HD **Woolworths Ltd Update on Home Improvement Conference Call (Investor Briefing) - Final**

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Presentation

OPERATOR: Good day, everyone, and welcome to the home improvement update conference call. Today's call is being recorded.

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At this time, for opening remarks, I'd like to turn the conference over to your moderator today, Mr. Grant O'Brien . Please go ahead.

GRANT O'BRIEN, CEO, WOOLWORTHS LIMITED : Good morning, everyone. Thanks for joining us today for the update on our home improvement business. I'm joined this morning by our CFO, David Marr ; and Matt Tyson , our Managing Director of the home improvement business.

From the beginning, we've been upfront and transparent about progress on our home improvement business, and today is a continuation of that. And so in keeping with that, I'm going to take you through the FY14 full-year results for home improvement, and then make some general comments that will cover things off from a Woolworths Limited perspective before handing it over to Matt.

Home improvement is entering its next phase of growth from our point of view from start up to grown up. This is how we term it. And this is why we recruited Matt Tyson . Matt is an outstanding home improvement retailer with direct experience in taking big box formats into profitable scalable businesses. And I'll ask Matt to give you a bit more detail around both his experiences and his plans a little bit later.

But firstly to the results. The home improvement division recorded sales of AUD1.527 billion in the financial year 2014. Masters' part of that was AUD752 million for the year, which was an increase of 42.2% on the previous year. However, this was lower than we'd expected. Home timber and hardware sales were AUD775 million, an increase of 9.2% on the previous year.

These sales results were achieved despite a highly competitive market and a particularly soft, or softer consumer market in the second half.

In terms of financial returns, Masters' losses were higher than anticipated at AUD176 million, and home timber and hardware with an EBIT of AUD7 million was a disappointing result.

This means we've missed our guidance. The losses for FY14 would be no more than FY13. And given this, we'll not reach the guidance given when we first entered the market of achieving break even during 2016.

Woolies has a history of setting ambitious targets from the outset, and this is part of Woolies' DNA. We were right in my view to set challenging targets for the business, and we'll continue to have stringent internal levels covering profitability and return on funds employed that the home improvement business needs to meet.

What is unchanged is our confidence that home improvement will be a material profit contributor for Woolies, and will deliver an acceptable return on investment. We've got a track record of building new great businesses here, like our successful liquor business. And it's worth recalling that it wasn't that long ago that we acquired a small liquor chain of five stores in Melbourne called Dan Murphy 's.

I remember it well. I was part of the team that developed and executed that growth strategy. And remember that by 2000, we'd built a liquor business that had 41 standalone liquor stores, but we were still not at break even, even at that point.

Looking back today on it, no one would argue that the investment logic of building a new business like a Dan Murphy 's business was the right thing to do. Today, it's Australia's premium drinks destination, both in store and online. As well as the solid track record of developing new growth businesses, there are five key things I want to call out that underpins our confidence in this particular business, the home improvement business.

Firstly is the rationale for entering the home improvement market remains compelling. I think it's clear to everyone that this is a large market, AUD45 billion of annual sales in the home improvement sector, and its growing with annual sales growth around 5%.

And it's fragmented. The top three retailers have got approximately 22% of the available share.

It's in the process of consolidation, and the 42% sales growth that we've been able to achieve in Masters, and of sales growth enjoyed in home timber and hardware, are both evidence of this consolidation.

As retailers, we can't turn a blind eye to that domestic opportunity. We strongly believe we're bringing some much needed competition and consumer choice to this sector that will inevitably benefit customers.

Secondly is we have the sites. We've made a strong start at 49 Master stores up and running in less than three years, as well as the continuing growth of home timber and hardware store network. Additionally, we've got a strong pipeline of sites that we've spoken about before that will deliver future growth as we develop our store networks.

Third is the short period of time that we've achieved -- in a short period of time we've achieved strong growing brand awareness. Masters is 75% unprompted brand awareness in the areas where we have a store presence. This is an impressive achievement for any new brand in such a fragmented market.

And fourthly is we have the time, we have the commitment, and we have the right team. I believe that we've a responsibility to invest in Woolworths in growth over the long term, as well as managing the business we have today successfully.

As custodians of the business, which has been built in the past by several generations of Australians, we think a balance of focus on current performance and investing in future growth drivers is the right mix. These businesses take time to build, and we have the skills and commitment to make home improvement a successful business, just like we did with hotels and liquor.

Finally, I think all successful companies need a willingness to learn and adjust. We're testing and refining our plans to make our offer more appealing to our customers. Matt will tell you a little bit more about what he's doing on two key principles; heavily focused store rollout plan, and an enhanced store format and range.

I'm also very pleased to report this morning that we continue to have a very supportive joint venture partner in Lowe's . Their ongoing commitment to this business has been recently further demonstrated through a modification to the terms of the put option, removing the requirement for an annual deferral.

The opening date for the put option exercise period is deferred indefinitely. From October 2015, Lowe's can issue a notice setting an exercise date for the option, triggering a 13-month notice period, after which the option can be exercised.

Finally, just a note on our disclosure practices moving forward. With the new management team and Masters' transition into the new phase of growth, we will now update the market in full on our progress at full-year and half-year results rather than providing forward guidance for home improvement.

I want to make it clear that our expectations for this business and its milestones have not changed significantly. However, we need to give Matt and his team the ability to make the appropriate, long-term decisions for the business, without being tied to a forecast that was set when we entered the market long before Matt joined the team.

This was never a short-term business plan, and we'll continue to take the steps necessary to ensure we create a sustainable and relevant business. And I believe we've shown excellent progress.

Following Matt's appointment, we asked him to look objectively at the market and how we build on the current foundations to take advantage of the opportunities available. I'm now going to hand over to Matt, and then I'll come back and take your questions.

So, Matt, over to you.

MATT TYSON , MD HOME IMPROVEMENT, WOOLWORTHS LIMITED : Thanks, Grant. Firstly, I want to introduce myself, and then I'll give you an update on our home improvement business.

Before joining Woolworths , I worked with Kingfisher for 28 years. Many of you may know that Kingfisher is a multinational home improvement retailer based in the UK, operating over 1,000 stores in nine countries, primarily under B&Q and Castorama brands.

