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Kmart Group update and expected FY20 significant items

Kmart Group update

- First phase of Target review has identified actions to accelerate the growth of Kmart and address the unsustainable financial performance of Target
- Actions include the conversion of suitable Target stores to Kmart stores, the closure of a number of Target stores and a restructuring of the Target store support office
- Redeployment opportunities in Kmart and other Wesfarmers businesses will minimise the effect of these changes on Target team members

Significant items expected in the 2020 full-year results

- Restructuring costs and provisions in Kmart Group of approximately \$120 to \$170 million before tax, primarily reflecting Target store closure costs, inventory write-offs and a restructure of the Target store support office
- Non-cash impairment in Kmart Group of approximately \$430 to \$480 million before tax, including an impairment of the Target brand name
- Non-cash impairment in the Industrial and Safety division of approximately \$300 million before tax, primarily relating to the impairment of goodwill
- Pre-tax gain on sale of 10.1 per cent interest in Coles of \$290 million, and one-off pre-tax gain of \$221 million on the revaluation of the remaining Coles investment
- The estimates of the significant items remain subject to auditor review

Wesfarmers provided an update on the review of Target, including changes to the Target and Kmart store networks. The Group also provided an update on significant items expected in the 2020 full-year results.

Following the completion of the first phase of the Target review, Kmart Group has identified a number of actions to accelerate the growth of Kmart and address the unsustainable financial performance of Target. These actions include the conversion of suitable Target and Target Country stores to Kmart stores, the closure of between 10 to 25 large format Target stores, the closure of the remaining 50 small format Target Country stores, and a significant restructuring of the Target store support office. Wesfarmers is continuing its assessment of strategic options for a commercially viable Target and its remaining store network.

Wesfarmers Managing Director Rob Scott said that these actions and further investment in Kmart will enhance the overall position of the Kmart Group, while also improving the commercial viability of Target.

“For some time now, the retail sector has seen significant structural change and disruption, and we expect this trend to continue. With the exception of Target, Wesfarmers’ retail businesses are well-positioned to respond to the changes in consumer behaviour and competition associated with this disruption,” Mr Scott said.

“The actions announced reflect our continued focus on investing in Kmart, a business with a compelling customer offer and strong competitive advantages, while also improving the viability of Target by addressing some of its structural challenges by simplifying the business model.

“The reduction in the Target store network will be complemented by increased investment in our digital capabilities, following the continued strong growth in online sales across the Kmart Group and the pleasing progress in Catch since its acquisition in August 2019. The expansion of our digital offer will provide customers with access to the Kmart and Target products they love, together with over two million products from the Catch marketplace, via home delivery or click and collect.

“While accounting standards require us to recognise an impairment of assets within Target to implement the restructuring, these actions will allow us to enhance the overall value of Kmart Group and further strengthen Kmart.”

Coinciding with the significant changes to the store networks in Kmart and Target, Kmart Group will complete the trial of Anko stores in Seattle, United States prior to the end of the financial year and close these operations. A number of the initiatives trialled are expected to be progressively implemented in Kmart stores.

Following the deterioration in economic conditions since the first-half results, Wesfarmers has also assessed the carrying value of the Industrial and Safety division and expects to recognise a non-cash impairment, primarily relating to the impairment of goodwill.

“In recent months we have seen improved execution and continued progress on the turnaround of Blackwoods,” Mr Scott said. “Despite this progress, the deterioration in economic conditions has resulted in lower customer demand in Workwear Group and GreenCap, and, along with uncertainty as to future economic conditions, has impacted our assessment of the carrying value of the overall Industrial and Safety division, requiring an impairment of goodwill.”

