Kathmandu Holdings Limited

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Xavier Simonet
Good morning everybody and welcome to the FY19 Half Year Results presentation for Kathmandu Holdings. My name is Xavier Simonet and I am the CEO of the company. I am joined on the call by Reuben Casey, our CFO and COO. We will be talking to the presentation filed on the NZX and ASX this morning. Most of the numbers are in our reporting currency, NZD unless when it is specifically mentioned that they are in AUD, GBP or USD.

If we move to slide 2, the results summary, the key message is that we delivered a record profit in the first half of FY19. Normalised EBIT grew by 10.0% to nearly $20m. Normalised NPAT grew by 7.3% to $13.2m. Our total group sales increased by 13.3% to $232m. We enjoyed significant gross margin improvement for the Kathmandu business in Australia and New Zealand as well.

Summit Club which is our loyalty club and key to our success, grew to 2m members which is a key milestone to us considering the importance of Summit Club for our business and the opportunity we have to engage with our Summit Club members through social media and digital marketing.

Oboz which we acquired back in April last year, achieved its acquisition earn-out target and continued in the first half of FY19 to deliver strong sales growth of nearly 39% and EBIT growth of 77%.

The interim dividend is unchanged from prior year at 4 cents per share.

One last point which is not mentioned in the presentation is as a company we are open to diversity and we actually believe that diversity is a key factor of success for our business and we are very international. We currently employee between Kathmandu and Oboz people from 70 different nationalities.

Moving on to slide 5, Strategy, we are on a journey of transformation. Transformation from being a leading Australasian retailer to becoming a brand-led global multi-channel business. Firstly, we retain a strong focus on our core. Kathmandu and Oboz are iconic and authentic brands and inspiring customers with distinctive products is at the core of the strategy for both brands. At Kathmandu, through our bricks and mortar stores and our online channel, we also focus on providing our customers with an always improved customer experience. But beyond that, the combination of Kathmandu and Oboz accelerates the journey of transformation of our group with two key objectives. The first one is to fuel growth and accelerate growth opportunities and the second one is to diversify our company as well as reduce the risk and volatility of our business. Diversifying our business means reducing gradually our reliance on Australasia and on Winter and opening new channels like wholesale. The transformational journey we are on will also help us deliver operating efficiencies by leveraging costs related to structures and systems. Continuing this journey of transformation is key to deliver value to shareholders to continue growing our business and to being able to diversify our company.

Moving onto slides 6, 7, 8, 9 and 10. I am just going to make a few comments around more details on the slides. Slide 6, we are customer centric in whatever we do. This half year, our loyalty club, Summit Club, reached a key milestone of two million members. Summit Club is core to Kathmandu and our priority is to increase our level of engagement with Summit Club members by delivering inspiring content particularly through social media and digital marketing.

Slide 7, Authentic and inspirational, that's how we want the Kathmandu brand and also the Oboz brand to be perceived by our customers because we believe that that's what we are. In this first half year, we dramatically increased our social media reach and content and the participation of our customers to sports and sustainability activities organised by Kathmandu.

Slide 8, Product distinctiveness. As a design led and product led business we design at Kathmandu original, sustainable, engineered and adaptive products with an increased emphasis on sustainability and recycled material. As we have started our international journey, the need for increased differentiation and product distinctiveness versus our competitors has become even more obvious.

Slide 9, Oboz, in the first half of FY19, Oboz delivered strong sales and profit growth. Oboz is the fastest growing major hike footwear brand at REI, North America's largest outdoor retailer. It is also the fastest growing footwear brand in Kathmandu sores. Last but not least, we have appointed Amy Beck as Oboz President, but she is also going to be the President of Kathmandu North America and she is starting in her job this week. Amy has a great track record for building up authentic brands in the US and for driving profitable growth.

Moving onto slide 10, International. Based on a low risk capital light wholesale model, we are continuing on our international journey. We are launching with a number of new customers particularly in North America where Autumn Winter 2019 will be our first season. Among others we are going to do a trial with REI starting in August 2019, leveraging the relationships and capabilities of Oboz. We will also do a trial with Blacks in the UK, which is one of the major outdoor retailers there. We have also been listed by Bachli, which is the leading outdoor retailer in Switzerland. At GO Outdoors in the UK, we improved our sell-through in Autumn Winter 2018, yet GO Outdoors are rationalising their business with a focus on key brands and we will only be available online from Autumn Winter 2019 with them.

