on the Trading Day on which the trades took place, as determined by the ASX Limited in accordance with its customary practice.

1.2 Interpretation

In this agreement, headings are for convenience only and do not affect interpretation and, unless the context requires otherwise:

(a) words importing the singular include the plural and vice versa;

(b) words importing a gender include any gender;

(c) other parts of speech and grammatical forms of a word or phrase defined in this agreement have a corresponding meaning;

(d) a reference to a person includes an individual, the estate of an individual, a corporation, an authority, an association or a joint venture, a partnership, a trust and any Government Agency;

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(e) a reference to a clause, party, attachment, exhibit or schedule is a reference to a clause of, and a party, attachment, exhibit and schedule to this agreement, and a reference to this agreement includes any attachment, exhibit and schedule;

(f) a reference to a statute, regulation, proclamation, ordinance or by law includes all statutes, regulations, proclamations, ordinances or by laws amending, consolidating or replacing it, whether passed by the same or another Government Agency with legal power to do so, and a reference to a statute includes all regulations, proclamations, ordinances and by laws issued under that statute;

(g) a reference to any document (including this agreement) is to that document as varied, novated, ratified or replaced from time to time;

(h) the word "includes" in any form is not a word of limitation;

(i) a reference to "$" or "dollar" is to Australian currency;

(j) a reference to any time is, unless otherwise indicated, a reference to that time in Melbourne, Australia;

(k) a term defined in or for the purposes of Chapter 6 of the Corporations Act has the same meaning when used in this agreement; and

(l) a reference to the Listing Rules includes any variation, consolidation or replacement of these rules and is to be taken to be subject to any waiver or exemption granted to the compliance of those rules by a party.

1.3 Business Day

Where the day on or by which any thing is to be done is not a Business Day, that thing must be done on or by the next Business Day.

2 Agreement to proceed with the Transaction

(a) Coles agrees to propose the Scheme on and subject to the terms of this agreement.

(b) Bidder agrees with Coles to assist Coles to propose the Scheme upon and subject to the terms of this agreement.

(c) Wesfarmers agrees with Coles to use all reasonable endeavours to procure that the Bidder complies with its obligations under this agreement.

3 Conditions precedent and pre-implementation steps

3.1 Scheme conditions precedent

Subject to this clause 3, the Scheme will not become Effective and the obligations of Bidder under clause 4.2 are not binding, unless each of the following conditions precedent is satisfied or waived in accordance with clause 3.3:

(a) **No Coles Prescribed Occurrence**: No Coles Prescribed Occurrence has occurred between the date of this agreement and 6 pm on the day before the Second Court Date;

(b) **Coles representations and warranties**: the representations and warranties of Coles set out in clause 8.3 are materially true and correct as at the date of this agreement and as at 6pm on the day before the Second Court Date;

(c) **Bidder and Wesfarmers representations and warranties**: the representations and warranties of the Bidder in clause 8.1 and of Wesfarmers in clause 8.5 are materially true

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and correct as of the date of this document and as at 6pm on the day before the Second Court Date;

(d) **No Wesfarmers Prescribed Occurrence**: No Wesfarmers Prescribed Occurrence has occurred between the date of this agreement and 6 pm on the day before the Second Court Date;

(e) **Listing of New Wesfarmers Shares**: the New Wesfarmers Shares to be issued to Coles Shareholders under the Scheme have, before 6 pm on the day before the Second Court Date, been approved for official quotation on the ASX (subject only to the issue of the New Wesfarmers Shares on implementation of the Transaction);

(f) **Shareholder approval**: Coles Shareholders approve the Scheme at the Scheme Meeting by the requisite majorities under the Corporations Act;

(g) **Court approval**: the Court approves the Scheme in accordance with section 411(4)(b) of the Corporations Act;

(h) **Restraints**: No temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction or Government Agency or other legal restraint or prohibition preventing the Scheme is in effect at 6pm on the day before the Second Court Date; and

(i) **New Zealand Overseas Investment**: Consents, as required, have been obtained pursuant to the provisions of the *Overseas Investment Act 2005* in connection with the implementation of the Scheme before 6pm on the day before the Second Court Date.

3.2 Reasonable endeavours

(a) Bidder and Wesfarmers must use their reasonable endeavours to procure that the conditions precedent in clauses 3.1(c), 3.1(d), 3.1(e) and 3.1(i) are satisfied.

(b) Coles must use its reasonable endeavours to procure that the conditions precedent in clauses 3.1(a) and 3.1(b) are satisfied.

(c) Each party must use its reasonable endeavours to procure that:

(1) the conditions precedent in clauses 3.1(f), 3.1(g) and 3.1(h) are satisfied; and

(2) there is no occurrence within the control of Coles or Bidder or their subsidiaries that would prevent the conditions precedent in clause 3.1 being satisfied (as the context requires).

(d) Without limiting this clause 3.2, Bidder must, to the extent it has not already done so, promptly apply for approval under the *NZ Overseas Investment Act 2005* and:

(1) provide Coles with a copy of such application;

(2) take all steps it is responsible for as part of such approval process, including responding to requests for information at the earliest practicable time,

provide Coles with all information reasonably requested in connection with the applications for such approval.

(e) If Coles considers that any consent required to satisfy the condition precedent in clause 3.1(i) (New Zealand Overseas Investment) may not be obtained before the Second Court Date, Coles will take action to divest itself of any interests that have created the need to obtain that consent, provided it obtains the prior consent of Bidder (not to be unreasonably withheld).

3.3 Waiver of conditions precedent

(a) The conditions precedent in clauses 3.1(e), 3.1(f), 3.1(g), 3.1(h) and 3.1(i) cannot be waived.

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(b) The conditions precedent in clauses 3.1(c) and 3.1(d) are for the sole benefit of Coles and may only be waived by Coles (in its absolute discretion) in writing.

(c) The conditions precedent in clause 3.1(a) and 3.1(b) are for the sole benefit of Bidder and may only be waived by Bidder (in its absolute discretion) in writing.

(d) If a party waives the breach or non-fulfilment of any of the conditions precedent in clause 3.1, that waiver does not prevent it from suing the other party for any breach of this agreement that resulted in the breach or non-fulfilment of the condition precedent.

3.4 Consultation on failure of condition precedent

(a) Consultation: If:

(1) any event occurs which would prevent any conditions precedent to the Scheme being satisfied, or there is an occurrence that will prevent the conditions precedent being satisfied by the date specified in this agreement for its satisfaction; or

(2) the Scheme has not become Effective by the End Date,

the parties must, within 5 Business Days of a notice having been provided in accordance with clause 3.5(a)(1), consult in good faith to:

(3) consider and if agreed determine whether the Transaction may proceed by way of alternative means or methods;

(4) consider and if agreed change the date of the application made to the Court for an order under section 411(4)(b) of the Corporations Act approving the Scheme or adjourning that application (as applicable) to another date agreed to in writing by Coles and Bidder (being a date no later than 5 Business Days before the End Date); or

(5) consider and if agreed extend the relevant date or End Date.

(b) **Termination**: If the parties are unable to reach agreement under clause 3.4(a) within 10 Business Days of a notice having been provided in accordance with clause 3.5(a)(1), then unless that condition precedent is waived by Coles and/or Bidder as provided in clause 3.3, either of them may (if not in breach of clauses 3.2 or 3.5) terminate this agreement without any liability to the other party.

(c) **Effect of Termination**: Subject to clauses expressed to survive termination, upon termination of this agreement, no party shall have any rights against or obligations to any other party under this agreement except for those rights and obligations which accrued prior to termination.

3.5 Certain notices

(a) Notice of failure of condition precedent:

(1) If, before the time specified for satisfaction of a condition precedent, any event that will prevent that condition precedent being satisfied occurs, the party with knowledge of that event must immediately give the other party written notice of that event.

(2) If the condition precedent is not listed in clause 3.3(a), the party that has the right to waive the condition must give written notice to the other as soon as possible (and in any event no later than 8 Business Days) after giving or receiving notice of the relevant event, as to whether or not it waives the breach or non-fulfilment of any condition precedent resulting from the occurrence of that event, specifying the condition in question.

(b) **Waiver**: waiver of a breach or non-fulfilment in respect of one condition precedent does not constitute:

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(1) a waiver of breach or non-fulfilment of any other condition precedent resulting from the same event; or

(2) a waiver of breach or non-fulfilment of that condition precedent resulting from any other event.

(c) **Notice of changes**: Coles, Bidder and Wesfarmers must promptly advise each other orally and in writing of any change or event causing, or which, so far as can reasonably be foreseen, would cause:

(1) a representation or warranty provided by the party in this agreement to be false;

(2) a breach or non-fulfilment of any of the conditions precedent; or

(3) a material breach of this agreement by the party.