Now during my time at Kingfisher, I helped develop the UK's first big box home improvement stores for B&Q , and I continued to manage that chain as it grew to over 100 stores.

In 1999, I joined Castorama France to help them build a big box chain for France, a chain that's now over 100 stores strong and is France's leading home improvement retailer.

I've also worked in **China**, and latterly in Russia, renewing Castorama's big box hardware stores and putting them on a path to profitability.

In short, I've a lot of experience in taking young businesses from start up to grown up, and from these experiences, I've learned that you first need to seek to understand before you make judgment. It's important to test, learn and adapt the model until it works. And it's that experience that I bring to Woolworths .

Now when I arrived, Grant asked me to look objectively at the market and to look at how we could build on the current foundations to take advantage of the opportunities available. It's my assessment that we've got real opportunity here to develop a sustainable and a profitable home improvement business for Woolworths , and we're getting on with that.

So I can't stress enough that the Masters business remains in its development phase with stores having traded on average only 17 months at the end of FY14. The current store network includes a number of stores in regional and future growth areas which will take longer to mature.

Now having a strong presence of 49 Masters stores is undoubtedly an advantage at this stage of our development. The store network is a solid foundation to establish a national brand, and to have 75% unaided brand awareness in the areas where we have a store is absolutely terrific, especially for a business that's less than three years old.

But to get this network, we took opportunities to open stores as the DA approvals arose. We moved at pace in markets like Victoria and Queensland where the planning approvals were achieved quickly. Now this has resulted in uneven national coverage and a less efficient supply chain at this stage of our development.

Going forward, we'll focus on key metropolitan areas and selectively fill the gaps in our store network. In the coming months, we'll open two stores in Adelaide, a market where we currently have no presence.

We're focused on bringing more stores to metropolitan areas in New South Wales and in Queensland. As a result of that refocused approach, we expect to open fewer new stores over the next two years, and will not deliver the previously communicated target of 90 stores by the end of 2016.

We plan to open 10 to 15 Masters stores per year over the next few years, and we'll continue to selectively grow the home timber and hardware store network. This includes our agreement to acquire 15 sites from Hudson Building Supplies .

Now while Masters has strong national awareness, customer traffic and conversion rates need to be improved. Now one of the ways we're addressing this is by giving more space to footfall driving categories like hardware. Our test stores and our customers are being provided with new hardware lines. Both of these initiatives have resulted in stronger performance in these areas. And we'll take the best of these new products and fast track them into the stores across the network.

We're also continuing to differentiate ourselves with a stronger offer in project categories like kitchens and bathrooms. These changes will take some time to roll out to all of our existing stores, and as a result, we do not expect to see the full benefit in the short term.

Along with the evolution of store design, we'll offer a wide range of the best Australian and international brands. In fact, we're currently in final negotiations that will enable us to bring some really exciting Australian [firsts] to the market.

In conclusion, this is just the start for the Woolworths home improvement business. As with any new venture, you learn along the way, and we'll continue to learn and adapt the model to ensure we create sustainable and relevant business. We have the right team and the right plans in place, and we're focused on executing these to make home improvement a material profit contributor to the Woolworths **Group** .

I'll now hand back to Grant and I look forward to answering your questions.

GRANT O'BRIEN: Good on you, Matt. Thank you very much. And as I said, we're keen to leave plenty of time for questions and we'll get straight into that now. So we'll take the first question, please.

Questions and Answers

OPERATOR: Tom Kierath, Morgan Stanley .

TOM KIERATH, ANALYST, MORGAN STANLEY : I think last time you talked to the market, you spoke about higher wage costs and lower gross margins than you had expected. Has there been much improvement on that since --? I think it was July last year when you last update the market.

GRANT O'BRIEN: Yes. That's right, Tom. That's exactly what we said about costs, wage costs in store openings, and we've made quite some progress on that. And I'll ask Matt just to talk to specifically the costs around wages and also gross margin.

MATT TYSON : This continues to be a competitive market, but in terms of store efficiencies, we made good progress over the course of last year in terms of store efficiency. And I think that's evidenced by the drop in losses per store.

TOM KIERATH: And then secondly, Matt, to move to a break-even point, I presume you're not going to give us guidance on that again, but to move to a break-even point, what needs to happen? Is it just sales, or is it the whole lot; sales, costs and gross margin?

MATT TYSON : We've said in our announcement today in effect that we're working on a number of things. We're working on enhancing our range in footfall-driving categories, and we've called [unclear][unclear]out hardware there. Hardware is a key traffic-driving category for us, and our early tests show some good results, actually. The challenge is now to roll that back into our existing **estate** as quickly as we can.

There are opportunities to drive efficiencies in areas like supply chain, and you'll see in the attached pack that we've made good progress, and will continue to make that progress across the course of the year.

My experience is, Tom, that it takes time to iterate and evolve a proposition, and in every market I've worked, you have to iterate to get that customer offer right and it takes time to build the relationships with those customers. I'm absolutely confident that we have an incredible opportunity here. This is a very fragmented market and one which there is ample space for us to build a profitable business in.

TOM KIERATH: Okay. Thanks for that.

OPERATOR: David Errington, Merrill Lynch .

DAVID ERRINGTON, ANALYST, BOFA MERRILL LYNCH : Grant, how many stores do you own? How many Masters stores do you own?

GRANT O'BRIEN: David, it's about 70/30. So we've got 49 open at the end of the financial year, as contained in the pack; and I don't have the number down to a store number, but the ratio is about 70% owned, 30% leasehold. And as you know, in the beginning, we assumed that that would be 100% owned, but 70/30.

DAVID ERRINGTON: Why don't you charge the business lease charges, Grant, which is the normal practice that you do in other businesses? (Multiple speakers).

GRANT O'BRIEN: Sorry. I missed the second part of your question, David.

DAVID ERRINGTON: Because that's like-- my concern is if you did that, you're talking 45 stores, you're probably talking around about 32/33 stores that you own, and the average lease would be around AUD2 million to lease. So you're talking -- you'd probably need to add another AUD60 million onto the loss; the depreciation is not that meaningful. And I suppose that's the highlight of my concern is that the losses are now -- if you add those leases in, the losses are now getting really into that significant stage.

