Conference Transcription

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Kathmandu Limited

Kathmandu Half Year Result Analyst Call

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Start of Transcript

Operator: Good day, everyone and welcome to the Kathmandu Half Year Result Analyst Conference Call. This conference is being recorded. At this time for opening remarks I would like to turn the conference over to your moderator today, Mr Xavier Simonet. Please go ahead, sir.

Xavier Simonet: Thank you, Keith. Good morning, ladies and gentlemen. Welcome to the Kathmandu first half year results presentation. With me today on the call is Reuben Casey, our Chief Financial Officer. We are going to be discussing our results for the six months that ended on 31 January 2016. We'll be talking to the results and half year presentation that we filed this morning on the ASX, NZX and our corporate website, and the reporting currency will be the New Zealand dollar.

The presentation will be about 20 minutes and then we will have time for questions with the total allocated time of 35 minutes. So let's get started with the results overview. Please turn to page 4 of the slide presentation. We are pleased to report a strong performance in the first half of FY16 with top-line sales growth, gross margin improvement and also cost efficiencies improvements.

In terms of sales, our total sales grew by 9.3% which is the combination of same-store sales growth and the sales generated by the stores we open. Our same-store sales growth in Australasia was up 3.8% which is a positive number, and more than that, we experienced a strong improvement in our gross margin by 350 basis points, and getting at the same time sales growth and serious improvement in our gross margin is something that we tried to achieve and that is quite pleasing. It demonstrates our capacity to sell more products at a lower level of commercial discount and highlights the strength of our brand and of our products.

Last but not least, operating expenses decreased 380 basis points, which is a combination of the cost reduction program we went through and the efficiencies we drove in the first half of FY16. So all in all, we are reporting an EBITDA of $21.9 million, up $15 million on last year and a net profit after tax of $9.4 million, up $11 million on last year.

Now, if you move to page 7, sales. Total sales increased 9.3% across Australia and New Zealand with an increase of 8.9% in Australia and 4.6% in New Zealand. I'd like to point out the strong performance of our online business with a sales growth of 23.5% and online accounts for 6.6% of our total sales.

If you move to page 8, same-store sales growth. We are really pleased to have had a strong same-store sales growth in the first half, particularly as we were reducing the levels of discounts and increasing the gross margin. Our total same-store sales growth was 3.8% for Australasia with 4.3% in Australia and 3.1% in New Zealand. This is despite one fewer week of promotional activity versus last year and also in the first half of FY15 we were cycling high clearance activity that we had in the first quarter of last year. So it's really pleasing to see some same-store sales growth. I believe particularly for Australia it's reversing a trend that has been going on for some time.

Reuben?

Reuben Casey: Thank you, Xavier. Just moving on to gross margin, we had a strong gross margin improvement year-on-year, which continued the improvement that we saw in winter. In winter you may recall we improved our gross margin by 354 basis points and then in the first half we had a 350 basis point improvement. We got this through an increase in our full-price sell-through so less clearance sales but also an overall lift in our average selling price of the current products as well. It was particularly strong in New Zealand as we took action to assist with us offsetting the impact of currency with an eye to the future.

When we look at operating expenses on slide 10, we took a careful consideration of our operating expenses over the first half. We did signal at the full year that we were targeting $7 million of cost savings. We have recorded approximately $3 million of that in the first half. Rent continues to increase; we have experienced between 3% and 4% like-for-like rent increases across Australia and New Zealand, and we have opened the two flagship stores, one in Melbourne CBD and one in Adelaide Rundle Mall, which has contributed to our rent increase.

When you look at other operating costs, we have reduced, both as a percentage of sales and in terms of dollars spent, and the two main areas where that has happened is advertising where we've reduced our spend on promotional activity, and distribution where we're seeing efficiencies come through from our investment in core systems platforms. The other thing to note on operating expenses is that the first half does include $1 million of non-recurring expenses relating to - half-relating to the UK store exit and half relating to our support office restructuring that we carried out in August/September last year.