4 Transaction steps

4.1 Scheme

Coles must propose the Scheme (or such other form as the parties agree in writing) under which:

(a) all of the Coles Shares will be transferred to Bidder; and

(b) the Coles Shareholders (other than the Excluded Shareholders) as at the Scheme Record Date will be entitled to receive the Scheme Consideration.

4.2 Scheme Consideration

(a) Bidder undertakes and warrants to Coles (in Coles' own right and separately as trustee or nominee for each of the Scheme Shareholders) that in consideration of the transfer to Bidder of each Coles Share held by a Scheme Shareholder under the terms of the Scheme, Bidder will on the Implementation Date:

(1) accept that transfer; and

(2) pay each Scheme Shareholder (or procure the payment to each Scheme Shareholder of) the Scheme Consideration in accordance with the terms of the Scheme.

(b) Any fractional entitlement of a Scheme Shareholder to a part of a New Wesfarmers Share:

(1) which is 0.5 or greater will be rounded up to the nearest whole number of New Wesfarmers Shares; and

(2) which is less than 0.5 will be rounded down to the nearest whole number of New Wesfarmers Shares.

4.3 Ineligible Foreign Shareholders

The New Wesfarmers Shares to which an Ineligible Foreign Shareholder would otherwise have become entitled will be issued to a nominee appointed by Bidder who will, in accordance with the Scheme, sell those New Wesfarmers Shares and pay the proceeds received, after deducting any applicable brokerage, stamp duty and other taxes and charges, to the Ineligible Foreign Shareholder. Bidder agrees to appoint the nominee at least two weeks prior to the Scheme Meeting. The identity of the nominee and the terms and conditions of the appointment of the nominee are subject to Coles' prior approval, acting reasonably.

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4.4 New Wesfarmers Shares to rank equally

Bidder and Wesfarmers covenant in favour of Coles (in its own right and on behalf of the Scheme Shareholders) that:

(a) the New Wesfarmers Shares will rank equally in all respects with all existing Wesfarmers Shares and confer an entitlement to participate in any dividends or benefits that accrue on or after the date of this agreement, other than the Permitted Wesfarmers Dividend;

(b) it will do everything reasonably necessary to procure that official quotation of the New Wesfarmers Shares on the ASX will be effective on the first Business Day immediately following the Implementation Date; and

(c) on issue, each New Wesfarmers Share will be fully paid and free from any mortgage, charge, lien, encumbrance or other security interest.

5 Coles Options and Performance Shares

5.1 Exercise of discretions

The Coles Board must, as soon as practicable after the execution of this agreement, exercise any discretions in relation to:

(a) Performance Shares granted during the financial years ending in 2006 and 2007 (but not for Performance Shares granted during the financial year ending in 2005); and

(b) Coles Options which are subject to unsatisfied exercise conditions,

to vest some or all of those Performance Shares or permit the exercise of some or all of those Coles Options, conditional on the Scheme becoming Effective and on the holder agreeing to the cancellation of any remaining unvested Performance Shares granted during the financial years ending in 2005 and 2006 or any remaining Coles Options which, at the Effective Date, are subject to unsatisfied exercise conditions. Coles must disclose to Bidder as soon as practicable the extent to which these discretions have been exercised.

5.2 Performance Shares

Coles must issue any Coles Shares to be issued on vesting of any Performance Shares, whether as a result of the exercise of a Board discretion or not, before the Scheme Record Date (so that the holders will participate in the Scheme).

5.3 Deeds

Coles must use best endeavours to ensure that each holder of a Coles Option or a Performance Share enters into a deed (in a form reasonably acceptable to Bidder) as soon as practicable under which they agree, subject to the Scheme becoming Effective:

(a) to the cancellation any Coles Options or Performance Shares which are to be cancelled in the circumstance contemplated in clause 5.1; or

(b) to the extent that any Coles Option is or becomes exercisable as at the Effective Date, to exercise that Coles Option before the Scheme Record Date and to the cancellation all of their remaining Coles Options,

on the Effective Date for the consideration described in clause 5.4.

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5.4 Consideration for cancellation of Coles Options

Bidder covenants in favour of Coles (in its own right and separately as trustee or nominee for each holder of Coles Options) that, in consideration for the entry into a deed described in clause 5.3, Bidder will pay to each holder on, or as soon as practicable after, the Implementation Date the following cash consideration:

(a) for each Coles Option that is or becomes exercisable on or before the Effective Date, the aggregate of:

(1) the Cash Consideration payable for each Scheme Share; plus

(2) the value of the Scrip Consideration payable for each Scheme Share (to be determined to the extent the Scrip Consideration comprises ordinary shares in Wesfarmers by reference to the Wesfarmers VWAP for Wesfarmers Shares over the 5 Trading Days before the Scheme Record Date and to the extent the Scrip Consideration comprises partially protected shares in Wesfarmers by reference to the Wesfarmers VWAP for the partially protected shares over the first 5 Trading Days for the partially protected shares); plus

(3) the Coles Dividend plus an amount equal to the franking credit attached to that dividend; minus

(4) any amount payable on exercise of the Coles Option; and

(b) for the cancellation of each other Coles Option held on the Implementation Date, for nil consideration.

6 Conduct of business before Implementation Date

6.1 Conduct of Coles business

From the date of this agreement up to and including the Implementation Date, Coles must, unless it first obtains the written consent of Wesfarmers (such consent not to be unreasonably withheld), conduct its business, and procure that the Coles Group conducts its business, in the ordinary course, consistent with past practice, in substantially the same manner as previously conducted and, in particular, to:

(a) preserve intact its current business organisation, including by not:

(1) acquiring or Disposing of any business, asset, entity or undertaking, the value of which exceeds $50 million, individually or (other than in respect of assets) when aggregated with all such businesses, entities or undertakings;

(2) entering into, varying or terminating any contract, joint venture, partnership or commitment involving total expenditure greater than $50 million, individually or when aggregated with all such contracts, joint ventures, partnerships or commitments;

(3) without limiting paragraph 6.1(a)(2) above, entering into, varying or terminating the GE Arrangements or the NAB Arrangements; or

(4) entering into any individual employment contract pursuant to which the total remuneration package (including the value of any share or other equity participation or benefit received as part of the package) is $1 million or more per annum;

(5) initiating or settling any legal proceedings, claim, investigation, arbitration or other like proceedings where the amount claimed is $2 million or more; and

(6) authorising, committing, announcing or agreeing to take any of the actions referred to in any of paragraphs 1, 2, 3, 4 or 5 above;

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(b) use reasonable endeavours to preserve its relationships with suppliers, landlords, licensors, licensees and others having business dealings with it; and

(c) use reasonable endeavours to maintain the condition of its business and assets, including maintaining at least its current level of insurance (provided such level of insurance continues to be generally available).

6.2 Permitted activities

Nothing in clause 6.1 restricts Coles from doing anything that is:

(a) contemplated by this agreement;

(b) a Disclosed Transaction or disclosed in any business plan disclosed to Bidder prior to the date of this agreement; or

(c) approved in writing by Bidder (which must not unreasonably withheld or delayed).

6.3 Certain transactions

For the avoidance of doubt, the parties accept that it is within the ordinary course of Coles Group's business, and permitted under clause 6.1, if any member of the Coles Group:

(a) acquires or Disposes of any business, asset, entity or undertaking, the value of which does not exceed $50 million; or

(b) enters into any contract or commitment involving total expenditure no greater than $50 million.

6.4 Change of control rights

As soon as practicable after the date of this agreement, Coles and Bidder must seek to identify any change of control or similar provisions in leases and material contracts to which Coles or a Coles Group company is party which may be triggered by the implementation of the Transaction. In respect of those leases and contracts, the parties agree as follows:

(a) Coles and Bidder will agree a proposed course of action and then jointly initiate contact with the relevant landlords and other counter-parties and request that they provide any consents required. None of the Bidder, Wesfarmers or any of their Related Persons may contact any landlords or other counter-parties without Coles or without prior written notification to Coles;

(b) Coles must cooperate with, and provide reasonable assistance to, Bidder to obtain such consents as expeditiously as possible;

(c) Bidder and Wesfarmers must take all action necessary to comply with any requirements of the landlords and other counter-parties under the property leases or relevant agreements that are required to be complied with by an assignee or transferee or new controller, including in the case of leases, without limitation, to:

(1) provide any information required by landlords or landlords' mortgagees;

(2) enter into direct property leases with landlords on the same terms as existing property leases or on terms no less favourable to Bidder than the terms of existing property leases are to the relevant Coles Group lessee company, or agreeing to an assignment of existing property leases;

(3) provide parent company guarantees or such other forms of guarantee or security as landlords may require under the property leases; and

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(4) make representatives available, where necessary, to meet with landlords, head landlords or mortgagees to deal with issues arising in relation to the transfer or assignment (or deemed transfer or assignment) of those leases,

A failure by a member of the Coles Group to obtain any landlord or third party consent will not constitute a breach of this agreement by Coles and, together with any consequences that arise, will be disregarded when assessing the operation of any other provision of this agreement.

