WOOLWORTHS LIMITED

18 July 2013

Market Update - July 2013

KEY UPDATES

- Home Improvement trading and performance
- Dick Smith sale finalisation
- Debt buy back - redemption of US 144A Bonds
- Victorian transport fleet changes
- Upgrade to earnings guidance

HOME IMPROVEMENT

Overview

Woolworths Limited (Woolworths) is pleased that good progress has been made in rolling out the Masters business.

The rationale for entering the Australian Home Improvement market remains compelling and attractive with substantial opportunity for growth. The market is a significant one with more than $42 billion in sales in FY12. While most similar international markets, including New Zealand, have at least two major players, the Australian market is fragmented and has had just one major chain with around 16% market share. Masters is bringing competition to this market for Australian consumers.

As a greenfields business we expected many challenges and along with our joint venture partner Lowe's Companies, Inc. (Lowe’s), we have learnt a lot over the last two years. With Lowe's guidance and expertise, particularly with its recent entries into Canada and Mexico, Masters is designed to be more than a big box hardware store and competes across many categories other than hardware.

At the announcement of our Home Improvement strategy in 2010, we said it would take five years from the first store opening for the joint venture to become a profitable division in its own right.

We are confident that our Home Improvement business remains on track to be a business that will be built in the first five years and deliver returns in the following years.

Financial highlights

Sales for the Home Improvement division in FY13 were $1.239 billion, up 49.6% on last year - Danks $710 million, up 4.1% and Masters $529 million, up 262% on a 53 week basis.

Announcement

Masters

- 15 Masters stores opened for more than 12 months are in line with the business case sales target, however our budgets were too optimistic in FY13
- Adjustments to cost and gross profit mix have been required

Danks

- Danks' high reliance on the trade and building sectors and the softness of the segment has affected delivery of sales relative to our expectations in FY13
- Budgeted sales levels were higher than those achieved during FY13. This reflects the softness in the market as described above and lower levels of acquisition activity than expected

Financial update

Actual losses were more than anticipated mainly due to overly optimistic sales budgets, relatively higher wage costs for new store openings and lower gross margins due to the sales mix. Steps have been taken to address these issues.

Based on our planned store rollout profile (targeting approximately 90 stores opened by the end of FY16), and having recently updated our forecasts, we are still forecasting that Masters will break even during FY16. This forecast assumes moderate growth in sales per store for a start up business, improvements in gross margin as the sales mix stabilises, efficiencies in store and increased fractionalisation of costs in the distribution and support network as sales levels increase. Given the greenfields nature of the Masters business, short term results will continue to vary, however, we expect the losses for FY14 not to exceed this year's level.

Danks' earnings are lower than forecast due to the factors stated above combined with higher levels of competition in a subdued trade and building sector.

More generally, it is important to note that the Home Improvement sector as a whole has been impacted by consumer uncertainty, similar to other retail categories.

As a result EBIT for FY13 for Home Improvement is as follows:

$m	**Forecast**	**Actual**
Masters	(119)	(157)
Danks	38	18
Total	(81)	(139)

Masters store pipeline

At the end of FY13, 31 stores were open with a presence in all Australian mainland states. At the end of FY12 there were 15 stores open. At the end of FY13 just 15 sites had traded for more than 12 months.

There are currently 120 active sites in total.

Due to the timing of approvals and construction, the number of store openings in 1H14 will be lower than the recent run rate which will provide us with an opportunity to make further enhancements to our operating model that will benefit both the existing store network and new stores.

Trading highlights

The customer response to Masters' unique range and service offering has been very pleasing. We are particularly pleased with the kitchen, flooring and whitegoods categories. We have continued to tailor the range based on customer feedback and international innovation to ensure we offer the widest range of brands and private labels at market leading prices. The Trade offer is also being well received.

As the business matures and we trade through future seasons and events, we will continue to improve the customer offer and operating model. Specifically, we have adjusted the labour model while maintaining our leading customer service promise. Inventory management will continue to improve as we achieve a critical mass of stores.

As we traded through the first 12 months we made lower gross margins than anticipated due to the sales mix and steps have been taken to mitigate for this going forward. We have also improved our engagement program with Trade customers and will continue to make adjustments where necessary.

Masters has market leading multi-option capabilities including a click and collect service from all stores, a transactional website, mobile site and app. Customers can compare products and prices with those of competitors, chat online with our customer service team and view DIY articles, videos and handy hints and tips. The Masters website receives around 25,000 visitors everyday and growing. These capabilities will ensure the business is well placed for future growth in this area and we will continue to innovate and evolve the multi-option offer to suit our customers' needs.