If we look at the country-by-country results, starting on slide 13 with Australia, as Xavier mentioned, we saw some good like-for-like sales growth but also overall top-line sales growth with the impact of stores we opened in the last financial year and three new stores in the first half of this year as well. Also, we saw margin improvement but when you look at the EBITDA margin of Australia it does cost a lot more to operate in Australia than New Zealand, and that's primarily rent and store labour costs. So improvement in profitability in Australia is a key focus for us going forward.

When you look at New Zealand on slide 14, again strong gross margin improvement and sales growth was slightly stronger than we expected, particularly considering we were cycling a very strong clearance activity in the first half of FY15. We did reduce our advertising spend more in New Zealand than in Australia, so that has also contributed to the improvement in the EBITDA margin.

If we move on to the UK on slide 15, Covent Garden was closed during the first half and Bristol and Spitalfields stores will close in this quarter. That leaves us with one remaining store, which is Kensington High Street, and that's remaining open while we market the site.

Okay, if we move on to cash flow and balance sheet, so cash flow on slide 17. We had a strong operating cash flow result for the first half, generating $24 million of operating cash flow, which is a $30 million improvement on the first half of last year. CapEx, we have spent more than last year overall. IT CapEX has reduced as last year we were finishing off our Microsoft AX implementation. A major area of spend in the first half on infrastructure-related CapEx was our new Australian distribution centre, which will go live in August of this year.

If we move on to the balance sheet on slide 18, net debt has reduced by circa $17 million from this time last year and is actually in line with our year-end position. Normally we see more of a peak at this time of the year, so we're very pleased with how that has unfolded. Inventory dollars are slightly higher on a per-store basis, 1.2% at constant exchange rates, but when you look at the underlying number of units on hand it's around 9% below last year and the US dollar appreciation is driving the dollar increase here. Also, in terms of clearance stock we've got 35% less than last year.

Moving on to the dividend on slide 19. We've declared an interim dividend of $0.03 per share. This will be fully imputed for New Zealand shareholders but will be unfranked for Australian shareholders. The payment date for that dividend is 17 June 2016 and we do expect to be able to fully frank the final dividend. I'll hand back to Xavier now to update us on growth strategies.

Xavier Simonet: Thank you, Reuben. Where do we go from there? Let me give you an update on our growth strategies. The first thing I want to say is that the customer is at the centre of whatever we do. We've got a very customer-centric approach in terms of understanding the customer, engaging with the customers and driving transactions and loyalty with our customers. So what's our growth strategies? We've got two big buckets here; one is about Australasia, it's about growing same-store sales, about driving sales and gross margin densities in our stores and particularly with a focus on our existing stores. It's about driving profitable growth and leveraging our key assets.

If I look at the different activities we are running, the first activity I'd like to mention is the work we have been doing on pricing and promotion. We have worked with an external party and we have defined a strategy to improve our pricing and promotional model. The strategy is all about giving great value to our customers, which is one of our key pillars. Our brand is about offering great products to our customers at great value.

The work we have done is around giving more clarity to our promotions for our customers, improving our pricing, an elasticity approach, working on how we can drive footfall to the stores, refining our promotional calendar and also our Summit Club offer. After the review we did over the last few months we are now starting to execute those new strategies with a very customer-centric approach and we'll see some results in the next coming months.

The second activity we are driving is focused on store optimisation. It's all about driving same-store sales growth, it's about driving gross margin densities in our existing stores, and it's about sales and costs, it's about optimising sell-through, improved space allocation, having the right products at the right time during the year, but it's also about optimising costs such as store labour and we're investing in some assets in that area.

Last but not least on that page, of course we're not just a retailer selling products in our stores. Kathmandu is much more than that; we are a brand and we have been working hard on growing our brand equity and improving social media interaction with our customers. It's really about being inspirational, it's all about offering distinctive products with distinctive marketing and it's about engaging with our customers, focusing on our

Summit Club members, which account for a big part of our business. We've got 1.5 million Summit Club members across Australia and New Zealand.