6.5 Financing information and cooperation

(a) As soon as reasonably practicable after the date of this agreement and at Wesfarmers cost, Coles must provide, and procure that its Related Persons provide, all information and cooperation reasonably requested by Bidder or its Related Persons for the purpose of, or in connection with, any raising of debt or syndication of any debt or equity finance raised directly or indirectly for the purpose of financing the Scheme, including the following:

(1) preparation of financial and other information, financial statements and reconciliations and financial data; and

(2) participation in, and assistance with the preparation of materials for, meetings, presentations, road shows, due diligence sessions, sessions with ratings agencies and verification processes.

(b) As soon as reasonably practicable after the date of this agreement and at Wesfarmers cost, Coles must take, and procure that its Related Persons take, all steps (including the giving of any notice) reasonably requested by Bidder or its Related Persons in connection with, or for the purpose of, the repayment on or after the implementation of the Scheme by Bidder or a Related Person of Bidder of any Coles indebtedness or debt securities in existence as at the date of this agreement, including the following:

(1) swapping out existing foreign exchange hedges;

(2) scheduling existing debt for repayment;

(3) closing interest rate hedging;

(4) maintaining existing transactional banking relationships; and

(5) replacing existing bank guarantees.

6.6 Business Engagement and Integration Committee

(a) As soon as practicable after the date of this Agreement, the parties shall establish a Business Engagement and Integration Committee made up of 3 executives nominated by Wesfarmers and 3 executives nominated by Coles, or such other persons as the parties may agree from time to time (the ***Business Engagement and Integration Committee***).

(b) The Business Engagement and Integration Committee will meet at least weekly until the Implementation Date.

(c) Observers and advisers may attend meetings of the Business Engagement and Integration Committee on request.

(d) The Business Engagement and Integration Committee will act as a forum for consultation between the parties and will consider, among other things:

(1) the trading and financial performance of the Coles Group business;

(2) any matter outside the ordinary course of the business;

(3) any significant or unusual events affecting the business;

(4) any significant decisions to be made in connection with the business; and

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(5) subject to any existing confidentiality obligations owed to third parties and applicable laws, information material to the obtaining of any consents or approvals required to be obtained from third parties in order to effect an orderly implementation of the Transaction.

(e) The Business Engagement and Integration Committee may also:

(1) discuss matters relevant to carrying on of the business following implementation of the Scheme;

(2) subject to any existing confidentiality obligations owed to third parties and applicable laws, consider and manage requests for access to documents and other information, premises, personnel, and advisers of the business, including any request made under clause 6.6(h);

(3) assist Wesfarmers to obtain an understanding of the operations of the business in order to facilitate implementation of the plans of Wesfarmers for the business following implementation of the Scheme; and

(4) consider any other matter agreed by the Chief Executives of Coles and Wesfarmers.

(f) Where the Business Engagement and Integration Committee cannot agree on any matter following discussions in good faith, the matter must be escalated to the Chief Executives of Coles and Wesfarmers for consideration.

(g) Subject to this Agreement, nothing in this clause requires either party to act at the direction of the other. The business of each party and its subsidiaries will continue to operate independently of the other until the Implementation Date. Nothing in this Agreement shall constitute the relationship of a partnership or a joint venture between the parties.

(h) At meetings of the Business Engagement and Integration Committee, Coles must:

(1) provide Wesfarmers with:

(A) a copy of the weekly Transformation Express (TEX) report;

(B) a copy of the weekly sales reports;

(C) a copy of the Coles Group monthly financial report including its cashflow, working capital position, and capital expenditure; and

(D) subject to clause 6.1, information supporting any significant acquisitions or disposals and any significant new contracts or other long term commitments which exceeds $50 million; and

(2) following consultation, and subject to clause 6.6 (i), as soon as reasonably practicable, provide to Wesfarmers reasonable access to senior management of Coles to enable Wesfarmers to plan the transition of ownership of the business.

(i) Requests for access and co-operation under this clause 6.6 must be reasonably necessary for Wesfarmers to plan the transition of ownership of the business and must not place an unreasonable burden on the ability of Coles or any of its subsidiaries to operate its businesses, and are subject to any existing confidentiality obligations owed to third parties and applicable laws.

6.7 Conduct of Wesfarmers business

From the date of this agreement up to and including the Implementation Date, Wesfarmers will conduct its business, and will procure that each of its subsidiaries conducts its business, in the ordinary course, consistent with past practice, in substantially the same manner as previously conducted.

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7 Implementation

7.1 Coles' obligations

Coles must take all steps reasonably necessary to implement the Scheme as soon as practicable and recognises that any delay is not in the best interests of Coles or Wesfarmers, and in particular Coles must:

(a) **Announce recommendation of Scheme:** following execution of this agreement, announce, in a form agreed between Coles and Bidder that each director of Coles:

(1) recommends to Coles Shareholders that the Scheme be approved; and

(2) who holds Coles Shares intends to vote his or her Coles Shares in favour of the Scheme,

subject to there being no superior proposal, and the Coles Board must not change or withdraw its recommendation in favour of the Scheme unless the Coles Board determines, in good faith, supported by written advice from the Coles Board's financial and legal advisers (a summary of the material terms of which has been provided to Wesfarmers), that their fiduciary duties require them to do so;

(b) **Independent Expert:** promptly appoint the Independent Expert and provide assistance and information reasonably requested by the Independent Expert to enable it to prepare its report for the Scheme Booklet as soon as practicable;

(c) **Preparation of Scheme Booklet:** prepare and despatch the Scheme Booklet in accordance with all applicable laws and in particular with the Corporations Act, ASIC Policy Statement 142 and the Listing Rules. The Scheme Booklet must include a statement by the Coles Board unanimously recommending that Coles Shareholders vote in favour of the Scheme in the absence of any superior proposal (unless the Board has determined otherwise in compliance with clause 7.1(a));

(d) **Consult with Bidder and Wesfarmers on form of Scheme Booklet**: consult with Bidder and Wesfarmers in good faith in relation to the form and content of the Scheme Booklet, including taking into account their reasonable comments and keeping them reasonably informed of any material matters raised by ASIC in relation to the Scheme Booklet;

(e) **Court direction:** apply to the Court for orders directing Coles to convene the Scheme Meeting;

(f) **Scheme Meeting:** convene the Scheme Meeting to approve the Scheme in accordance with the orders made by the Court pursuant to section 411(1) of the Corporations Act;

(g) **Security holder approval:** seek the approval of Coles Shareholders (other than the Excluded Shareholders) for the Scheme;

(h) **Section 411(17)(b) statement:** apply to ASIC for the production of a statement under section 411(17)(b) of the Corporations Act stating that ASIC has no objection to the Scheme;

(i) **Court approval**: subject to all conditions precedent in clause 3.1 being satisfied or waived apply to the Court for orders approving the Scheme as approved by the Coles Shareholders (other than the Excluded Shareholders) at the Scheme Meeting;

(j) **Lodge copy of Court order**: lodge with ASIC an office copy of the Court order approving the Scheme as approved by the Coles Shareholders (other than the Excluded Shareholders) at the Scheme Meeting on the day such office copy is received (or such later date as agreed in writing by Bidder);

(k) I**nformation**: at least 2 Business Days before the Implementation Date provide all necessary information, or have the registrar of Coles provide all necessary information, about the Scheme and Coles Shareholders to Bidder which Bidder reasonably requires in order to facilitate the provision by Bidder of the Scheme Consideration;

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(l) **Coles Dividend**: pay the Coles Dividend to Scheme Shareholders on the Implementation Date;

(m) **Registration**: subject to the Bidder and Wesfarmers satisfying their obligations under clauses 4.2, 4.4 and 7.3(c), register all transfers of Coles Shares on or as soon as practicable after the Implementation Date;

(n) **Appeal process**: if the Court refuses to make any orders directing Coles to convene the Scheme Meeting or approving the Scheme, appeal the Court's decision to the fullest extent possible (except to the extent that the parties agree otherwise, or an independent Queen's Counsel or Senior Counsel acceptable to Bidder (acting reasonably) indicates that, in his or her view, an appeal would have no reasonable prospect of success); and

(o) **Procure reconstitution of Coles board**: as soon as practicable after the Scheme Consideration has been paid, procure that all directors on the board of directors of Coles resign and that nominees of the Bidder are appointed to the board of directors of Coles.;

For the purposes of this clause 7.1 customary qualifications and explanations contained in the Scheme Booklet in relation to a recommendation to vote in favour of the Scheme to the effect that the recommendation is made in the absence of a superior proposal from a Third Party will not be regarded as a failure to make or withdraw the making of a recommendation in favour of the Scheme.