Leveraging our increasing presence

We are pleased that the Masters brand awareness continues to grow at 79%. Spontaneous Masters brand recognition is stronger than anticipated at 59%. Customer research consistently suggests that returning customers are demonstrating a high degree of customer loyalty and have responded positively to Masters' unique shopping experience.

To confirm our increasing presence in major markets, Masters was a sponsor of Seven's successful *House Rules* program and we were very pleased with the outcomes of this arrangement.

Lowe's relationship

Lowe's have been an invaluable partner and continue to provide Woolworths with great support from their team, experience and advice on store layout, access to new and iconic products and leverage in buying terms with multinational suppliers.

Lowe's are providing excellent product support in key categories with high quality brands and private labels, many of which are new and innovative to the Australian market. Examples are:

- Kobalt - Lowe's private label in categories such as hand tools, tool storage and garage organisation.
- Werner - Masters was given access to the world's leading ladder manufacturer through the joint venture with Lowe's. Masters being the first to bring this market leading brand to the Australian Trade and Consumer market.
- Valspar – Lowe's leading strategic paint vendor invested heavily in the Australian market to support the joint venture by purchasing market leading paint manufacturer Wattyl. Wattyl (including Solagard) is now supplied big box exclusive to Masters. Future global paint technology launches will be shared between Lowe's and Masters.
- Many more in the pipeline.

Lowe's have been a very strong partner and they remain highly supportive of the business. In late 2012 they advised us that they were looking forward to a long partnership with us as we seek to redefine the Home Improvement sector in Australia.

Further, Lowe's have extended the first exercise date of their put option for another 12 months to October 2014.

Conclusion

We believe we are firmly on the right path to ensure our Home Improvement division is a sustainable and profitable business into the future. Our record in building new businesses and the size of the opportunity gives us confidence that the plans we are making and work we are undertaking will be to the benefit of shareholders and Australian consumers.

As previously announced, and as planned from the beginning of the joint venture, Don Stallings has returned to Lowe's in the United States. Melinda Smith is the Director of Masters and Mark Burrowes is the General Manager of the HoME Timber and Hardware Group.

DICK SMITH SALE FINALISATION

Further to the update that we provided at the FY13 half year, Woolworths has agreed to release Anchorage Capital Partners (Anchorage) from its obligation to provide agreed benefits to Woolworths from any upside resulting from a future sale of Dick Smith by Anchorage.

In return, Woolworths will receive certain payments totalling $74 million ($50 million paid on 28 June 2013 and a further $24 million payable in 12 monthly instalments commencing July 2013).

The additional consideration will all be recorded as income in FY13 within our results from discontinued operations. As a result of the additional proceeds, the loss on sale of our Consumer Electronics businesses of $65.7 million (after tax) shown in our HY13 disclosures will become a profit of $7.9 million in FY13.

This brings total proceeds from the sale of Dick Smith to $94 million. The additional funds received have opportunistically been used to repurchase debt.

DEBT BUY BACK

The redemption of US 144A bonds was finalised in June 2013. US$615 million of bonds were redeemed with a one-off cost to the profit and loss of approximately A$58 million after tax (A$83 million before tax). This will be listed as a significant item.

The projected undiscounted net interest saving as a result of the redemption is A$109 million including A$24 million in FY14.

VICTORIAN TRANSPORT FLEET

During the second half of FY13, Woolworths entered into arrangements with Linfox to outsource its Victorian transport fleet. The Victorian trucking fleet was the last in the network to be owned and operated by Woolworths and the change brings arrangements into line with all other areas. This incurred a once off redundancy cost of approximately $18 million after tax ($26 million before tax). This will be listed as a significant item.

SUMMARY OF SIGNIFICANT NON-RECURRING ITEMS

Significant Items ($m after tax)	FY12	FY13
Continuing Operations		
One-off costs associated with creation of SCA *	-	(29)
Victorian Transport Fleet	-	(18)
US 144A bond redemption	-	(58)
	-	(105)
Discontinued Operations		
Dick Smith - restructure provision	(384)	-
Profit on sale of Consumer Electronics businesses	-	8
	(384)	8

** As disclosed at the 2013 Half Year. Primarily represents cost of rental guarantees provided by Woolworths to SCA in relation to specialty leasing risk*

EARNINGS GUIDANCE

We revise our previous guidance and now expect net profit after tax from continuing operations (excluding the above significant non-recurring items) to grow in the range of 5% to 6% (on a normalised 52 week basis). Previous guidance was 4% to 6%.

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