I am now handing over to Reuben who is going to give a result overview.

Reuben Casey

Thank you Xavier, so moving on to slide 12, the Results Overview, as Xavier said earlier our sales growth for the half was 13.3% or $27.2m and of this $28.7m came from North America. Excluding North America and at constant exchange rate, we grew our business by 1.3% at the top line. When we look at EBIT on a normalised basis it grew by 10% half on half with North America contributing $3.7m to the group results. We had a one-off pretax gain of $1.1m and $0.8m tax adjusted which related to GST which we have excluded from the normalised reporting. There is a reconciliation to the statutory results in the appendix of the presentation.

Moving on to slide 14. In the first half of FY19 our sales grew by 2.7% in our largest market which is Australia and declined in New Zealand by 1.9%, and we saw some good growth coming through online channels. It continues to be our fastest growing channel for Kathmandu and over the past 12 months it now makes up 9.5% of total company sales. And we are really pleased to see wholesale sales through Oboz growing on a pro forma basis by 38% which is a fantastic result for that business.

Looking at Same Stores Sales on slide 15 now, we had a strong start to the first half. We had a really strong positive same store sales in the first quarter but of course this is a much smaller quarter than quarter two that includes Christmas, Boxing Day, and Black Friday promotions. For the full half we ended up recording same store sales growth in Australia of 1.2% and in New Zealand same store sales declined by 2.2%, which means in total for the group we were flat year on year for the first half which was a slight improvement from our trading update that we issued in early January.

When we look at slide 16 and gross margin we actually improved gross margin in both Australia and New Zealand over the half. The main reason behind this was with promotional discounting, which means we actually managed to achieve a higher average selling price. For the Australasian business we do have a long-term target which has been communicated a number of times which is 61%-63% and we did end up above this but we do know inflationary pressures are coming especially from foreign currency are present over the medium term. The Oboz gross margin was 39.3%.

Looking at cost of doing business on slide 17. The journey we are on as a business is evident in the improvement in operating costs as the percentage of sales. When we include the wholesale business in our overall group structure it does help us drive a lower percentage of sales overall and also it is important to note we did invest $600,000 or $0.6m in setting up Kathmandu North America. Overall Oboz contributed $7.3m to the operating costs in the first half.

We maintain a really strong focus on controlling our key areas of spend particularly including Kathmandu's bricks and mortar and online business, retail labour which as a percentage of sales was held flat in Australia and increased slightly in New Zealand. The other big area of spend is retail rents, and our property team have secured some rent reductions over the period and we are continuing to negotiate hard with landlords on stores where occupancy costs remain at unsustainable levels.

Moving onto the segment results. I will start with Australia on slide 21. Same store sales were lower than we would have liked but this was really offset by an improvement in gross margin. We opened three new stores during the period, closed two and refurbished five existing stores. Operating expenses did increase as a percentage of sales in Australia primarily due to rent, but with the gross margin improvement and the modest sales growth, meant we were able to maintain our operating EBIT margin in Australia.

When we look at New Zealand, this is a more mature market for us. Where we are always trying to strike the balance between sales growth, gross profit dollars and cash flow generation. Same store sales did decline in the half despite having a good first quarter. Gross margin improved but wasn't enough to offset the sales decline. We did control our operating expenses well but given the sales decline, expenses did increase as a percentage of sales.

Moving onto Oboz. So Oboz continued to grow strongly as we did expect and the EBITDA earn-out target that was USD $7.1m for the December 2018 calendar year was achieved. And in the first half year, on a pro-forma basis sales grew by 38% and EBIT margin improved to 16% of sales and as mentioned earlier we invested $0.6m into starting the Kathmandu North America startup costs.

Looking at the Rest of World on slide 23, we actually achieved a flat sales top line. Wholesale sales is approximately 40% of sales for this segment and we did manage to actually turn this part of business into a slight profit making which is one thing we are trying to do, drive a profitable sustainable business over the long term, so it was pleasing to see this segment turn a profit.

Now looking at our Balance Sheet on slide 25. You will see the increase in net debt which is really brought about by of the acquisition of Oboz last year. If you exclude this we are relatively flat with prior year. We are showing increased inventory levels as at 31 January which is a combination of obviously including Oboz, rectifying some stock shortages that we identified in core products, and the increases we need ahead of our international business, and there is some excess which has arisen from sales under-performance. But importantly the excesses in core product which we can manager over the next 6 months by reducing future buys, and clearance stock as at 31 January is flat with last year.