7.2 Bidder's obligations

Bidder must take all steps reasonably necessary to assist Coles to implement the Scheme as soon as is reasonably practicable and recognises that any delay is not in the best interests of Coles or Wesfarmers, and in particular Bidder must:

(a) **Bidder Information**: expeditiously prepare and provide to Coles the Bidder Information for inclusion in the Scheme Booklet (and any supplementary Scheme Booklet), including all information regarding the Bidder Group and the Scrip Consideration required by all applicable laws, the Listing Rules and ASIC Policy Statements, which information must:

(1) contain all information necessary to ensure that the Scheme Booklet complies with the requirements of section 411(3) of the Corporations Act and ASIC Policy Statement 60 in respect of that information;

(2) contain all the information that would be required under section 636(1)(g) of the Corporations Act if the Scheme Booklet was a bidder's statement offering the Scrip Consideration as consideration under a takeover bid, to the extent reasonably applicable; and

(3) be updated by all such further or new information which may arise after the Scheme Booklet has been despatched until the date of the Scheme Meeting which is necessary to ensure that it is not misleading or deceptive in any material respect (whether by omission or otherwise),

(4) and, as expeditiously as practicable, give to Coles any further information reasonably required by Coles (including information as to Bidder's intentions for Coles following Implementation of the Scheme), to ensure that the Bidder Information is not misleading or deceptive and there are no material omissions from the Bidder Information;

(b) **Independent Expert's report**: provide any assistance or information reasonably requested by Coles or by the Independent Expert in connection with the preparation of the Independent Expert's report to be sent together with the Scheme Booklet;

(c) **Regulatory Approvals**: must promptly apply for, and obtain by the expected date of the Scheme Meeting, all approvals, consents, clearances, decisions, determinations or other acts by any Government Agencies (including liquor licensing and gaming regulatory authorities) which are required to be obtained by Bidder (or Wesfarmers) in order for the Bidder (and Wesfarmers) to execute and perform this agreement;

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(d) **Representation**: procure that it is represented by senior counsel at the Court hearings convened for the purposes of section 411(4)(b) of the Corporations Act, at which through its senior counsel, Bidder will undertake (if requested by the Court) to do all such things and take all such steps within its power as are necessary in order to ensure the fulfilment of its obligations under this agreement and the Scheme;

(e) **Deed Poll**: Prior to the First Court Date, enter into a deed poll in favour of the Coles Shareholders in the form of Attachment 2;

(f) **Not act inconsistently**: not act in a manner inconsistent with obtaining Court approval for the Scheme; and

(g) **Scheme Consideration**: pay the Scheme Consideration in the manner and amount contemplated by clause 4.2 on the Implementation Date.

7.3 Wesfarmers' obligations

Wesfarmers must take all steps reasonably necessary to assist Coles and Bidder to implement the Scheme as soon as is reasonably practicable, and in particular Wesfarmers must:

(a) **Deed Poll**: Prior to the First Court Date, enter into a deed poll in favour of the Coles Shareholders in the form of Attachment 2;

(b) **Bidder's obligations**: use all reasonable endeavours to procure that the Bidder satisfies its obligations under this agreement and under the Deed Poll, including (but not limited to) the obligations of the Bidder to pay the Scheme Consideration in the manner and amount contemplated by clause 4.2 on the Implementation Date.

(c) **Covenant to pay**: subject to the Scheme becoming Effective, cause the payment of the Scheme Consideration to the Bidder (or Coles Shareholders directly) on the Implementation Date so as to enable the Bidder to satisfy its obligations under this agreement and the Deed Poll.

For the purposes of clause 7.3(c), Wesfarmers covenants to pay, or cause the payment of, the Scrip Consideration by procuring:

(1) the issue of the Scrip Consideration due to Scheme Shareholders under the Scheme and the entry of the Scheme Shareholders' names in the Wesfarmers' register of members as the holder of such Scrip Consideration; and

(2) on, or as soon as practicable after, the Implementation Date, the dispatch of an uncertificated holding statement representing such Scrip Consideration to the Scheme Shareholders by pre-paid post to his or her address as shown in the Register; and

(d) **Regulatory Approvals:** procure that Bidder promptly applies for, and obtains by the expected date of the Scheme Meeting, all approvals, consents, clearances, decisions, determinations or other acts by any Government Agencies (including liquor licensing and gaming regulatory authorities) which are required to be obtained by Bidder (or Wesfarmers) in order for the Bidder (and Wesfarmers) to execute and perform this agreement.

7.4 Scheme Booklet

(a) Bidder Information: Bidder:

(1) consents to the inclusion of the Bidder Information in the Scheme Booklet; and

(2) acknowledges that:

(A) it is responsible for ensuring that the Bidder Information is not misleading or deceptive in any material respect (whether by omission or otherwise) and that Coles will not verify or audit that information

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and will disclaim responsibility for that information in the Scheme Booklet; and

(B) the Scheme Booklet will state that Bidder is responsible for the Bidder Information.

(b) **Final determination as to the Scheme Booklet**: If, after a reasonable period of consultation, the parties are unable to agree on the form or content of the Scheme Booklet, Coles must make the final determination as to the form and content of the Scheme Booklet and if Bidder disagrees with the final form and content:

(1) Coles must include a statement to that effect in the Scheme Booklet; and

(2) if Coles' concerns relate to the Bidder Information, Coles must include a statement that Bidder takes no responsibility for the relevant form or content to the extent that the Bidder disagrees with the final form and content.

7.5 Conduct of Court proceedings

(a) Coles and Bidder are entitled to separate representation at all Court proceedings affecting the Transaction.

(b) This agreement does not give Coles or Bidder any right or power to give undertakings to the Court for or on behalf of the other party without that party's consent.

(c) Coles and Bidder must give all undertakings to the Court in all Court proceedings which are reasonably required to obtain Court approval and confirmation of the Transaction as contemplated by this agreement.

8 Representations and warranties

8.1 Bidder's representations

Bidder represents and warrants to Coles (in its own right and separately as trustee or nominee of each of the Coles Indemnified Parties) that:

(a) **Bidder Information**: the Bidder Information provided to Coles for inclusion in the Scheme Booklet:

(1) will be prepared and provided in good faith and on the understanding that each of the Coles Indemnified Parties will rely on that information to prepare the Scheme Booklet and to propose and implement the Scheme in accordance with the Corporations Act;

(2) will be true and correct in all material aspects as at the date of the Scheme Booklet sent to Coles Shareholders;

(3) will comply with all applicable laws (including without limitation, the Corporations Act) and ASIC policy statements applicable to schemes of arrangement; and

(4) as at the date the Scheme Booklets are despatched to Coles Shareholders, will not contain any statement which is materially misleading or deceptive including by way of omission from that statement.

(b) **New information**: it will, as a continuing obligation, provide to Coles all further or new information which arises after the Scheme Booklet have been despatched until the date of the Scheme Meeting which is necessary to ensure that there would be no breach of clause 8.1 if it applied as at the date on which that information arose;

(c) **Validly existing**: it is a validly existing corporation registered under the laws of its place of incorporation;

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(d) **Authority**: the execution and delivery of this agreement has been properly authorised by all necessary corporate action of Bidder;

(e) **Power**: it has full corporate power and lawful authority to execute, deliver and perform this agreement;

(f) **No default**: this agreement does not conflict with or result in the breach of or a default under:

(1) Bidder's certificate of incorporation or constitution; or

(2) any writ, order or injunction, judgment, law, rule or regulation to which it is party or by which it is bound,

other than such exceptions in the case of clause 8.1(f)(2) as would not be reasonably expected to have a material adverse effect on Bidder's ability to consummate the Transaction;

(g) **No shareholder approval**: no shareholder approval or consent of Bidder or any of its Related Bodies Corporate is required to be obtained by Bidder in order to execute and perform this agreement.

(h) **Scheme financing**: as at the date of this agreement it is satisfied that it will have sufficient funds available to it to satisfy its obligations under clause 4.2 in a timely manner.

8.2 Bidder's indemnity

Bidder agrees with Coles (in its own right and separately as trustee or nominee of for each of the Coles Indemnified Parties) to indemnify the Coles Indemnified Parties against any Claim, action, damage, loss, liability, cost, expense or payment of whatever nature and however arising which any of the Coles Indemnified Parties suffers, incurs or is liable for arising out of any breach of any of the representations and warranties in clause 8.1.

