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News Release

Wesfarmers

23 July 2018

Coles demerger update

- Demerger of Coles expected to be completed in November 2018, subject to shareholder and other approvals
- Wesfarmers to retain 15 per cent of Coles and 50 per cent of flybuys
- The demerger represents a significant repositioning of the Group's portfolio to set up both Wesfarmers and Coles for success over the next decade
- Coles will be demerged with a strong balance sheet; net debt of approximately $2.0 billion to support a strong Baa1/BBB+ credit rating with substantial headroom
- Coles intends to follow Wesfarmers' long-established approach to dividends; expected to result in a dividend payout ratio ranging from 80 per cent to 90 per cent
- James Graham AM to be appointed Chairman of Coles on completion of the demerger, and David Cheesewright, Jacqueline Chow and Richard Freudenstein to be non-executive directors. Discussions underway with potential additional directors.

Wesfarmers today confirmed it had made good progress with preparations for a demerger of its Coles division and announced further details of the transaction. The demerger is expected to be completed in November 2018, subject to shareholder and other approvals.

Wesfarmers plans to retain a minority ownership interest of 15 per cent in Coles to support strategic alignment between the two companies in relation to various growth initiatives, including in the areas of data, digital and loyalty. Wesfarmers will also retain its existing ownership of 50 per cent of flybuys to support continued development of the loyalty program and better leverage the combined Coles and Wesfarmers digital and data ecosystem to improve their respective customer offers.

Wesfarmers also announced a number of proposed non-executive director appointments to the board of Coles. James Graham AM will be appointed Chairman if the demerger proceeds, bringing extensive commercial, capital markets and board leadership experience to the role. Following his appointment as Chairman-elect of Coles, Mr Graham has stepped down as a non-executive director of Wesfarmers.

The other non-executive directors proposed are David Cheesewright, Jacqueline Chow and Richard Freudenstein. Together they will bring extensive global executive and board experience to Coles, including in international retailing, technology and communications, data and analytics, and supply chain management and relationships in the fast moving consumer goods (FMCG) sector.

Mr Cheesewright will be the Wesfarmers nominee on the Coles Board in recognition of its retention of a shareholding interest. Mr Cheesewright is also to be appointed an advisor to the Wesfarmers Board.

Archie Norman will step down as Deputy Chairman of Coles and advisor to the Wesfarmers Board to become an advisor to the new Coles Board, continuing his strategic contribution to the business.

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Wesfarmers Managing Director Rob Scott said the demerger represented a significant repositioning of the Group's portfolio to set up both Wesfarmers and Coles for success over the next decade. "The demerger will reposition the Group's portfolio to target a higher capital weighting towards businesses with strong future earnings growth prospects," Mr Scott said. "Post-demerger, Wesfarmers will have a portfolio of cash generative businesses, with strong returns on capital, good momentum and leading positions in their respective markets."

"Following a successful turnaround under Wesfarmers' ownership, Coles has developed strong investment fundamentals as a mature and cash generative business with a resilient earnings profile. Coles is well-positioned to be operated and owned separately, having established strong corporate infrastructure and management capabilities under Wesfarmers' model of divisional autonomy.

"Maintaining a strategic stake in Coles provides an important connection with Wesfarmers to reinforce opportunities to collaborate in the data, digital and loyalty areas. Flybuys will be better able to realise its potential as a leading data and loyalty company through the ongoing support and investment of both Coles and Wesfarmers and by leveraging the broader networks of the Wesfarmers Group, including the existing partnerships with Kmart and Target.

"Wesfarmers is committed to demerging Coles with a strong balance sheet. Coles is expected to have net debt of approximately $2.0 billion to support a strong Baa1 and/or BBB+ credit rating. Combined with a favourable lease commitment profile, this will provide good access to capital and balance sheet capacity to support strategic flexibility, dividends and investment plans."

Board appointments

Wesfarmers Chairman Michael Chaney said the initial appointments announced today ensured Coles will be led by an exceptional board with the complementary and diverse skills and experience required to position the business for continued success as a separate listed company in a dynamic and competitive environment.