GRANT O'BRIEN: David, this is a point we've covered before in relation to the leases, or the question of a lease versus depreciation and interest costs, and you are right, as we agreed before. Our ambition is obviously at some point in the future to divest these boxes when it makes sense to do that, and we don't treat this business really that differently to any other business.

But in terms of our ambition to make this business profitable, certainly we've got factored in the very issue that you raise.

DAVID ERRINGTON: And just finally, Grant, I'll just ask one more question and others will have (inaudible), but the Lowe's put option, can you explain that? Because I'm trying to get my head around as to how that's actually a positive for Woolworths , the fact that they've extended their right to put to you indefinitely. Can you explain it in clear terms?

GRANT O'BRIEN: Yes. Look, David, the put option has been obviously part of this from day 1, and as far as we're concerned, it's a very natural provision to have in any contract where the joint venture partner is a minority holder and the business is being operated some distance from them, by us in this case.

Now what's happened is we've got to the end of the four-0year period, as you know, and that put option became live. And to be honest, it's been used to suggest that the Lowe's business is not committed to the joint venture. What's happened here is that effectively, beyond October 2015, it's not live until such time as they elect to give us notice, and then from that, it will be a 30-month period from which they could exit.

So there is no expectation, there was never an expectation that we would ask Lowe's to give back that right. What they've done here is go as far as they can to demonstrate their support of the business without giving up that right. I hope that explains it for you.

DAVID ERRINGTON: Yes, I think so. It's just the way you worded it in your announcement. You said that that was reaffirming their commitment, whereas I'm struggling to read it that way.

GRANT O'BRIEN: Well, it's still a put option. There's no gray around that, David; you're right. But in respect to the question of whether or not they could give us the notice tomorrow, which is effectively what the current term allows them to do, this gives greater line of sight and greater certainty because that start or opening date for the put option is now deferred in perpetuity.

DAVID ERRINGTON: Okay. Thanks, Grant.

OPERATOR: Grant Saligari, Credit Suisse .

GRANT SALIGARI, ANALYST, CREDIT SUISSE : Just maybe two questions from me, Grant, if I could, just one on the put option. Can you outline the value of the put option under the new arrangements now that it's obviously been extended, and the basis on which that value might change obviously over subsequent years?

GRANT O'BRIEN: There's no change to the calculation for the valuation, Grant. I'll just refer to David on that to see if there's anything in it?

DAVID MARR , CFO, WOOLWORTHS LIMITED : No, Grant, that's exactly right. There's no change in the calculation, and the value will just depend on how the business is funded. And going forward, so we won't give forward guidance on the valuation, but it's consistent with what it's always been.

GRANT SALIGARI: Maybe just for everyone's benefit, could you just -- the key points in the way in which that option value is arrived at?

DAVID MARR : Well, it's calculated on a fair market value, which at the moment as a start-up business is -- we're approximating the current book value for that.

GRANT SALIGARI: So it would increase in line with further equity investments, I presume?

DAVID MARR : Correct, yes.

GRANT SALIGARI: Thank you for that. My second question I had was just around the home timber and hardware business, and what strikes me is you're actually buying a lot of bolt-on businesses there and the profit performance obviously over a number of years has been quite poor; it's deteriorated quite significantly. So I just seek to understand the strategy there and what the reasons for the profit decline have been.

DAVID MARR : Excellent question, Grant. I think -- I would say up front that the home timber and hardware business is a critical part of our overall home improvement strategy because the trade aspect of the AUD45 billion market is a sizeable part of that market.

So to gain access to the accessible market, we were clear from the beginning that we needed to have a trade offer within our portfolio and the Danks acquisition formed that, albeit that in its original state, it was effectively a wholesale business.

We've added I think 28 acquisitions, or stores that we've acquired, trade stores that we've acquired. And more recently, we've announced the further acquisition of 15 stores that are under the Hudson's banner that are mainly focused in areas where we don't have a presence, or a strong presence in trade, being New South Wales and Queensland.

The profit fall-away this year is down to really three things, Grant. First of all, we on **sold** a number of those acquisitions last year; so in line with David's earlier point we had rental costs that we needed to deal with in this year in the home timber and hardware business. And so that's been an additional cost in this year for home timber and hardware.

Secondly, we've started the process of substantial refurbishments, and refurbishments have a cost to the business in relation to both disruption and costs, as well as the capital that we apply to those refurbishments.

And the third thing is we've invested in pricing for our wholesale customers in the home timber and hardware wholesale business.

So there are three aspects I would call out to the profit decline, but this is a business that we likewise are confident about; this is a business that we're growing. And with James [Aylen], who is the new leader, and with Matt's input, we've got a really clear plan going forward there.

But the trade's really important to us and we're making good progress in there, and our expectation is the profit will improve in that business.

GRANT SALIGARI: Thank you for that. That's helpful.

OPERATOR: Shaun Cousins, JPMorgan .

SHAUN COUSINS, ANALYST, JPMORGAN : Just a question. Could you maybe talk a bit about like-for-like sales growth, whether you've got positive like-for-like sales growth; and whether or not you're still experiencing flat sales per square meter, which I think you mentioned at one of the quarterly sales? Sorry. This is particularly regarding Masters.

GRANT O'BRIEN: Shaun, I'll answer that in a different way, if you don't mind; and if you've got a pack there, I'd ask you to turn to slide number 4 in the pack, because I think this goes a long way to explain sales, average sales per store, sales per square meter, and the like. So do you have that pack in front of you, Shaun?

SHAUN COUSINS: Yes, I do. Thanks.

GRANT O'BRIEN: If you go to slide 4, we've picked a market. And Matt may have mentioned before our ability in Victoria to get planning approval and zoning approval more quickly than just about any other market. And that's allowed us the opportunity to put stores down more quickly, which we've taken.

And what we've shown in that little map on slide 4 is the stores that we had in the Melbourne Metropolitan area at the end of FY12 numbering, I think about six, in FY14, at the end of the year we've just finished, we've got 17 in that marketplace.