8.3 Coles' representations

Coles represents and warrants to Bidder (in its own right and separately as trustee or nominee for each of the other Bidder Indemnified Parties) that:

(a) **Validly existing**: it is a validly existing corporation registered under the laws of Victoria;

(b) **Authority**: the execution and delivery of this agreement has been properly authorised by all necessary corporate action of Coles;

(c) **Power**: it has full corporate power and lawful authority to execute, deliver and perform this agreement;

(d) **Capital structure**: as at the date of this agreement, there are:

(1) 1,198,780,888 Coles Shares on issue;

(2) 5,841,946 Coles Options on issue; and

(3) 4,297,590 Performance Shares on issue,

and Coles and each member of the Coles Group has not issued (and is not required to issue) any other securities, options or instruments which are still outstanding (or may become outstanding) and which may convert into Coles Shares other than to a member of the Coles Group;

(e) **No default**: this agreement does not conflict with or result in the breach of or a default under:

(1) Coles' constitution; or

(2) any writ, order or injunction, judgment, law, rule or regulation to which it is party or by which it is bound,

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other than such exceptions in the case of clause 8.3(e)(2) as would not be reasonably expected to have a material adverse effect on Cotes' ability to consummate the Transaction;

(f) **Coles Information**: the Coles Information:

(1) will be prepared in good faith and on the understanding that each of the Bidder Indemnified Parties will rely on that information for the purposes of considering and approving the Bidder Information in the Scheme Booklet;

(2) will be true and correct in all material aspects as at the date the Scheme Booklet is sent to Coles Shareholders;

(3) will comply with all applicable laws (including without limitation, the Corporations Act) and ASIC policy statements applicable to schemes of arrangement; and

(4) as at the date the Scheme Booklet is sent to Coles Shareholders, will not contain any statement which is materially misleading or deceptive, including by way of omission from that statement;

(g) **Continuous disclosure**: on the date of this agreement, the First Court Date, the Scheme Meeting and the Second Court Date, it is in compliance with its disclosure obligations under the Listing Rules.

8.4 Coles' indemnity

Coles agrees with Bidder (in its own right and separately as trustee or nominee for each Bidder Indemnified Party) to indemnify Bidder and each of the other Bidder Indemnified Parties from any Claim, action, damage, loss, liability, cost, expense or payment of whatever nature and however arising which Bidder or any of the other Bidder Indemnified Parties suffers, incurs or is liable for arising out of any breach of any of the representations and warranties in clause 8.3.

8.5 Wesfarmers representations and warranties

Wesfarmers represents and warrants to Coles (in its own right and separately as trustee or nominee for each of the Coles Indemnified Parties) that:

(a) **Validly existing**: it is a validly existing corporation registered under the laws of its place of incorporation;

(b) **Authority**: the execution and delivery of this agreement has been properly authorised by all necessary corporate action of Wesfarmers;

(c) **Power**: it has full corporate power and lawful authority to execute, deliver and perform this agreement;

(d) **No default**: this agreement does not conflict with or result in the breach of or a default under:

(1) Wesfarmers' certificate of incorporation or constitution; or

(2) any writ, order or injunction, judgment, law, rule or regulation to which it is party or by which it is bound,

other than such exceptions in the case of clause 8.5(d)(2) as would not be reasonably expected to have a material adverse effect on Bidder's ability to consummate the Transaction;

(e) **No shareholder approval**: no shareholder approval or consents of Wesfarmers or any of its Related Bodies Corporate are required to be obtained by Wesfarmers or the Bidder in order to execute and perform this agreement;

(f) **financing**: as at the date of this agreement it is satisfied that it will have sufficient funds available to it to satisfy its obligations under clause 7.3 in a timely manner;

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(g) **ranking of shares**: the New Wesfarmers Shares to be issued in accordance with clause 4.2 and the terms of the Scheme will be duly authorised and validly issued, fully paid and free of all security interests and third party rights and each New Wesfarmers Share will rank equally with all other Wesfarmers Shares then on issue, with the exception of conferring an entitlement to participate in the Permitted Wesfarmers Dividend; and

(h) **continuous disclosure**: it is in compliance with its disclosure obligations under the ASX listing rules and is not withholding any information from disclosure in accordance with ASX listing rule 3.1A (other than any information disclosed to Coles or its Related Persons prior to execution of this agreement or any information which will be disclosed in the public announcement referred to in clause 13).

8.6 Wesfarmers' indemnity

Wesfarmers severally agrees with Coles (in its own right and separately as trustee or nominee of for each of the Coles Indemnified Parties) to indemnify the Coles Indemnified Parties against any Claim, action, damage, loss, liability, cost, expense or payment of whatever nature and however arising which any of the Coles Indemnified Parties suffers, incurs or is liable for arising out of any breach of any of the representations and warranties given by Wesfarmers in clause 8.5.

8.7 No representation or reliance

(a) Each party acknowledges that each other party has executed this document and agreed to take part in the transactions that this document contemplates in reliance on the representations and warranties that are made in clause 8.

(b) Bidder and Wesfarmers each acknowledge that it has not entered into this agreement in reliance on any warranty or representation made by or on behalf of Coles, except the warranties and representations set out in this agreement.

8.8 Survival of representations

Each representation and warranty in clauses 8.1, 8.3 and 8.5:

(a) is severable; and

(b) survives the termination of this agreement.

8.9 Survival of indemnities

Each indemnity in this agreement (including those in clauses 8.2, 8.4 and 8.6):

(a) is severable;

(b) is a continuing obligation;

(c) constitutes a separate and independent obligation of the party giving the indemnity from any other obligations of that party under this agreement; and

(d) survives the termination of this agreement.

8.10 Timing of warranties

Each representation and warranty made or given under clauses 8.1, 8.3 or 8.5 is given:

(a) at the date of this agreement; and

(b) at 6pm on the day before the Second Court Date; or

(c) where expressed, at the time at which the representation or warranty is expressed to be given.

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9 Releases and non-reliance

9.1 Bidder directors and officers

(a) Coles releases its rights against, and agrees with Bidder that it will not make a Claim against, any Bidder Indemnified Party in connection with:

(1) any breach of any representations, covenants and warranties of Bidder or of Wesfarmers or any member of the Bidder Group in this agreement; or

(2) any disclosures containing any statement which is false or misleading whether in content or by omission,

to the extent that the Bidder Indemnified Party has acted in good faith and has not engaged in wilful misconduct.

(b) This clause 9.1 is subject to any Corporations Act restriction and will be read down accordingly. Bidder receives and holds the benefit of this clause to the extent it relates to each Bidder Indemnified Party as trustee for them.

9.2 Coles directors and officers

(a) Bidder releases its rights against, and agrees with Coles that it will not make a Claim against, any Coles Indemnified Party in connection with:

(1) any breach of any representations, covenants and warranties of Coles or any member of the Coles Group in this agreement; or

(2) any disclosures containing any statement which is false or misleading whether in content or by omission,

to the extent that the Coles Indemnified Party has acted in good faith and has not engaged in wilful misconduct.

(b) Subject to the Scheme becoming Effective, Bidder undertakes that it will:

(1) for a period of 7 years from the Implementation Date, ensure that the constitutions of Coles and each of the members of the Coles Group continues to contain such rules as at the date of this agreement which provide for each of them to indemnify each of their officers against any liability incurred by that officer in his or her capacity and to any person other than Coles or a related body corporate of Coles; and

(2) procure that Coles and each member of the Coles Group each member of the Coles Group comply with the deeds of indemnity, access and insurance made by them in favour of their respective directors and officers from time to time.

(c) This clause 9.2 is subject to any Corporations Act restriction and will be read down accordingly. Coles receives and holds the benefit of this clause 9.2 to the extent it relates to each Coles Indemnified Party as trustee for them.

(d) Subject to the Scheme becoming Effective, Coles undertakes that it will in respect of all directors and officers of Coles and each member of the Coles Group immediately prior to the Scheme becoming Effective (**Retired Directors**), Coles shall prepay directors and officers insurance for their benefit for a period of 7 years from the retirement date of each Retired Director, provided it is on commercially reasonable terms with a reputable insurer at current coverage levels as disclosed to Bidder prior to entry into this agreement. Such policy shall include a term that the policy cannot be cancelled unless the insured consent to the cancellation.

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9.3 Due diligence investigations

Bidder and Wesfarmers acknowledges on its own behalf and on behalf of each of its Related Persons that:

(a) prior to entry into this agreement, they and their Related Persons have undertaken and concluded their own due diligence investigations in relation to the Coles Group and have conducted discussions with Coles and certain of its Related Persons; and

(b) in the course of those investigations and the negotiations and discussions prior to entry into this agreement, Coles and its Related Persons have provided to Bidder and Wesfarmers the Coles Due Diligence Information.