Mr Chaney said Mr Graham had extensive commercial, capital markets and governance experience, including as a former Chairman of Rabobank Australia and Darling Harbour Authority, and a strong understanding of the Coles business through his Wesfarmers directorship. In his corporate advisory career, he had worked with the boards of many companies across a range of sectors on all aspects of the development and positioning of large corporate businesses.

"James' experience and integrity, coupled with his affinity for the Coles business, and respect and understanding of the brand and its history, positions him ideally to help guide its future strategic direction and ongoing focus on the creation of value for Coles shareholders," Mr Chaney said. "He has been an outstanding director of Wesfarmers and will be a passionate and committed Chairman of Coles."

"David Cheesewright's career includes more than 25 years in international retailing and manufacturing, including 19 years with Walmart, where he ultimately held the position of President and CEO of Walmart International. Jacqueline Chow has extensive FMCG and marketing experience, with a particular focus on data and analytics, and Richard Freudenstein will bring deep experience in the global media and digital environment, including disruptive strategies in mature and start-up businesses."

Mr Chaney said further appointments would be announced in due course, with the full Coles Board expected to comprise the Chairman, Managing Director and six non-executive directors including the Wesfarmers nominee. As previously announced, Steven Cain has been appointed the next Managing Director of Coles, to succeed John Durkan, and will join Coles in mid-September 2018.

Mr Graham said it would be a privilege to be appointed Chairman of Coles at such a dynamic time in retailing. "While Coles continues to innovate and adapt to evolving consumer needs, our success will always be founded on a steadfast commitment to fostering strong and enduring relationships and trust with our customers, suppliers and the community, while ensuring Coles remains a great place to work for all of our team members," Mr Graham said.

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"The new board of Coles looks forward to supporting management in building long-term value for our shareholders."

Mr Chaney acknowledged the significant role that Archie Norman has played as Deputy Chairman of Coles and as an advisor to the Wesfarmers Board since the acquisition of Coles as well as his instrumental role in the successful turnaround of the business. Mr Norman's ongoing advisory role with Coles will further support the ongoing leadership transition and development of Coles as an independent listed company.

Capital structure

Post-demerger, Coles is expected to have net debt of approximately $2.0 billion. In addition, Coles will have operating lease commitments of approximately $9.6 billion[1] with a weighted average lease expiry of approximately 6.5 years[1]. The proposed Coles capital structure is considered conservative and is expected to support a strong Baa1 and/or BBB+ rating from Moody's and Standard & Poor's, respectively, providing funding capacity to support dividends along with the business' strategic and operational objectives.

The strength of Coles' balance sheet will be supported by a portfolio of profitable and cash generative businesses, and a relatively favourable lease maturity profile which provides for future operational flexibility.

Coles is expected to have committed bank facilities of approximately $4.0 billion, from a group of leading domestic and international banks, with a prudent maturity profile. These facilities will provide significant liquidity headroom to cover seasonal cash flow variations, including peak working capital requirements, capital expenditure, dividend payments and bank guarantees. Subject to future market conditions, Coles intends to further diversify its funding sources and lengthen its maturity profile through capital markets issuances.

Wesfarmers expects to retain its current credit ratings (A3 and A-), supported by a portfolio of cash generative businesses with good earnings growth prospects. The Group's balance sheet will continue to be strong, preserving the capacity to act opportunistically and to invest in organic growth opportunities.

Dividend policies

Coles' approach to dividends will be determined by the Coles Board at its discretion and may change over time.

Coles currently intends to follow Wesfarmers' long-established dividend policy which has regard to current earnings and cash flows, available franking credits, future cash flow requirements and targeted credit metrics. This approach is expected to deliver a dividend payout ratio ranging from 80 per cent to 90 per cent while enabling Coles to retain strategic flexibility.

Wesfarmers' dividend policy will remain unchanged following the demerger.

It is anticipated that, taken together, the dividends to be declared by Coles and Wesfarmers for the year ending 30 June 2019 will be broadly equivalent to the dividends that Wesfarmers would otherwise have declared if the demerger did not proceed (including in respect of franking).

Demerger process and timing

The Demerger will be effected by way of a scheme of arrangement, under which eligible shareholders will receive one Coles share for every Wesfarmers share held on the applicable record date. Wesfarmers will retain a 15 per cent shareholding in Coles. Wesfarmers shareholders will also retain their shareholding in Wesfarmers.