Significant items expected in the 2020 full-year results

As a result of the actions outlined above, along with the recent partial sale of its interest in Coles, Wesfarmers expects to recognise the following significant items in its 2020 full-year results:

- Restructuring costs and provisions in Kmart Group of approximately \$120 to \$170 million before tax, primarily reflecting Target store closure costs, inventory write-offs and a reduction in the Target store support office
- Non-cash impairment in Kmart Group of approximately \$430 to \$480 million before tax, including an impairment of the Target brand name, property, plant and equipment, the capitalised value of leases and other assets
- Non-cash impairment in the Industrial and Safety division of approximately \$300 million before tax, primarily relating to the impairment of goodwill
- Pre-tax gain on sale of 10.1 per cent interest in Coles of \$290 million, and one-off pre-tax gain of \$221 million on the revaluation of the remaining Coles investment

The estimates of the significant items outlined above remain subject to auditor review. In the 2021 financial year, Kmart Group is also expected to incur one-off non-operating costs of approximately \$120 to \$140 million relating to the conversion of stores and stock clearance activity prior to closure or conversion.

Target review

As announced in April 2020, Wesfarmers is conducting a strategic review of Target. Following the completion of the first phase of the review, the Kmart Group has identified the following actions to optimise the Target store network and reduce Target’s unsustainable cost base:

- The conversion of between 10 to 40 large format stores to Kmart, subject to landlord support
- The conversion of approximately 52 Target Country stores to small format Kmart stores
- The closure of between 10 to 25 large format Target stores and the closure of the remaining 50 Target Country stores which are not suitable for conversion to Kmart
- A significant reduction in the size of the Target store support office
- Ongoing negotiations with landlords to support the transition to a sustainable store network

These actions are expected to be implemented over the next twelve months with the majority occurring in calendar year 2021. The conversion of suitable stores to Kmart will address gaps in the Kmart network and is expected to result in an improved financial performance for the Kmart Group while meeting the Group's return on capital hurdles.

The conversion of suitable Target Country stores to small format 'Kmart Hub' stores will leverage Kmart Group's learnings from trialling small format Anko stores in the United States while providing regional customers with increased access to a selected range of Kmart's home, apparel and general merchandise products.

In line with continued strong growth in online sales and the increasing number of customers who prefer to shop online, Kmart Group will continue its investment in its digital channels. Through an expanded click and collect offering, the full range of Kmart, Target and Catch products will be available at all stores across the Kmart Group, including 'Kmart Hub' stores.

The Group is continuing its assessment of strategic options for a commercially viable Target and its remaining store network, including further optimisation of the store network and changes to the operating model. An update on this assessment will be provided at the Group's full-year results in August 2020.

Impact of network changes on Target team members

Wesfarmers and the Kmart Group recognise that these actions will have a significant effect on a number of Target team members and are committed to supporting them through this process. All team members in Target stores scheduled for conversion to Kmart will receive an offer of employment from Kmart. Target team members affected by store closures will be given consideration for new roles created in Kmart and Catch as those businesses continue to grow. In addition, Wesfarmers has established a cross-divisional working group to identify redeployment opportunities for affected team members, including in Bunnings and Officeworks.

With the majority of the proposed Target store closures planned to occur in the 2021 calendar year, this provides considerable time to explore all available options to redeploy affected team members. Target team members who are unable to be redeployed will be provided with access to support services, along with all entitlements.

Kmart Group Managing Director Ian Bailey said that the decision to significantly reduce the Target store network was difficult but necessary.

"Leveraging the strengths of the Kmart Group, we have made a significant effort to avoid store closures, retain our valued team members, keep serving our customers and supporting our suppliers. Unfortunately, the disruptive and competitive nature of the retail sector requires us to make some difficult decisions to ensure we have a viable Target business into the future, while continuing the strong growth of Kmart and Catch," Mr Bailey said.

"We continue to believe that Target has a future as a leading retail brand in Australia and is much loved by many customers, but a number of actions and changes are required to ensure it is fit for purpose in a competitive, challenging and dynamic market, including a smaller number of stores and a stronger online business."

Impact on credit rating and dividend policy

The accounting impairments in Target and Industrial and Safety are non-cash in nature and will not impact the Group's credit rating, debt facilities or the final dividend for the 2020 financial year.

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This announcement was authorised to be given to the ASX by the Wesfarmers Board.