9.4 No Coles warranty or liability

Bidder and Wesfarmers acknowledge and agree both on their own behalf and on behalf of each of their Related Persons, that each of Coles and its Related Persons:

(a) makes no representation or warranty:

(1) as to the accuracy or completeness the Coles Due Diligence Information;

(2) in respect of any Forward Looking Information, as to the reasonableness of any such information or the accuracy, completeness or relevance of any assumptions underlying any such information (and Bidder and Wesfarmers expressly acknowledges that all such information is necessarily a matter of opinion, is inherently uncertain and subject to change and when provided did not take into account any investment criteria or other considerations which may have determined or influenced the decision of Bidder and Wesfarmers to enter into this agreement);

(3) that any of the Coles Due Diligence Information has been audited, verified or prepared with reasonable care; or

(4) that the Coles Due Diligence Information is the totality of the information that a person would require or expect to find to make a decision to enter into this agreement or to acquire Scheme Shares (or Coles Options) pursuant to the Transaction;

(b) has no legal liability or responsibility to Bidder or Wesfarmers, their Related Persons or any other person for any false, inaccurate, misleading or deceptive Coles Due Diligence Information or for any omission from the Coles Due Diligence Information which is or may be misleading or deceptive or for any opinion or interpretation formed, conclusion drawn or decision made by Bidder or Wesfarmers as a result of examining the Coles Due Diligence Information, including a decision to enter into this agreement, to acquire Scheme Shares or Coles Options pursuant to the Transaction or for any other purpose;

(c) has no legal liability or responsibility to inform Bidder or Wesfarmers of any matter arising or coming to the notice of Coles which may affect or qualify any of the Coles Due Diligence Information or to update or correct any of the Coles Due Diligence Information; and

(d) has no legal liability or responsibility for any loss of any kind (including, without limitation, any indirect, consequential or economic loss or loss of profit or opportunity) arising from any inaccuracy, incompleteness or misleading or deceptive nature (including by omission) of any of the Coles Due Diligence Information or any default, negligence or lack of care in relation to the preparation or provision of the Coles Due Diligence Information, and the Bidder and Wesfarmers acknowledge and agree both on their own behalf and on behalf of each of their Related Persons not to make any claim or pursue any proceedings against Coles or its Related Persons for any loss of any kind arising from:

(1) an error, inaccuracy, incompleteness or similar defect in the Information; or

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(2) any default, negligence or lack of care in relation to the preparation or provision of the Information,

except to the extent that liability cannot by law be excluded.

9.5 Own enquiries

Without limiting clause 9.3 and 9.4, Bidder and Wesfarmers hereby acknowledges and agrees both on their own behalf and on behalf of each of their Related Persons, that:

(a) Bidder and Wesfarmers have made their own independent assessment of all Coles Due Diligence Information;

(b) Bidder and Wesfarmers have carried out, and relied solely on, their own investigation and analysis of the Coles Due Diligence Information and the Transaction;

(c) in relation to Forward Looking Information:

(1) there are uncertainties inherent in attempting to prepare the Forward Looking Information and Bidder and Wesfarmers is familiar with these uncertainties;

(2) Bidder and Wesfarmers is taking full responsibility for making its own evaluation of the adequacy and accuracy of all Forward Looking Information (including the reasonableness of any assumptions and contingencies which may affect the Forward Looking Information); and

(3) neither Coles nor any of its officers or employees is liable under any Claim arising out of or in connection with any party's use or disclosure of any such Forward Looking Information; and

(d) Bidder and Wesfarmers have utilised the Coles Due Diligence Information for information purposes only and solely at their own risk.

9.6 Benefit

The acknowledgements, confirmations and agreements given and made by Bidder and Wesfarmers on their own behalf and on behalf of their Related Persons in clause 9.3, 9.4 and 9.5 are given to Coles on its own behalf and separately as trustee for each of the Coles Indemnified Parties.

10 No-talk and no-shop obligations

10.1 Termination of existing discussions

(a) Coles undertakes to terminate any existing negotiations or discussions, in respect of any Competing Transaction, with any Third Party.

(b) Coles warrants and represents that it has requested in writing the immediate return or destruction of all Coles Confidential Information that has been provided to any Third Party since 23 February 2007 and that all such Third Parties (other than those Third Parties notified in writing by Coles to Wesfarmers on or before the date of this Agreement), have confirmed to it that the Coles Confidential Information has been returned or destroyed.

(c) Coles undertakes to take any steps reasonably requested by Wesfarmers to enforce any breaches of the terms of any confidentiality arrangement in relation to the Bidding Process (as defined in the Confidentiality Deed) entered into between Coles and a Third Party where the breach relates to any standstill obligation in relation to the acquisition of Coles Shares or a requirement on the recipient of information to return or destroy any information received.

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10.2 No-talk

During the Restricted Period, Coles must ensure that neither it nor any of its Related Persons:

(a) directly or indirectly participate in any negotiations or discussions, provide or make available any information (including by way of providing information and access to perform due diligence), or communicate any intention to do any of these things, in respect of or in response to any expression of interest, offer or proposal by any person in relation to any Competing Transaction;

(b) disclose any information about the business or affairs of the Coles Group to a Third Party (other than a Governmental Agency) other than in the ordinary course of business or as required under Coles' existing contractual obligations; or

(c) provide any information to a Third Party for the purposes of enabling that person to make an expression of interest, offer or proposal which may reasonably be expected to lead to a Competing Transaction.

10.3 No-shop

During the Restricted Period, Coles must ensure that neither it nor any of its Related Persons directly or indirectly solicit or encourage any Competing Transaction or initiate steps or discussions with any Third Party which may reasonably be expected to lead to an offer or proposal by any Third Party in relation to any Competing Transaction.

10.4 Limitation to No-talk

(a) Clause 10.2 does not prevent Coles or a Related Person from undertaking an act otherwise prohibited by clause 10.2 in relation to a bona fide Competing Transaction which:

(1) was not solicited by Coles;

(2) was not otherwise brought about as a result of any breach by Coles of its obligations under this clause 10; and

(3) constitutes, or which is reasonably likely to constitute, a Superior Transaction; and

(4) where failure to undertake such act in response to the Competing Transaction may constitute a breach of the Coles directors' fiduciary or statutory obligations, after having received written advice to that effect from Coles' external lawyers (a summary of the material terms of which has been provided to Wesfarmers).

(b) Clause 10.2 does not prevent Coles continuing to make normal presentations to brokers, portfolio investors and analysts in the ordinary course of business or promoting the merits of the Transaction.

10.5 Notification

(a) During the Restricted Period, Coles must promptly notify Bidder:

(1) of any approach, inquiry or proposal made to (including providing a summary to Bidder of the material terms of any such approach, inquiry or proposal), and any attempt to initiate or continue negotiations or discussions with, Coles or any of its Related Persons with respect to a Competing Transaction, whether solicited or otherwise;

(2) of any request for information or access to books or records to Coles or any of its Related Persons, which may lead to a current or future Competing Transaction ; or

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(3) if it takes, or proposes to take, any action of the kind referred to in clause 10.2.

(b) Coles must not enter into a legally binding agreement in relation to, or publicly recommend, a Competing Transaction unless:

(1) clause 10.4 applies;

(2) Coles notifies Bidder in writing of all material terms of the Competing Transaction, including details of the proposed consideration, conditions, timing and any break fee; and

(3) Coles has provided Bidder at least 3 Business Days to match the terms of the Competing Transaction and the Bidder has failed to do so.

11 Break fee

11.1 Background

(a) Coles and Bidder acknowledge that, if they enter into this agreement and the Scheme is subsequently not implemented, Bidder, Wesfarmers and its Related Persons will have incurred significant costs, including:

(1) advisory costs;

(2) costs of management time;

(3) out of pocket expenses, including air fares and hotel accommodation;

(4) commitment fees and other financing costs; and

(5) significant opportunity costs including by Bidder and its Related Persons in pursuing the Transaction or in not pursuing other alternative acquisitions or strategic initiatives.

(b) In the circumstances referred to in clause 11.1(a), Bidder has requested that provision be made for the payment outlined in clause 11.2, without which Bidder would not have entered into this agreement and its proposal would not have been put to Coles.

(c) The Coles Board and the Bidder Board both acknowledge that they have received legal advice in relation to this clause 11 and consider that it is reasonable and appropriate to agree to the payments referred to in this clause 11 in order to secure the significant benefits to it (and its shareholders) from participation in the Transaction.

11.2 Payment of Break Fee

Subject to clause 11.3, if:

(a) a Competing Transaction for Coles is announced or made prior to the earlier of termination of this agreement and the Second Court Date and, within 12 months after the date of this agreement, the person announcing or making the Competing Transaction:

(1) acquires (whether directly or indirectly) or becomes the holder of all or a substantial part of the business of the Coles Group;

(2) acquires (whether directly or indirectly) all or a substantial part of the Coles everyday needs business or the K-mart, Target or Officeworks businesses, or acquires management rights over any of those businesses (or any part of them) or any other right to participate in the profits of any of those businesses (other than as a shareholder in Coles Group);

(3) acquires control (as determined in accordance with section 50AA of the Corporations Act) of Coles; or

(4) otherwise acquires or merges with Coles;

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(b) at any time prior to the termination of this agreement, the majority of Coles directors withdraw their recommendation of the Scheme, other than where the Independent Expert concludes in a report (a copy of which is released to ASX) that the Scheme is no longer in the best interests of the Coles Shareholders on the basis of the occurrence of a Wesfarmers Material Adverse Change, or adversely modify an earlier recommendation or recommend a Competing Transaction; or

(c) Bidder terminates this agreement in accordance with clause 12.1(a)(2) for a material breach of this agreement by Coles,

then, Coles must pay to the Bidder the amount of $150 million (the **Break Fee,** which for the avoidance of doubt is only payable once) as compensation for the Bidder's costs within 5 Business Days of the relevant event occurring and the Bidder demanding payment of such amount in writing. Coles agrees and acknowledges that clause 9.2 has no application to its obligations under this clause 11.2.