And when we look at Cash Flow on slide 26, operating cash flow was an outflow in the first half, which is a result of that inventory increase and the timing of some of supplier payments. We also had to pay tax. Following a strong finish to last year we had to pay some tax payments which was done in August, and some incentive payments to start the year, which weren't there the prior year.

Moving onto dividends on slide 27, we have set the dividend unchanged at NZ 4.0 cents per share. The dividend will not be imputed or franked for shareholders and has an eligible record date of 7 June 2019 and will be paid on 21 June 2019.

Moving onto Slide 28, foreign currency. As I commented on in gross margin and also prior result calls, currency headwinds will have an impact on first half FY20, with hedging rates around about 5% below the half we have just completed. I will hand back to Xavier to summarise.

Xavier Simonet
Thank you Reuben. I would like to conclude with a few closing remarks. First one is by fueling growth and diversifying our group, the Oboz acquisition has advanced our transformation from a leading Australian retailer to a multi-channel global brand-led business. It's going to take time, it's a long term strategy but we are seeing the first benefits of trying to diversify our group and looking at new growth opportunities.

Kathmandu itself accelerates its journey from being a retailer to being an authentic brand that designs original, sustainable, engineered and adaptive products. The retail environment is certainly challenging and we are focused as a company on sales and profit growth in our core Australian markets through customer engagement and by being an even more inspiring brand, offering distinctive products and also with a focus on continued cost control. In Kathmandu and Oboz, we have two great iconic brands with significant international growth potential. Thanks very much and we are now going to open the floor for questions, back to you Stephanie.

Moderator - Stephanie
Thank you if you would like to ask a question please press star one on your telephone keypad. If you are using a speaker phone please make sure you mute function is turned off to allow your signal to reach our equipment. Again, it is star one if you have a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

And we'll take our first question from Andrew Steele, with First NZ Capital.

Andrew Steele - First NZ Capital
Good morning Xavier and Reuben, good morning guys. The first one from me is actually just on the sales deceleration that you saw through the course of the first half. I guess now that you have come through the end of it and you had a number of peers reporting their results as well, how much of the deceleration would you say is that you weren't too aggressive on price or lacking sufficient promotional activities? And what have you learnt from optimising that balance in the second half?

Xavier Simonet
Christmas becomes a very big promotional period anyway. It's not really anymore about Christmas gifting it's really about getting the best deal and at Kathmandu what we are trying to do is find the right balance between protecting our gross margin as a brand, but also offering value to customers, So sure this time at Christmas we didn't find the right balance there, and we didn't drive sales as much as we expected.

Andrew Steele - First NZ Capital
Ok then I guess then looking at your gross margin guidance for the second half, where you expect pressure to flow through, how should we be thinking about it for the second half margin? Is it going to be on the retail side more aligned with your 61% to 63% range or is it still going to be above that range do you think?

Reuben Casey
I think it will be below last year, by how much it's below we are just working through some of the detail on that, but I think it will be at the top end if not slightly above that range.

Andrew Steele - First NZ Capital
Great thank you. Just on Oboz thinking about the second half, is there any I guess seasonality that we need to be aware of that is in that business looking one half into second half? And I guess on that as well there has been some investment into the North American business, how do we think about that investment into the second half?

Reuben Casey
Starting with Oboz they've got a slight minor skew towards their first half, they kind of run their business more on a calendar year more than our financial year so there is a slight skew to their first half as they are very strong in hike products which sells primarily more in the first half than second half. Looking at sell-through rates through REI they've had a very strong start to the year so we do expect another good half from Oboz. In terms of the investment in the North America business I think the level of investment will be very similar for the second half than it was in the first half. We start shipping some product to customers in first half of FY20 in North America, so there will be some support required to support those launches and support customers to drive sell through.

Andrew Steele - First NZ Capital
And just a couple of points of clarification on that when you say it's skewed in the first half, is that both a margin and sales volume skew? And the second point of clarification when you say a similar level of investment in the second half, is that incremental? so take first half investment, is that second half just flat or is it incremental in line with the first half?

Reuben Casey
Slightly above first half I think, and in terms of Oboz seasonality gross margin is slightly better in the first half just. There is no close out activity that happens in the first half so much, and the sales volume is slightly up as well.