We've been working on an improvement of our brand equity, and I'll give you an example. We drove an activity in the last few months called If You Could Take Only One Trip or One Jacket, and had a few movies that we posted on social media, and we've had three million viewers across all social media platforms to watch these videos and then an opportunity to transact with us. We're also investing in systems such as the marketing cloud, an upgrade on CRM and a responsive website to engage more with our customers and we're going to see a better outcome with the investments we have made and we're going to be able to leverage these investments to drive engagement with our customers.

The last example I'd like to give is we have seen on our website an increased number of visitors and customers coming from the youngest segment, 18 to 24, 18 to 30-year-old, which is typically a segment we're targeting, particularly in Australia and New Zealand. It's really pleasing to see that the brand strategy we've initiated to be more inspirational, more engaging and strengthening our distinctiveness is starting to give good results. We've got these two big pillars; one is about value, offering great products at great value to our customers; and the second pillar is about being an inspirational brand.

If you move to page 22, a few additional growth strategies to drive growth in Australasia. We still plan to open more stores. We're not going to continue opening 15 stores a year and we are fully focused on driving same-store sales growth in existing stores as well as driving gross profit densities with a strong focus on our existing assets, but as opportunities arise we will still continue opening stores.

We're also focusing on an omni-channel approach, which is yes, about the investment we've made in systems but also it's very much about driving cultural change and being able, again with a very customer-centric view, to give the customers the same experience whether they go to our stores or to our online shop and give them the opportunity to engage with us and transact with us seven days a week, 24 hours a day.

Last but not least, we will continue to drive cost efficiencies, and this is a very strong focus for the Company and for myself and Reuben. There are a few things there; one is about strengthening the partnerships with our key suppliers in terms of getting better costs and better prices, particularly in the context of strengthening US dollar, but also it's about potentially moving some of our production to new countries where we can manufacture at a cheaper price.

It is also driving efficiencies as far as our marketing and advertising spend is concerned, as far as our distribution costs are concerned and it's all in all about optimising the resources we have across the business with clear metrics and a good view on our return on investment.

So the first bucket is how we're going to drive growth in Australasia and I've just talked about it. The second bucket for us is the work we're starting to do on international. I strongly believe that Kathmandu can be a strong international brand based on the products we sell and the great technology we bring to the market and the solutions we offer our customers, but also based on the strong brand equity, our roots and our ability to inspire customers not just in Australasia but in more countries.

So the work we are doing is obviously based on a capital light approach with a blended model for international expansion that will include wholesale, online and franchise partnerships. We have recruited a dedicated resource who works at Kathmandu and has a strong international wholesale experience. We are currently working on identifying the gaps between our existing vertical retail model and the needs of the wholesale business, as well as the ongoing analysis in terms of the metrics between countries, channels, margins and costs. Obviously it's a very customer-centric approach and we are taking into account customer views on the category. So that's for our international expansion plan and that's all I want to share today.

As far as the UK is concerned, we are still in the process of closing physical stores, but we're not pulling out of the UK and we're going to continue supporting our online shops as well as the partnerships we have with wholesale customers in the UK.

Moving to page 25, FY16 outlook, I would like to stress again our customer-focused approach. We are customer centric in whatever we do and that is a big evolution for us as a company. We are putting a high priority on products. We have recently reorganised the team to give a stronger focus on products as well as on trading, but really on products because it's our distinctiveness, it's our ability to deliver great distinctive sustainable quality products that's going to drive growth before anything else.

We are also putting an increased focus on market penetration in Australia. There is a big opportunity to grow our market share in Australia, particularly with the younger customer that we are targeting, but also by strengthening our market share with our core customer who loves getting value from us; international will become, step by step, a stronger focus as we drive the execution of the strategy. All of this is happening in the context of an increased competition, particularly from value driven retailers and brands and we know our gross margin will be under pressure because of strengthening US dollar and that's why we will continue to put a strong focus on cost control and delivering efficiencies. We remain committed to our FY16 NPAT target of $30.2 million.

Thank you. Please, if there are questions, we are happy to take them now.