11.3 Qualifications

(a) No amount shall be payable by Coles under clause 11.2 if the Scheme becomes Effective, notwithstanding the occurrence of any event in clause 11.2. To the extent that any amounts have already been paid under this clause 11.2 and the Scheme becomes Effective, such amounts shall be immediately refunded to Coles.

(b) If a court or the Takeovers Panel determines that the agreement by Coles to make the payment, or the making of any payment, to Bidder pursuant to clause 11.2:

(1) constituted, or constitutes, or would constitute, a breach of the fiduciary or statutory duties of the Coles Board to it;

(2) constituted, or constitutes, or would constitute, unacceptable circumstances within the meaning of the Corporations Act; or

(3) was, or is, or would be, unlawful for any other reason,

then, to that extent (and only to that extent), Coles will not be obliged to make that payment and the Bidder must refund to Coles any payment already made. To the extent reasonably practicable, Coles must submit in any relevant proceedings that no such determination should be made or that if any such determination is to be made, it should apply only to the extent that the payment is made or to be made in excess of the amount of the actual costs incurred, directly or indirectly, by Bidder and its Related Persons as a result of the Transaction not being implemented in accordance with this agreement.

(c) Coles must not make, nor may it cause or permit to be made, any application to a court or the Takeovers Panel for or in relation to a determination referred to in paragraph (b).

(d) No amount shall be payable by Coles under clause 11.2 if Coles has terminated this agreement in accordance with clause 12.1 (a)(l) for a material breach of this agreement by Bidder or Wesfarmers.

11.4 Exclusive remedy

Notwithstanding any other provision under this agreement, where a Break Fee becomes payable to the Bidder under this agreement (or would be payable if a demand was made), neither the Bidder nor Wesfarmers can make any Claim against Coles or the Coles Indemnified Parties in relation to an event or occurrence referred to in clauses 11.2(a) or clause 11.2(b) or for any material breach of referred to in clause 11.2(c).

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12 Termination

12.1 Termination

(a) Without prejudice to any other rights of termination under this agreement, either Coles or the Bidder may terminate this agreement by written notice to the other party:

(1) **Material breach by Wesfarmers or Bidder**: at any time before 6pm on the day before the Second Court Date if Wesfarmers or Bidder is in material breach of any provision of this agreement and Coles has given written notice to Bidder in a timely manner setting out the relevant circumstances and stating an intention to terminate, and the relevant circumstances continue to exist *5* Business Days (or any shorter period ending at 6 pm on the day before the Second Court Date) from the time the notice is given;

(2) **Material breach by Coles**: at any time before 6pm on the day before the Second Court Date if Coles is in material breach of any provision of this agreement and Bidder has given written notice to Coles in a timely manner setting out the relevant circumstances and stating an intention to terminate, and the relevant circumstances continue to exist 5 Business Days (or any shorter period ending at 6pm on the day before the Second Court Date) from the time the notice is given;

(3) **Court or Government Agency order**: at any time before 6pm on the day before Second Court Date if a Court or Government Agency has taken any action permanently restraining or otherwise prohibiting the Transaction, or has refused to do any thing necessary to permit the Transaction, and the action or refusal has become final and cannot be appealed;

(4) **Failure to satisfy conditions precedent**: in the circumstances set out in, and in accordance with, clause 3.4(b);

(5) **End Date**: subject to clause 3.4(a)(5), after the End Date, if the Effective Date has not occurred by that date; or

(6) **Agreement by Coles and Bidder**: if agreed to in writing by Bidder and Coles.

(b) **Change of recommendation**: Bidder may terminate this agreement by written notice to Coles if at any time before 6pm on the day before the Second Court Date the majority of the Coles Board withdraws its recommendation that Coles Shareholders vote in favour of the Scheme or makes a public statement indicating that it no longer supports the Transaction or that it supports some a Competing Transaction.

(c) **Change of recommendation**: Coles may terminate this agreement by written notice to Bidder if at any time before 6pm on the day before the Second Court Date the Coles Board recommends a Superior Proposal and if within 5 Business Days the Coles Board does not reinstate its recommendation of the Transaction.

(d) **Subsequent dealing**: Coles may terminate this agreement by written notice to Bidder if at any time before 6pm on the day before the Second Court Date Bidder or Wesfarmers (or any of their Related Persons) enters into any arrangement, agreement or understanding with a Third Party, without the prior written consent of Coles (to be given in Coles discretion), pursuant to which the Third Party would or may acquire any ownership interests or management rights in the Bidder, Coles or any business operated by the Coles Group for a consideration of $100 million or more.

12.2 Effect of termination

If this agreement is terminated by either party under clauses 3.4(b) or 12.1, except to the extent that the termination results from a breach by either party of its obligations under this agreement, this agreement will become void and have no effect, without any liability or obligation on the part of any party, other than in relation to rights and obligations that

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accrued prior to termination and other than in relation to the provisions of this clause 12 and of clauses 8 (Representations and warranties), 9 (Releases and non-reliance), 11 (Break Fee), 13 (Public announcement), 14 (Confidentiality), 15.1 (Stamp duty), 15.2 (Costs and expenses), 16 (GST), 17 (General), which will remain in force after termination.

13 Public announcement and media

Immediately after the execution of this agreement, Coles, Bidder and Wesfarmers must issue public announcements in a form previously agreed to in writing between them. Any further public announcements and dealings with the media by Coles, Bidder or Wesfarmers in relation to, or in connection with, the transactions contemplated under this Agreement will be made in accordance with protocols agreed in writing between Coles and Wesfarmers, except where:

(a) an announcement is required by law or under ASX Listing Rules and it is impracticable for the entity required to make the statement to comply with the protocols; or

(b) the announcement relates primarily to a Competing Transaction.

14 Confidentiality

14.1 Coles' obligations

Coles agrees that:

(a) it must use Bidder Confidential Information only for the purpose of preparing the Scheme Booklet and implementing the Scheme and for no other purpose and, without limitation, will not make any use of Bidder Confidential Information or any part of it to the competitive disadvantage of Bidder or Wesfarmers;

(b) it must keep Bidder Confidential Information in confidence and will not disclose Bidder Confidential Information except:

(1) to such Related Persons of Coles as require Bidder Confidential Information for the purpose of preparing the Scheme Booklet and implementing the Scheme, but only if any such person owes a duty of confidentiality to Coles and is aware of the obligations of Coles under this clause 14.1;

(2) as required by law; or

(3) with the prior consent of Bidder;

(c) it must immediately notify Bidder of any suspected or actual unauthorised use, copying or disclosure of Bidder Confidential Information; and

(d) it must, upon request by Bidder, return to Bidder or destroy (the choice between return and destruction being at Coles discretion) all Bidder Confidential Information provided to Coles and its Related Persons, together with any notes, records or copies of Bidder Confidential Information generated by any such person.

14.2 Bidder and Wesfarmers' obligations

(a) Subject to paragraph (c), the Confidentiality Deed continues to apply with full force and effect. Such deed also applies to the Bidder as if it was named as a Recipient in the Confidentiality Deed.

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(b) Any information provided under this agreement is subject to the terms of the Confidentiality Deed.

(c) Coles acknowledges and agrees that the confidentiality undertakings in clause 3 of the Confidentiality Deed do not extend to the use of Coles Confidential Information by Bidder, Wesfarmers or their Related Persons for the purpose of, or in connection with, any raising of debt or syndication of any debt or equity finance raised directly or indirectly for the purpose of financing the Scheme provided any person given information pursuant to this clause 14.2(c) is under an obligation of confidentiality in favour of Coles.

15 Duty, costs and expenses

15.1 Stamp duty

Bidder must pay all stamp duties and any fines and penalties with respect to stamp duty in respect of this agreement or the Transaction or the steps to be taken under this agreement or the Transaction.

15.2 Costs and expenses

Except as otherwise provided in this agreement, each party must pay its own costs and expenses in connection with the negotiation, preparation, execution and performance of this agreement and the proposed, attempted or actual implementation of this agreement and the Transaction.

16 GST

(a) Any consideration or amount payable under this agreement, including any non-monetary consideration (as reduced in accordance with clause 16(e) if required) (**Consideration**) is exclusive of GST.

(b) If GST is or becomes payable on a Supply made under or in connection with this agreement, an additional amount (**Additional Amount**) is payable by the party providing consideration for the Supply (**Recipient**) equal to the amount of GST payable on that Supply as calculated by the party making the Supply (**Supplier**) in accordance with the GST Law.