Andrew Steele - First NZ Capital
Ok thank you and just a last one from me on inventory. Looking at the inventory build year on year, could you give some indication of how much that inventory relates to Oboz, how much relates to wholesaling and how much is the core business?

Reuben Casey
Sure, so Oboz year on year added about $12m, which you can see in our media release as well, international $6m, and the remainder is the core business.

Andrew Steele - First NZ Capital
That's great. That's all from me thanks guys.

Xavier Simonet
Thanks Andrew have a good day.

Moderator - Stephanie
Up next is Wassim Kisirwani from Deutsche Bank.

Wassim Kisirwani
Can I just ask about Oboz penetration within Kathmandu, you did sort of call it out but can you give more colour on how that is going and what the expectations are around that? In terms of the brand through the Kathmandu ANZ business?

Reuben Casey
Oboz has always been a part of our footwear offer in our stores and now that we own the brand we are trying to improve and increase the number of options allocated to Oboz, and it's our fastest growing footwear brand in our business. It's not our #1 footwear brand. Our #1 footwear brand is obviously Kathmandu. But Oboz is our fastest growing brand and is in all of our stores.

Xavier Simonet
Obviously Wassim now that we own Oboz we are putting a stronger focus on Oboz as one of our brands, and in terms of visual merchandising elevation, in terms of number of options, in terms of training and focus with the teams. It's a good brand, great product, very authentic so the message goes through very well.

Wassim Kisirwani
Ok great and in terms of the Kathmandu REI trial over this second half and going into next year can you remind us how extensive that will be, initially across range and what the expectations are around that trial?

Xavier Simonet
Sure. First we are very happy to be able to leverage the Oboz relationship with REI and their connections to start launching Kathmandu at REI. It's a limited trial for the second half so for Autumn Winter in North America. Its 2 stores, one is a physical store which is the flagship store in Seattle and the second one is the online channel which is a key channel at REI. So a bricks and mortar store and the online channel. It's limited to a few products that are products where there is a lot of distinctiveness and products that are travel products and these products are equipment products. Does that answer your question?

Wassim Kisirwani
Yes that's great. And just finally from me on the gross margin and the expectation around the second half are you able to flesh that out a bit more and the expectation there? Is it just to get that balance to drive sales or is it a broader view on the market going into Easter and potentially beyond that?

Reuben Casey
Probably all of those things to be fair Wassim. Mindful of higher levels of inventory than we would like. We need to make sure, as much as possible, we optimise our sell-through without overbalancing on particularly gross margin, so all those things you mentioned plus conscious of the inventory level that we are carrying.

Moderator - Stephanie
Up next is Jeremy Simpson from Forsyth Barr.

Jeremy Simpson – Forsyth Barr
Good morning, whats your expectation around the Australian new store numbers over the next couple of years?

Reuben Casey
With our store network we are trying to improve our store network all the time so whether it's through relocations or refurbishments or new stores as opportunities arise. We've got one new store due to open in Sunshine Plaza on the Sunshine Coast and we don't have anything else directly lined up in the pipeline. We are exploring other options. We opened a store in the Melbourne Airport during the half which has been very successful for us, so we looking at other opportunities around that but really as opportunities arise that makes sense from an incremental profitably stand point.

Jeremy Simpson – Forsyth Barr
In terms of the operating cash flow based on what you mentioned about it, mainly core stock and international expansion and timing differences you are pretty confident that the negative operating cash flow will turn around for the full year?

Reuben Casey
Yes we are, yes.

Jeremy Simpson – Forsyth Barr
In the presentation you mentioned as part of the transformation program and strategies to improve operating efficiencies what are the key areas of focus there?

Xavier Simonet
Just an example of what it currently is, we are leveraging the resources of Oboz to launch North America, so we've added a few costs like we've got a Vice President of North America for Kathmandu focused on driving sales for Kathmandu, but all the rest is basically leveraging the existing resources of Oboz.

Jeremy Simpson – Forsyth Barr
And just lastly on the move by GO Outdoors to go online channel, was that disappointing or is that just the way things are moving with more of these retailers?