Now that's for me to start to communicate a little better why we talk about cannibalization, we've opened 11 new stores there in the course of two financial years. Now that sort of store openings more typically would have occurred over a five-plus year period. But given that we've opened so many on a small base, we've seen that average sales per store actually decreased. It's got more to do with the number of stores that we've put into that marketplace than it's got to do with the deteriorating performance of the stores.

Our expectation is that that will from this point on improve. We're putting I think, Matt, only one store into the Victoria and Metro market this year, which gives these stores the opportunity for the first time to have some clear air to grow any expectations that that's exactly what they would do.

So I've just used that market as an example, Shaun, of what happens when you've got a start-up business; when you've got a small number of stores and you plug a good number of that small portfolio into a particular market, you get cannibalization, you get falling average store sales for a period of time before it consolidates.

Matt, did you want to add to that point?

MATT TYSON : Only to say, Grant, that my experience of overseas markets is exactly the same. We saw exactly the same picture. When you're moving the [pace], you can impact yourself in the short term.

Our home improvement business should expect to mature in over the four years post opening, and we should see maturity in those stores now that they've got that clear air.

SHAUN COUSINS: Wouldn't you guys have been alert to this issue? And wouldn't you have been alert to the fact that store profitability coming under pressure for a start-up business could actually impact the economics of the business?

I'm just curious. I know you guys don't launch new businesses regularly, I think BIG W was 1977, but I would have thought you would have been a bit more aware of some of these risks, be they cannibalization and getting to profitability, which it appears that store profitability has been negative and outweighed on overall Group -- pardon me, divisional profitability.

GRANT O'BRIEN: A couple of things there, Shaun, first of all, the guidance that we gave all those years ago before we had a store on the ground. And whilst we were confident of the store numbers that we could get, we weren't particularly sure where they would be. And that's the point. That's why I used Victoria as an example. We took the opportunities to open stores where we had planning approval to do so. We didn't know when we originally set out exactly where we would get planning approval for, and the guidance was set as part of that.

It's true that we haven't hit that guidance, and that's what we're saying very clearly today. And we're disappointed by that. We would have liked to have been in a position where we broke, broken even, or were confident of breaking even in FY16, and we remained that way up until this point in time.

The other thing I'd just call out for you is the point that Matt has touched on before, and we're making good progress here. Last year, our losses per store were in the order of -- were [up to] AUD5 million. This year, our losses per store are around AUD3.5 million.

So our losses per store have decreased by 30%. This is the pathway that we expect that this business will follow as we add scale to it and the businesses become more mature.

So I think you've got to look at the whole scenario here and not just that particular one, but I'm not hiding from the fact that we're not going to hit our guidance.

SHAUN COUSINS: Okay. Maybe just for fiscal 2015, Matt, you've noted that some of the initiatives you're looking to do in terms of changing product mix within the store might cause some disruption. Is there a risk that actually losses increase in fiscal 2015? I'm just curious, particularly about this disruption element and how that may weigh on profitability next year where it looks as though -- pardon me, in fiscal 2015, this current year, where it looks as though you'll be doing quite a bit of work.

GRANT O'BRIEN: I don't think we want to overplay the disruption piece, but nor do I want to say that -- nor do I want to take away from the fact that we are going to make some changes across our network. And Matt's got -- identified some of those. They're in test stores at the moment. We'll be rolling those out over the course of the next year.

Matt, did you want to add anything to that?

MATT TYSON : No, I don't think so, Grant, other than to say that I absolutely agree. We're not expecting to see significant disruption. And as with any business, as you evolve the proposition, it takes time to bed in.

GRANT O'BRIEN: What I am going to do is make sure that Matt's got the time that he requires to make those changes. We like the plans that the team have developed. We like the early signs that we've seen. But part of what we're going to do here is we're going to give detailed updates on the business at each half. We're not going to give guidance.

SHAUN COUSINS: Okay. And maybe just in terms of the Dan Murphy example, can you talk a bit about the quantum of losses that you had in Dan Murphy ? I'm just curious. Businesses that generate AUD169 million of losses, and what with nearing on over AUD400 million of losses over a period of time, it's a little hard to come back from that.

I'm just curious about the experience you've had with Dan Murphy 's in terms of what the quantum of loss is there, and while you had a period of losses, you got to break even. And it's obviously a great business now but the losses here are quite significant.

GRANT O'BRIEN: I think people look at our food and liquor business, Sean, and see a big strong business. You're right. The liquor business has done well in recent years and will continue to do well.

I think if I take you back 14 years, you would see a different story, the business that we were growing. And as I said, back then, we had 40 stores, 40 standalone stores. Today, I think we've got over 1,100 freestanding stores, and obviously a multi, multibillion dollar business as a result.

I don't have the numbers off the top of my head but you know that I was there and part of that, and I know what it takes to get a business from zero to 100 miles an hour.

And I'm confident that we will do that with the home improvement business, just as we're able to look back at the liquor business and look at a brand that's now permanently entrenched, a business that's trading very strongly and growing, when it came from a position of having very little market share, no brand presence, and a very small number of stores in a loss-making environment.

Woolworths have done this a number of times before, and we'll do it again here.

SHAUN COUSINS: Okay. And just finally, are you comfortable with the carrying value of your **property** in terms of obviously generating trading losses? Do you think the PP&E is appropriately valued on your balance sheet?

GRANT O'BRIEN: Yes, we do. Dave, do you want to comment on that?

DAVID MARR : Yes. We test that annually, and in fact, we test that twice yearly, and not only just across all of our businesses but specifically around the carrying value of -- if there's any indicators of impairment. We did at the half and full year, and as of the full year we're comfortable with the carrying value.

SHAUN COUSINS: Thank you.

OPERATOR: Phillip Kimber, Goldman Sachs .

PHILLIP KIMBER, ANALYST, GOLDMAN SACHS : Just wanted to get a bit more of an understanding of the increase in losses. Has there been much change in the overhead base? If we thought about the four wall profits at the store level and then the overhead, what's been the bigger driver of the increase in losses in fiscal 2014?