(c) The Additional Amount payable under clause 16(b) is payable at the same time and in the same manner as the Consideration for the Supply, and the Supplier must provide the Recipient with a Tax Invoice. However, the Additional Amount is only payable on receipt of a valid Tax Invoice.

(d) If for any reason (including the occurrence of an Adjustment Event) the amount of GST payable on a Supply (taking into account any Decreasing or Increasing Adjustments in relation to the Supply) varies from the Additional Amount payable by the Recipient under clause 16(b):

(1) the Supplier must provide a refund or credit to the Recipient, or the Recipient must pay a further amount to the Supplier, as appropriate;

(2) the refund, credit or further amount (as the case may be) will be calculated by the Supplier in accordance with the GST Law; and

(3) the Supplier must notify the Recipient of the refund, credit or further amount within 14 days after becoming aware of the variation to the amount of GST payable. Any refund or credit must accompany such notification or the Recipient must pay any further amount within 7 days after receiving such notification, as

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appropriate. If there is an Adjustment Event in relation to the Supply, the requirement for the Supplier to notify the Recipient will be satisfied by the Supplier issuing to the Recipient an Adjustment Note within 14 days after becoming aware of the occurrence of the Adjustment Event.

(e) Despite any other provision in this agreement:

(1) if an amount payable under or in connection with this agreement (whether by way of reimbursement, indemnity or otherwise) is calculated by reference to an amount incurred by a party, whether by way of cost, expense, outlay, disbursement or otherwise (Amount Incurred), the amount payable must be reduced by the amount of any Input Tax Credit to which that party is entitled in respect of that Amount Incurred; and

(2) no Additional Amount is payable under clause 16(b) in respect of a Supply to which s 84-5 of the GST Law applies.

(f) Any reference in this clause to an Input Tax Credit to which a party is entitled includes an Input Tax Credit arising from a Creditable Acquisition by that party but to which the Representative Member of a GST Group of which the party is a member is entitled.

(g) Any term starting with a capital letter that is not defined in this agreement has the same meaning as the term has in the *A New Tax System (Goods & Services Tax) Act 1999* (Cth).

17 General

17.1 No representation or reliance

(a) Each party acknowledges that no party (nor any person acting on its behalf) has made any representation or other inducement to it to enter into this agreement, except for representations or inducements expressly set out in this agreement.

(b) Each party acknowledges and confirms that it does not enter into this agreement in reliance on any representation or other inducement by or on behalf of any other party, except for any representation or inducement expressly set out in this agreement.

17.2 No merger

The rights and obligations of the parties do not merge on completion of the Transaction. They survive the execution and delivery of any assignment or other document entered into for the purpose of implementing the Transaction.

17.3 Consents

Any consent referred to in, or required under, this agreement from any party may not be unreasonably withheld, unless this agreement expressly provides for that consent to be given in that party's absolute discretion.

17.4 Notices

Any communication under or in connection with this agreement:

(a) must be in writing;

(b) must be addressed as shown below:

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Party	Address	Addressee	Fax
Coles	800 Toorak Road Tooroonga, Victoria, 3146	Company Secretary	+61 3 9829 6787
	with a copy to (for information purposes only):		
	Freehills Level 42 101 Collins Street Melbourne, Victoria, 3000	Rodd Levy / Neil Pathak	+61 3 9288 1567
Bidder	Level 11, Wesfarmers House, 40 The Esplanade, Perth WA 6000	Chief General Counsel	+61 8 9327 4290
	with a copy to (for information purposes only):		
	Allens Arthur Robinson Level 25 Deutsche Bank Place 126 Phillip Street Sydney NSW 2000	Ewen Crouch/ Tom Story	+61 2 9230 5333
Wesfarmers	Level 11, Wesfarmers House, 40 The Esplanade, Perth WA 6000	Chief General Counsel	+61 8 9327 4290
	with a copy to (for information purposes only):		
	Allens Arthur Robinson Level 25 Deutsche Bank Place 126 Phillip Street Sydney NSW 2000	Ewen Crouch/ Tom Story	+61 2 9230 5333

except that any notice given to the Bidder will also be deemed to be notice to Wesfarmers.

(c) must be signed by the party making the communication or by a person duly authorised by that party;

(d) must be delivered to the address, or sent by fax to the number, of the addressee, in accordance with clause 17.4(b); and

(e) is regarded as received by the addressee:

(1) if sent by fax, at the local time (in the place of receipt of that fax) which then equates to the time at which that fax is sent as shown on the transmission report which is produced by the machine from which that fax is sent and which confirms transmission of that fax in its entirety, unless that local time is not a Business Day, or is after 5.00pm on a Business Day in the place of receipt, when that communication will be regarded as received at 9.00am on the next Business Day; and

(2) if delivered by hand, on delivery at the address of the addressee as provided in clause 17.4(b), unless delivery is not made on a Business Day, or after 5.00pm on a Business Day, when that communication will be regarded as received at 9.00am on the next Business Day.

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17.5 Governing law and jurisdiction

(a) This agreement is governed by the laws of Victoria.

(b) Each party irrevocably submits to the non-exclusive jurisdiction of the courts of Victoria and courts competent to hear appeals from those courts.

17.6 Waivers

(a) Failure to exercise or enforce, a delay in exercising or enforcing, or the partial exercise or enforcement of any right, power or remedy provided by law or under this agreement by any party does not in any way preclude, or operate as a waiver of, any exercise or enforcement, or further exercise or enforcement, of that or any other right, power or remedy provided by law or under this agreement.

(b) Any waiver or consent given by any party under this agreement is only effective and binding on that party if it is given or confirmed in writing by that party.

(c) No waiver of a breach of any term of this agreement operates as a waiver of another breach of that term or of a breach of any other term of this agreement.

17.7 Variation

This agreement may only be varied by a document signed by or on behalf of each of the parties.

17.8 No assignment

A party may not assign, novate or otherwise transfer any of its rights or obligations under this agreement without the prior written consent of the other party.

17.9 No third party beneficiary

This agreement shall be binding upon and inure solely to the benefit of each party to it and each of their respective permitted successors and assigns. Nothing in this agreement, express or implied, is intended to or shall confer upon any other person, any third party beneficiary rights, except where a clause expressly provides that it is given to a person as trustee or nominee for another person.

17.10 Further action

Each party will promptly do all things and execute all further documents necessary to give full effect to this agreement.

17.11 Entire agreement

This agreement supersedes all previous agreements or understandings in respect of its subject matter (including the scheme implementation agreement between the parties dated 2 July 2007, which is terminated and of no further force or effect) and together with the Confidentiality Deed embodies the entire agreement between the parties.

17.12 Counterparts

This agreement may be executed in any number of counterparts. All counterparts, taken together, constitute one instrument. A party may execute this agreement by signing any counterpart.

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Signing page

Executed as an agreement

Signed for
Coles Group Limited
by his/her/its attorney

sign here ► (Sgd) R Dammery
Attorney

print name Richard Dammery

in the presence of

sign here ► (Sgd) Andrea Van Loon
Witness

print name Andrea Van Loon

Signed for
Wesfarmers Retail Holdings Pty Ltd (formerly known as Cobico Pty Limited)
by his/her/its attorney

sign here ► (Sgd) T O'Leary
Attorney

print name Tom O'Leary

in the presence of

sign here ► (Sgd) S Gardner
Witness

print name Stephanie Gardner

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Freehills

Signing page

Signed for
Wesfarmers Limited
by his/her/its attorneys

sign here ► (Sgd) T O'Leary
Attorney

print name Tom O'Leary

in the presence of

sign here ► (Sgd) S Gardner
Witness

print name Stephanie Gardner

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Attachments

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Scheme

[Refer to Annexure B of Scheme Booklet]

Deed Poll

[Refer to Annexure C of Scheme Booklet]

Partially Protected Shares Terms of Issue

[Refer to Annexure A of Scheme Booklet]

Corporate Directory

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Coles Group Limited

Registered Office

Coles Group Limited
800 Toorak Road
Tooronga VIC 3146
Phone: +61 3 9829 3111
Fax: +61 3 9829 6787

Coles Group Information Line

(Australia) 1300 663 897
(Overseas) +61 3 9415 4314

Coles Group Share Registry

Link Market Services Limited

Level 9
333 Collins Street
Melbourne VIC 3000
Phone: 1300 130 278
or +61 2 8280 7768
Fax: +61 2 9287 0303

Financial Advisers

Lazard Carnegie Wylie

101 Collins Street
Melbourne VIC 3000
Phone: +61 3 9657 8400
Fax: +61 3 9657 8411

Deutsche Bank

Deutsche Bank Place
Corner of Hunter and Phillip Streets
Sydney NSW 2000
Phone: +61 2 8258 1234
Fax: +61 2 8258 1400

Legal Adviser

Freehills

101 Collins Street
Melbourne VIC 3000
Phone: +61 3 9288 1234
Fax: +61 3 9288 1567

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Coles Group Limited

ABN 11 004 089 936

Scheme Booklet Supplement