[1] As at 31 December 2017.

It is expected that the distribution of Coles shares to Wesfarmers shareholders will qualify for demerger tax relief, subject to an Australian Tax Office ruling being obtained.

The demerger is subject to final Board approval, regulatory, court and shareholder approvals. Subject to initial court approval, a scheme booklet containing detailed information about the demerger is expected to be sent to shareholders in October 2018, with a shareholder meeting to consider and vote on the demerger to be scheduled for November 2018. Final court approval will be sought following the shareholder meeting. If approved, the demerger is expected to be completed in late November 2018.

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COLES BOARD BIOGRAPHIES

James Graham AM

James has extensive corporate and governance experience, including as a non-executive director of Wesfarmers Limited since 1998. James is Chairman of Gresham Partners Limited having founded the Gresham Partners Group in 1985. From 2001 to 2009 he was a director of Rabobank Australia Limited, initially as Deputy Chairman and then Chairman, responsible for the Bank's operations in Australia and New Zealand. He was also Chairman of the Darling Harbour Authority between 1989 and 1995. James holds a Bachelor of Engineering in Chemical Engineering from the University of Sydney and a Master of Business Administration from the University of New South Wales. He is a Fellow of the Australian Academy of Technological Sciences and Engineering, a Senior Fellow of FINSIA, a Fellow of the Institution of Engineers Australia and a Fellow of Australian Institute of Company Directors. James was made a member of the Order of Australia in 2008.

David Cheesewright

David retired earlier this year as President and Chief Executive Officer of Walmart International, which comprises Walmart's operations outside the United States including more than 6,200 stores and more than 796,000 employees in 27 countries. He was previously President and CEO of Walmart EMEA (Europe, Middle East and Africa) and Canada region, overseeing the integration of the Massmart acquisition, and growth in the UK and Canada. David's other prior roles include Chief Operating Officer of Asda in the UK and a range of key positions with Mars Confectionary in the UK. He is a Board Member of Chinese online grocery business Yihaodian, Massmart, Queens Business School and The Retail Council of Canada. He holds a first-class honours degree in sports science and mathematics from Loughborough University, UK.

Jacqueline Chow

Jacqueline Chow is currently a director of NIB Holdings (appointed 2018) and Fisher & Paykel Appliances (appointed 2016) and a Senior Advisor at McKinsey Consulting RTS, advising clients across industrial, retail, telecommunications, financial services and consumer sectors on performance transformation projects. Jacqueline previously held senior management positions with Fonterra Co-operative Group, one of the world's largest dairy product producers and exporters, including most recently Chief Operating Officer, Global Consumer and Food Service. Prior to that she was in senior management with Campbell Arnott's and Kellogg Company. She was also Programme Steering Group Director, Ministry for Primary Industries, NZ (2013-2016) and Deputy Chair, Global Dairy Platform Inc (2014-2018). Jacqueline holds an MBA from Northwestern University Chicago and a Bachelor of Science (Hons) from the University of New South Wales. She is a Graduate of the Australian Institute of Company Directors.

Richard Freudenstein

Richard has been a non-executive director of REA Group since 2006, including as Chairman from 2007 to 2012. Since 2016, he has been a non-executive director of Malaysian direct broadcast satellite Pay TV service Astro Malaysia Holdings Berhad. He is also currently Deputy Chancellor of the University of Sydney and a member of the Advisory Committee of start-up artificial intelligence software company Afiniti Ltd. Richard was previously Chief Executive Officer of Foxtel (2011-2016), Chief Executive Officer of The Australian and News Digital Media at News Ltd (2006-2010), and Chief Operating Officer at British Sky Broadcasting plc (2000 to 2006). His previous Board director positions include Ten Networking Holdings (2015-2016), Foxtel (2009-2011), ESPN STAR Sports ESS (2009-2012), Nickelodeon UK (2003-2006, Chairman), Bell Shakespeare Company (2007-2013), English National Ballet (2003-2006) and Royal Television Society UK (2005-2006, Chairman). Richard has a Bachelor of Laws (Hons) and a Bachelor of Economics from the University of Sydney.