GRANT O'BRIEN: The overheads -- the issue here, Phil, for us is that we've had central costs in the beginning in a small number of stores in which to offset that cost. And that's part of the reason why we've seen a 30% reduction in our losses per store is because we're defraying those costs besides improving our cost margin positions in our individual stores. The addition of a further 18 stores in this financial year serves to defray the central costs.

Now central costs are well contained and we've made improvements in a couple of the large ones there. And Matt touched on one earlier around supply chain where we've made some good improvements, and we'll see the benefit of that in this coming year.

PHILLIP KIMBER: Sorry. So wouldn't it therefore mean that your actual losses per store before allocating overhead have actually gone up? If your overhead's been relatively flat, your losses have gone up year on year, the losses per store will always come down when you've got a massive overhead base and you add new stores. I'm trying to understand at the actual store level profit or loss, whether that's increasing or not.

GRANT O'BRIEN: No. No great change in that, and I didn't say that our overhead was -- or our central costs were flat. I said they hadn't grown significantly.

PHILLIP KIMBER: Okay. Just trying to understand, because everyone will do their own assumptions, but it feels like the bulk of the losses are in that overhead. Can we talk a bit about the sort of costs that are in there? Because my understanding is you're running two DCs. AUD100 million plus of overheads seems like a very big number.

GRANT O'BRIEN: We've got two major DCs and two feeder DCs now to support the Queensland and Western Australian markets where we've got stores. So that's part of what we've added to our central costs over the course of this year. Float-through warehouses; they're not picking DCs like the Hoxton **Park** and Hoppers Crossing DCs.

Obviously, we've got other substantial parts of our overhead costs with the **commercial** officers, the buying officers and the like.

So there's nothing unusual in those central costs that would be any different to the central costs we carry in most of our other businesses in terms of makeup.

PHILLIP KIMBER: Okay. And then one last one. I appreciate that chart on Melbourne about the impact of opening a lot of stores in a relatively small geographic area, but if you looked at some of your other stores, are sales per store actually going up if you try to remove some of those impacts? Because I would have thought the ramp up, and you said they're a four-year ramp-up profile, would almost offset any negatives from cannibalization of places like Melbourne.

GRANT O'BRIEN: Yes, well, 17 of our entire network is in Melbourne, which is why we picked that out. So it has a significant impact on the overall, which is the only number that we publish, obviously.

Now obviously, there are stores that are trading differently because they're not in competitive markets, in highly consolidated markets. But we've also pointed out before that we have stores in regional markets and stores in new growth markets, which likewise have to be viewed differently. We've called them out previously and we called them out again today.

I think the bottom line here, Phil, is what we've been saying for some time. It's a very immature store network. If you look at it in the last two years, we've opened 34 stores in the last two years. We don't have a store yet that's more than three years old.

So it's still a small network. Whenever you do what we did in a marketplace like Melbourne, it's going to affect your total sales and your average sales per store outcomes, and the like.

So it's small. Impacts like Melbourne affect the whole network, and that will be the case until such time as we've got a more mature network.

PHILLIP KIMBER: Okay, thanks. And one last one, if I can. Just still opening 10 to 15 stores a year; maybe for Matt. Is it easier to make these changes if you just stop rolling out stores for a period of time until you get it right and then start rolling out again? Or is that just not an option?

MATT TYSON : No. I think in reality, there's plenty of opportunity in this market, particularly in metro areas. It's sometimes, and I think this is true of any market across the world actually, it's often more difficult to get space in metro markets. It can take four or five years to bring that to reality. And that's true whether you're in Moscow, in London or in Sydney.

What we're now seeing is some of those early development sites start to come through. They will take time. Some of them will take two or maybe three more years to come through. But what we're focusing on now is picking off those sites, adding sites in metro markets where we know the demand is already there (technical difficulty) where we expect them to grow. And these are markets that are ready made for us.

PHILLIP KIMBER: Okay. Thank you.

OPERATOR: Ben Gilbert, UBS .

BEN GILBERT, ANALYST, UBS : Just first question. So just given that, as you say, you're going to get maturing stores, should we still think -- should we think of this year as a peak year of losses for FY14 for the hardware JV?

GRANT O'BRIEN: Ben, we're not giving any further guidance in relation to that. I think we've called out that we're going to slow down and refocus the store rollout program on metropolitan markets and we're going to make some changes in respect to category enhancements. So that's the extent of the guidance that we're going to give.

BEN GILBERT: Okay. And the second one from me, and maybe just one for Matt, when you go and talk to the customers at the moment what are -- and in the surveys -- what are they saying that's wrong? Why are they not necessarily coming back to the Masters' stores out there and maybe going to the competitors?

MATT TYSON : Actually, Ben, when you talk to customers, and I actually last Tuesday evening spent three hours with a customer in his home and went to the Masters' store, actually customers love Masters. But what you have to understand with home improvement, and again, I know it sounds like an old record, but this is the same the world over, home improvement -- typically in a mature market, you will see a customer visit home improvement store maybe six or seven times a year.

Now this is not food where the customer is visiting, sometimes twice a week. It takes time to build relationships, to change customer behavior. And that's a pattern that I've seen played out in many markets. We've made great progress to have 75% unprompted awareness, which is much higher than some other players in the market who've been here a long time. I think it's just a point in time you have to keep working to delight those customers. And that's exactly what we're doing.

BEN GILBERT: And the pricing perception and just the availability of brands in stores, is that being called out as an issue when you've had these focus groups as something you need to address?

MATT TYSON : Actually, price is not the issue with consumers. We are extremely competitive. And I think that can be seen in the market actually that prices overall have reduced since Masters came to the market. I don't think that's an accident. And Masters is extremely competitive. There is for sure opportunity for us to improve our ranging. That shouldn't be a surprise either. When you start something from scratch, you're never going to get everything right.

And we're working hard. We're working quickly to fill some of those gaps. And the example I use there is hardware, core hardware that does drive high visitation. If you are able to see one of our new test stores, Hoxton **Park** would be an example, you'd see we've filled those gaps in the ranging, and we're quickly rolling that back to our existing stores.

BEN GILBERT: Great. Thank you.