Operator: Thank you. If you would like to ask a question at this time, please press star/one on your telephone keypad. Please ensure the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find your question has already been answered, you may remove yourself from the queue by pressing star/two. Again, please press star/one if you would like to ask a question. We have our first question from Chelsea Leadbetter from Forsyth Barr. Please go ahead.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Thanks moderator and morning guys. If I can just ask a couple of questions, firstly on the guidance that you're obviously remaining committed to the forecast that you already have in the market, just wanting to understand a little bit more detail on what you're expecting in the key markets with respect to sales versus margins for that second half.

Reuben Casey: Okay, in terms of gross margin, obviously we finished our first half near the top of our 61% to 63% range and we expect the second half probably to be closer to the bottom of that range. I think sales we still expect will grow by, at like-for-like of 5% and we don't see any reason to change that at this stage.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay thank you and just on that gross margin size of business, your 61% to 63% range, you've done a lot of work now in pricing architecture and everything like that. I mean are you still confident that's a sustainable level for the business in the longer term?

Reuben Casey: Yes, definitely. We do expect this half to see the impact of the US dollar appreciation starting to come through more strongly. It takes a while to work through weighted average cost of inventory and as hedging matures and new hedging comes on, less favourable rates, we expect to see the impacts coming through more strongly. First half of FY17 we would expect to see the results of supply negotiations and moving some manufacturing locations away from China as well.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay great and just last question around store rollout for the second half, are there any key new stores planned?

Reuben Casey: We've got a couple of new stores; one is Gold Coast Harbour Town and we've got a couple of relocations where malls have been redeveloped like Warringah and Pacific Fair.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay, so similar CapEx levels to what we've seen in the first half?

Reuben Casey: Yes.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Great, thank you very much.

Xavier Simonet: Thank you Chelsea.

Operator: We will now take our next question from John Stavliotis from Morgan Stanley.

John Stavliotis: (Morgan Stanley, Analyst) Morning guys.

Xavier Simonet: Morning John.

John Stavliotis: (Morgan Stanley, Analyst) I was just following on with that gross margin, what's your effective hedged rate for the second half compared to 2H 2015?

Reuben Casey: Second half is about 761 in Australia and 701 in New Zealand.

John Stavliotis: (Morgan Stanley, Analyst) Sorry, what was that in Australia

Reuben Casey: 761.

John Stavliotis: (Morgan Stanley, Analyst) [761], okay and what was it in the 2015?

Reuben Casey: For 2015 did you say?

John Stavliotis: (Morgan Stanley, Analyst) Yes.

Reuben Casey: 882.

John Stavliotis: (Morgan Stanley, Analyst) Okay. New DC in Australia, are there any costs associated with that in the second half or in early FY17?

Reuben Casey: There will be some increased costs associated with that in terms of rent; it's a bigger facility. We expect some CapEx in the second half, that's probably only $0.5 million extra and we are putting automation into that facility, so we expect to offset the increased costs with labour savings over time.

John Stavliotis: (Morgan Stanley, Analyst) Okay and that's all included in the guidance I guess, the extra costs to set up the DC?

Reuben Casey: Yes, that's right. I mean the initial set up is going to be CapEx. That will be July to August.

John Stavliotis: (Morgan Stanley, Analyst) In terms of dealing with the currency, so you sort of flagged some of your longer term initiatives in terms of supply negotiations in new countries, what about price increases? Have you put anything through or are you planning to put anything through in the next six months?

Reuben Casey: Well I think if you look at our New Zealand gross margins, you can see we actually have lifted our average selling price, but it's not so much a price increase for us, it's engineering the discounts slightly less favourably so we end up with a result and a better average selling price across the half. We also did that at winter, so it's kind of an evolutionary process; I guess we're slightly ahead of where we need to be in terms of pricing and promotion. Does that make sense?

John Stavliotis: (Morgan Stanley, Analyst) Yes, makes sense. Just on inventory, you said 9% less stock but the value is up on constant currency basis 1.5%, so that just means you're holding higher value products and I guess what's the reason for that?

Reuben Casey: There's a little bit of that, but it's actually the impact of the US dollar coming through, so as the US dollar appreciates, of course the value of inventory is going to go up as well.

John Stavliotis: (Morgan Stanley, Analyst) Oh so it says in the preso up 1.5% on a constant currency basis.

Reuben Casey: That's constant exchange rates in terms of when you convert Australian dollars to New Zealand dollars.