Xavier Simonet
It is disappointing because we wanted to continue being available in their stores as well, but this is the beauty of the wholesale business. On the one hand you don't have the costs and the risks, but on the other hand of course it's not up to you to decide what range and assortment you are going to have in their stores. But I think the bigger picture is that the UK is in a very specific unique situation Brexit and consolidation of brands, and really a difficult retail business with change happening at GO Outdoors and in the context of their bigger business which is JD Sports as well. So I think we need to look at the bigger picture. On the other hand, we listed with new customers in Europe and North America and we are going to continue doing the work we are doing on brand distinctiveness and product differentiation.

Jeremy Simpson – Forsyth Barr
Thanks guys that's all from me.

Xavier Simonet
Thank you very much.

Moderator - Stephanie
Up next is Chenny Wang from Morgan Stanley.

Chenny Wang - Morgan Stanley
Morning guys, just a couple of questions from me. So just on the cash flow, I think you called out the inventory build as well as your expectations for the full year. I just wanted to get, I guess, the additional clarity on how we should be thinking about this going forward? So I guess previously cash conversion has been strong at the halves. Do you know going forward will that still be the case or will it be more the future second halves from this point onwards?

Reuben Casey
It really depends on timing. I think we should look at it on a full year view versus a half and I suppose this point in time it's a half year and obviously we are always trying to generate good cash flow conversion. It's really a timing difference along with the inventory build and we had a really strong finish to the year last year which meant that things like tax and incentive payments were higher than we had anticipated, and year on year that's creates a difference. But actually underlying, we're still driving a positive cash flow for the full year.

Chenny Wang - Morgan Stanley
And just in terms of the online sales do you have a target I guess as a percentage of your total sales?

Reuben Casey
Over the years we've had a target of 10%, but will go higher than that over time. We take a channel agnostic approach. We let the customers decide how they want to shop with us whether that be online or a combination of the two, and we continue to invest in our online channel to make it is as easy as possible for our customers to interact with us, and we continue to invest in our store network as well to make sure we provide a great customer experience in-store. So really a nominal target of online sales is a little bit arbitrary. It's really just how the customers want to shop with us as the natural flow of retail moves from bricks and mortar to online.

Chenny Wang - Morgan Stanley
Last one from me just in terms of the hedging rates. Do you have sense of impact on gross margin at this point?

Reuben Casey
Unmitigated, if you take the first half for example, and I'm sure you can do the math's as well. If you take the first half, if we did nothing with pricing, nothing with product, nothing with sourcing, it would be around about a 2% impact on gross margin for the first half. It's a 5% increase on cost of goods.

Xavier Simonet
Probably going to take a couple more questions.

Moderator - Stephanie
Up next is Tim Lawson from Macquarie.

Tim Lawson – Macquarie
Hi guy's thanks for taking my questions. Good morning. Just interested in the history of your trading when Easter has been relatively closely aligned to Anzac day and then falls together with school holidays?

Reuben Casey
Yeah Easter is always a difficult period to predict how people are going to shop. Easter is late and it can be more beneficial for colder climate product, but with the school holidays timing as well, it can complicate things as well, so it does vary from year to year.

Tim Lawson – Macquarie
The last time it happened, is it a fair read for what might happen this time? Is your inventory build expecting an abnormally good period through that time because I imagine you would get inventory in for that timing of that Easter and Anzac day now?

Reuben Casey
Yeah we have inventory in for that time for sure, but also got inventory in for launching for Winter as well so it's not just about Easter. The last time it happened it can be a good indication, and sometimes it cannot be a good indication with a completely different outcome, so I am not going to go into detail about how we traded last time Easter fell on this date, because it was quite a long time ago.

Moderator - Stephanie
Up next is Andrew Steele First NZ Capital.

Andrew Steele – First NZ Capital
Just a couple more follow up questions. Just wondering if you could provide some guidance on your expectations on full year Capex and where you expect Net Debt to be at the end of the year?

Reuben Casey
Full year Capex we expect around $18m, and Net Debt depends on how things trade obviously. We do expect an increase year on year in Net Debt from prior year.

Andrew Steele – First NZ Capital
Just one last one from me, I was wondering if you could comment on how your trading has been second half to date vs prior year?

Reuben Casey
We are not commenting on that as trading is always up and down, and such a short period we think it's a little bit meaningless, February being the shortest month of the whole year, it's a kind of a meaningless number.

Andrew Steele – First NZ Capital
Cool, great, thank you very much guys.

Xavier Simonet
Thank you.

Moderator - Stephanie
No further questions in the queue.

Xavier Simonet
Thank you all. Have a great day.

ENDS

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