OPERATOR: Craig Woolford , Citigroup .

CRAIG WOOLFORD , ANALYST, CITIGROUP : I just wanted to start off exploring -- obviously, Matt has had the opportunity to review this business. How do you know that the format size, the store sizes are right? These are very big stores and maybe you're forced to fill them up with product at 13,000 square meters. But to me, there's always been concern that you've got too much floor space for the opportunity you've got. Can you give us any feedback on that view?

GRANT O'BRIEN: I'll get Matt to give his perspective from his global experience, Craig. I think we've pretty much stuck to the format that we began with around 13,000 square meters. I know you'd be aware that others are opening much, much bigger boxes in the marketplace. We think that 13,000 square feet is about right for the range that Matt's described.

Matt, do you want to just give --?

MATT TYSON : I came at it with an open mind, Craig, as to what the right proposition was for the market. I increasingly believe that the size of store we've got is the right size. The reason I say that is when you look at this market, a significant portion of it, 80% plus, actually sits in the independent niche place.

Now to address those categories well, whether it be appliances, flooring, ceramics, you need space, and you need to offer every one of those stores within a store as being a better experience than those niche players. So you need space to be able to do it.

CRAIG WOOLFORD : Yes. Because one of the other areas that's quite a significant part of the floor space in the Masters stores is trade, and you've got a strategy for direct trade with acquisitions like Hudson and the home business generally, but do you feel that the trade precinct within the Masters stores (inaudible).

MATT TYSON : Trade is an important component of a big box retail proposition. There is very small overlap though between home timber and hardware trade businesses and Masters. In Masters, more play is on the trade convenience and trade distress; being there for the trade in early morning when they're passing, going to a job **site**; or at the end of the day when their normal outlet -- or on a Sunday when they're specialist is closed, being there for them with that pickup product they need. So trade is an important element of our proposition.

That same trade ranging though is also very important to the heavy DIY customer. So it's not just about the trade. The weekend warrior who's doing his decking project wants exactly the same range. So I see it as an important part of our proposition.

CRAIG WOOLFORD : Okay. Yes, it all comes back to whether you get enough sales productivity, but no doubt you're working on that.

The other issue that was interesting, you've said that hardware is a big focus. When I look at slide 1 in your pack, hardware products have a higher concentrated market; the top three players looking at that chart looks to be about 75%. So it feels like of all the categories that you can improve footfall and sales in, it's probably one of the ones that's going to be more difficult. What makes you confident that you can actually encroach on market share in hardware?

MATT TYSON : The early test results we've had from the stores where we've done this has almost given instantaneous results. In Hoxton **Park**, as an example, which was the first store we tested this in, we've instant results by improving the hardware range, and much higher participation than we would have seen in other stores.

So it might be a more competitive segment, and a number of the areas that we will improve our ranging in will be competitive. They also happen to be good footfall-driving categories. And there are things you would expect of any home improvement store, to be able to cover your whole projects, from a packet of screws to being able to build my home and finish it.

CRAIG WOOLFORD : Okay. Has any range been taken out? Like what other categories have been --? Is it more floor space added to hardware or just a change of a presentation?

MATT TYSON : In the test stores, we've given more floor space to hardware. In the existing stores, we will squeeze this range into existing space.

CRAIG WOOLFORD : Okay, great. And if I can just lastly ask from an accounting perspective, will the losses on Masters or home improvement be tax deductible?

DAVID MARR : Yes, they're sitting in there at the moment as a deferred tax asset.

CRAIG WOOLFORD : Okay. Thank you.

OPERATOR: Andrew McLennan, CBA.

ANDREW MCLENNAN, ANALYST, CBA: You obviously have a bit of an issue with the regional stores, whether it's a logistics cost to support that or the fact they do longer to mature. Can you just explain at the moment what proportion of your stores are in regional locations and whether or not they are leased or owned?

GRANT O'BRIEN: The short answer to your question, Andrew, is that i0t's a small number of our stores are in what you would term regional locations, like -- the four stores that we've located this year in regional locations are Taree and Bathurst and Ballarat. They're the sort of stores that we would term to be regional.

Those stores generally start off with a lower average sales per store, and that was our expectation, and that's why we've called it out as something that affects the overall average store sales for the network.

So we don't have a lot of them. Mostly you could cast the owned versus leased in the same sort of proportion of 70/30.

ANDREW MCLENNAN: Okay. So your decision to reduce your rollout into regional areas isn't going to impact on any specific **property** assets?

GRANT O'BRIEN: No.

ANDREW MCLENNAN: Okay. Also just -- I suppose it's a bit of a comparison. You're rolling out two stores in South Australia. Will you be servicing that out of the Melbourne DC? And what kind of scale do you need to actually make those stores profitable, or that region profitable?

GRANT O'BRIEN: The answer is that they will be out of the Melbourne DC. Matt?

MATT TYSON : Yes. No, absolutely will be out of the Melbourne DC. Actually, the on cost of those stores is not significant. It's very reachable from there.

ANDREW MCLENNAN: So you'd anticipated that there would be -- you'd need two stores to be profitable, or you'd require more than that?

MATT TYSON : No. We believe we can make those two stores profitable, even if we added no more. We see the opportunity to add more in the future.

ANDREW MCLENNAN: Can I just ask one final question? You've gone into a great amount of detail around what's happening to cannibalization, etc., but amongst the feedback that we do get, which tends to be relatively lackluster sales in the Masters' stores, there is some times where we get some real positive feedback that your stores are doing well. But you're not providing an indication of that in this presentation. Can you give us maybe one example of your better performing stores and what kind of sales you're generating in that store?

GRANT O'BRIEN: Well, we've got obviously across the network some stores that are performing particularly well. That's true, Andrew. We've not given individual store turnover, nor would we. But typically, those stores are the ones that have been more established in metropolitan areas. The commentary that we do give I think gives a clue as to where our successful stores are. They're in metropolitan areas. They're consolidated and not cannibalized by new store openings.

And we've got stores that are doing terrifically well and right where we need them to be. But it's a small network, and given country stores and the markets of significant size like Victoria in terms of the number of stores we've got there, affect our average sales per store.