John Stavliotis: (Morgan Stanley, Analyst) Okay, so there's US dollar still flowing through.

Reuben Casey: Yes.

John Stavliotis: (Morgan Stanley, Analyst) Just last one, just trading initial weeks and how you've seen the market and how that gives you confidence for the full year guidance.

Reuben Casey: Yes, I mean same store sales have been positive, but it would be a bit misleading to actually talk to specific numbers because we have one less promotional week in the first half of that that occurred in the second half and also Easter sale has just kicked off and it's a week earlier than last year, so there's a mismatch of promotional weeks, but misleading to talk about specifics.

John Stavliotis: (Morgan Stanley, Analyst) Okay, thanks.

Xavier Simonet: Thanks John.

Operator: Just a reminder, if you would like to ask a question, please press star/one on your telephone keypad. We now have our next question from Michael Peet from CBA. Please go ahead.

Xavier Simonet: Morning Michael.

Michael Peet: (CBA, Analyst) Morning Xavier and Reuben. Just a question on the ad spend, I mean how sustainable do you see that being particularly in New Zealand given the drop and what have you done in terms of getting better bang for your buck on ad spend?

Xavier Simonet: We've done two things. First one is yes, to reduce the ad spend, but it was fair to reduce the advertising spend because we were spending much more than what we should have done, versus peers, versus other brands, versus other retailers. As we open more stores, we spend more in terms of ads to support promotions and we realised through some analysis we did that having so much of an advertising spin was not needed.

So the found that if we reduced the advertising spend is actually reasonable; we're not underspending, we're not underinvesting, we're actually investing at a level that is more sustainable than in the past. Second thing, the advertising spend that we have kept, we've optimised it. We were doing lots of things, investing in lots of media channels that were not productive and for which we were not getting any return on investment. So we have done the data analysis on what media channel we should use to be able to drive promotions or to drive certain activities or to drive the brand equity and we're focusing on these channels.

Also, obviously we are investing more in social media and in the digital space, which is a key asset for us. Does that answer your question?

Michael Peet: (CBA, Analyst) Yes, thank you. Also, just on the same store sales growth, I mean it appears obviously you probably got more out of price given you were selling more at a lower discount, but can you give us a breakdown between average price and footfall maybe in terms of what's been happening in stores?

Reuben Casey: We only have footfall count in a few of our stores and actually only went live in November last year, so I can't really comment on footfall year-on-year, but I can tell you that we sold less units overall, around about 3% less units in New Zealand and Australia. Because if you remember last year we were driving a lot of clearance, so we sold a lot of products last year at lower prices and lower margins. So a part of the improvement is less clearance, of course, but part of it is actually just on current products, just an improvement in our average selling price that we've realised.

Michael Peet: (CBA, Analyst) Yes, okay good. Just the countries you're looking at to possibly move away from China, where are you looking at specifically to possibly move to?

Reuben Casey: Well we have moved some manufacturing already to Indonesia. There's a supplier there who currently manufacture for other outdoor brands and the other possibility, the other main one, would be Vietnam.

Michael Peet: (CBA, Analyst) Alright, and in terms of quality, how easy is it or difficult is it to maintain or monitor quality in those countries versus China?

Reuben Casey: It's actually no different. I mean they're already - if you look at us compared to other global outdoor brands, most other outdoor brands have around about, say, 50% to 60% of manufacturing in China, where we're more 90%. So they're already making good quality products for other brands and actually we think the Indonesia supplier that we've moved to is actually better quality than we have previously had; we've got no issues on that front.

Michael Peet: (CBA, Analyst) Great, thanks guys.

Reuben Casey: Thank you.

Xavier Simonet: Thank you Michael.

Operator: As a reminder, if you would like to ask a question, please press star/one on your telephone keypad, that's star/one for a question. We have no further questions at this time sir.

Xavier Simonet: Thank you Keith.

Reuben Casey: Thank you everybody.

Xavier Simonet: Thank you everybody, have a good day.

Operator: That will conclude today's conference call. Thank you ladies and gentlemen, you may now disconnect.

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