So we've got good performing stores. There's no doubt about that. We've got categories that I've called out a number of times. But within all of our stores are over-performing, particularly in the in-store categories, but there are the high traffic drivers that Matt's focused on in the hardware category that he's talked about, which is where a lot of the upside resides for us and we're pretty excited about that.

ANDREW MCLENNAN: Sorry. Just to follow on, are any of those stores profitable?

GRANT O'BRIEN: We don't talk about profitability, but what we have is we've said that the shape that we would see in the home improvement business is no different to what we see in our food business. And that's profitability -- individual store profitability one to two years, and then maturity three years to four years.

ANDREW MCLENNAN: Okay. Thank you.

OPERATOR: (Operator Instructions). Michael Simotas, Deutsche Bank .

MICHAEL SIMOTAS, ANALYST, DEUTSCHE BANK RESEARCH: In the last couple of quarters, anecdotally, you've done a lot more marketing in some of the key markets than what you have in the past. I'd call out sponsorship of House Rules. Can you talk about whether you've seen any benefit from that? And if so, what's the evidence of that?

GRANT O'BRIEN: Yes. I'll ask Matt to do that. Obviously, we did the House Rules again this year that we did last year, and I don't think there's any surprise that it's helped our [unprompted] brand awareness to be where it is. But we've also launched the program Australia's fastest growing hardware store. which likewise has been, I think, very positive.

Matt, did you want to talk about results on those?

MATT TYSON : Yes. In terms of the feedback from House Rules, it's been a great success for us. As Grant's already said, there's no doubt that House Rules has been one of the elements that's placed Masters at the forefront of consumers' minds. So it wouldn't be a surprise if we continued that sponsorship into this year.

In terms of customer experience overall, what we see is in our more mature businesses loyalty building with age, and that's not a surprise. That's exactly what we expect to see. So the more mature the business, the more the customer **transactions** build.

GRANT O'BRIEN: And I think we've also seen through the marketing programs that have played during the year, and as I touched on, the Australia's fastest growing hardware store, some of the products that we used in those like Futurewood and those sort of things have had terrific uptake and continue to do so.

So we've been measured in our growth into large-scale marketing programs, but they've certainly helped our awareness and they're helping our visitation.

MICHAEL SIMOTAS: And then just a second question from me surrounding the Lowe's put option. Was any concession given to Lowes in exchange for that change? And is it right to -- is my understanding right that if the option was exercised as early as it can be in November 2016, that the strike price would effectively be the book value of the investment?

GRANT O'BRIEN: I'll ask David to answer that question.

DAVID MARR : Yes. So there were no material concessions at all in Lowe's changing the option arrangement. With respect to the valuation, it would be a fair market valuation at the time.

OPERATOR: David Thomas , CLSA.

DAVID THOMAS , ANALYST, CLSA: Just a question around sites that you've secured. I know when you launched this, you talked about 150 sites, and when you opened your first one, I think you'd said that you'd secured 100 sites. Is that still the case, and is that also around the 70/30 type profile, or have they been acquired sites? Can you give us some color on that, please?

GRANT O'BRIEN: Yes. We've still got a very good **property** pipeline, and we've announced this morning, David, that we're going to focus on actioning some of those in the pipeline in the metropolitan markets, particularly in New South Wales and Queensland. And again, some good early work on that, but much more to do to access those opportunities.

In respect to owned versus leased, look, my expectation going forward is that that 70/30 will be about half of the future stores that we open out of the pipeline.

DAVID THOMAS : Right. So you've still got a lot of stores or sites that you've acquired that you're not going to build on for some time. Would that be a fair comment?

GRANT O'BRIEN: David, most of those have got options on them, not necessarily acquired. So it's again a mixture of some owned, but more with options or other holding instruments on them, and also others that are going to be developed for us in the agreed timeframe.

DAVID THOMAS : Okay. And just quickly for Matt, I was just wondering if you could give some color, given your international experience, about what sales levels in terms of dollars per store. You look around some of the big boxes on a global basis, they tend to be on average doing AUD30 million Aussie equivalent of sales to get to an optimum level. I was wondering if you could give us some color on your international experience on that number on whether or not you felt that that was something that was relevant in the Australian market.

MATT TYSON : No. I think, David, that's absolutely right. Typically, you would expect ultimately for a big box retailer to be doing somewhere in that range.

I think one of the things that we have to remember about Masters is it still is a very immature business; that you would expect the business to grow by circa 25% in its first four years of life. The shape of the network is not even. There's not a lot of stores in metro areas. So if you looked at retailers in other markets, what you would see is quite a big variation that's often flattered by the metro store sales. We've got very few stores in metro markets is one of the things that I would say.

I'd also say as well that I've had plenty of experience of retailers who've gone on to deliver those sort of level of sales, AUD30 million plus. But in the early days of their development, they were delivering nowhere near that, and maybe even less than the sales we have in Masters. And it's one of the things that gives me great confidence that we can [build] this business to profitability.

DAVID THOMAS : Okay. All right. Thank you.

OPERATOR: Paul Checchin, Macquarie.

PAUL CHECCHIN, ANALYST, MACQUARIE RESEARCH: Can you please make some comment around the visibility you have into opening those 10 to 15 stores over the next few years? So you've actually got your hands on the sites. Where are you at with planning approval, etc., with them?

GRANT O'BRIEN: Yes. It's quite a natural pipeline evolution, Paul, for every other division that we have. So for those that we've announced that we'll open next year, the majority of those would be either under construction or would all have planning approval. The ones for FY16, some would have planning approval and others are in the final stages of.

So we lock these numbers in and we lock them in based on having the **site**, having the planning approval, and then we add them to our list as a potential opening.

So for next -- the current year that we're in, obviously most of those will be under construction, so it's kind of locked in.

PAUL CHECCHIN: Great, thank you. And then just a follow up. Just when you refer, or use the words most attractive sites, and you mention those words a few times in your presentation, are you defining most attractive sites relative to the sites you've got your hands on? Or are these the most attractive sites if you just drew, or had a blank map of Australia and put little pins where you wanted to be? Are they the most attractive sites where you want to go?

So I'm just trying to understand are they the most attractive sites of actually where you want to be, or is with the scope or the sites you've got your hands on in a relative sense the most attractive sites?

MATT TYSON : In the short term it's the most attractive sites that we've got our hands on. So we could open more stores because of the pipeline. We're choosing to open stores in markets where we know the growth opportunity is there, particularly in New South Wales, South Australia, Queensland.

We are working hard with local government to actually try to speed the process of metro sites along. It always takes time wherever in the world you're dealing with that. But we're very happy with the pipeline. We've got a strong pipeline of stores.

PAUL CHECCHIN: Okay. Thank you.

OPERATOR: [Alvin Khan], [Alt] Asset Management.

ALVIN KHAN, ANALYST, ALT ASSET MANAGEMENT: Just a couple of really quick questions. First of all, excuse my ignorance. Are there any Masters stores that are near a Bunnings store?

GRANT O'BRIEN: Yes, Alvin. There are a number of stores where we -- directly across the road, next door to Bunnings stores. And that's pretty typical of what happens around the world. They've become kind of home improvement precincts where the major players congregate and they're effective places in which to trade.

So we've both moved into markets to position ourselves next to Bunnings, and we've experienced Bunnings moving into markets that we first occupied, and moving next to us; so a bit of both.

ALVIN KHAN: A bit of both. Just I guess my last question is in terms of value proposition, in the market right now, Bunnings has the -- I guess the lowest price guaranteed option for their products, at I guess one of those weekend warriors at home. What is the value proposition for a customer to go to a Masters store instead of a Bunnings store?

GRANT O'BRIEN: I think Matt's got a good way of talking about that when he talks that the whole project or the full gamut of projects can be accommodated at Masters, which is a unique part of the Masters offering. Did you want to expand on that.

MATT TYSON : No. I think from a customer perspective, if you think you could lay the foundations of your home, and you genuinely could fit that home out with Masters, with high quality products, whether that be kitchen or bathroom or lighting, ceramics, it is a full home solution proposition.

ALVIN KHAN: Well, I guess also, will Masters also compete on lowest prices with Bunnings as well to attract the marginal customer to your store?

MATT TYSON : Masters already competes on lowest price. I think I said earlier on the call that price for the consumer is very definitely not an issue. We price check ourselves, but in all the research we do, consumers recognize that Masters is very well placed on price.

ALVIN KHAN: Thank you very much.

OPERATOR: Tom Kierath, Morgan Stanley .

TOM KIERATH: Can you just clarify that you're reconfirming the 5% to 7% impact growth based on the weaker profitability or high loss from Masters?

GRANT O'BRIEN: No, Tom. If we were moving from that, we'd have said something about it.

TOM KIERATH: Okay. Thank you.

OPERATOR: Michael Simotas, Deutsche Bank .

MICHAEL SIMOTAS: Just a quick one on the cannibalization that you've called out in the Melbourne market. With the focus on metro sites in New South Wales, Queensland and South Australia, do you expect that cannibalization to be a feature of those metropolitan markets for the next couple of years as that rollout ramps up?

GRANT O'BRIEN: We won't get the same level of concentration of stores in New South Wales and South Australia that we've been able to get successfully in Victorian markets. So it won't be the same. That's my view.

Matt, do you --?

MATT TYSON : No. I absolutely agree with that. By definition, what we're doing here is filling in blanks on the map where we know we haven't got enough presence. So we don't expect to see that level of cannibalization.

MICHAEL SIMOTAS: Okay. Thank you.

OPERATOR: Richard Barwick, CLSA.

RICHARD BARWICK, ANALYST, CLSA: I just want to clarify one thing. In the previous discussion, if you go back to the update on Masters for July last year, you were very focused in saying if we roll out enough stores we can fractionalize costs and that will underpin going to a break-even position.

Clearly, you've changed the timetable to reach these 90 stores and seemingly giving a little bit more emphasis to increasing your sales per store. So can you just give a little bit of color there to how much of reaching break even depends on the 90 stores? Or is it more a case of actually growing the sales per store?

GRANT O'BRIEN: A couple of things I'd refer you to, Richard, in the commentary today. One thing I said earlier on is that it's clear that the expectations for the business and the milestones that, as Matt has said, have not changed significantly from what we set out to do originally. So I'd put that in there I guess up front.

The second thing I'd note is the decreasing cost or loss per store decreased by 30% this year. So it's factual that as we grow this chain, there's momentum towards breaking even. I think that's very evident.

But what we're doing here is still going to open 10 to 15 stores, but that will run, having 90 stores that we've talked about; that will have somewhere between 70 and 80 stores. So again, not a huge departure, but nevertheless, something that we wanted to call out.

The quality of the sites that Matt's working on in New South Wales, South Australia and Queensland, we think are going to be very helpful for us continuing to make progress.

RICHARD BARWICK: Okay. And do you have any plans, Grant, or at what point do you think you'll be in a position to actually talk to a like-for-like sales growth for the Masters business?

GRANT O'BRIEN: I don't think it's helpful at the moment, and that's why we went to the extent of putting a pack out to demonstrate markets like Victoria that have continued to shift around. It's not a mature business, where a mature business, comp sales are a useful measure. There is no doubt. This is not by any description a mature business. So comp sales are not helpful.

RICHARD BARWICK: So on that basis, we're probably two years away at least before you're in a position to or be willing to talk to that.

GRANT O'BRIEN: Well, we've said that on a store-by-store basis, maturity's up to four years.

RICHARD BARWICK: Okay. Great. Thank you.

OPERATOR: There are no further questions on the phones. I'd like to hand back to you now, Grant.

GRANT O'BRIEN: All right. Can I thank everyone for their questions and their interest this morning? Home improvement is a business that we remain very excited about, and its growth contribution to the Woolworths Group is something that we're investing heavily in, Matt and his team are very focused on.

And I'm pleased with the progress that we've made, albeit that we didn't deliver on the guidance that we gave. We're a business whose DNA is to grow and to set very stringent hurdles, and that's what we will continue to do.

So thanks for your time.

OPERATOR: That does conclude today's call. You may all disconnect.

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