

KATHMANDU HOLDINGS LIMITED

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**FY19 FULL YEAR RESULTS INVESTOR CALL TRANSCRIPTION**

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**Operator:** Thank you for standing by and welcome to the Kathmandu Holdings Limited FY19 Results Overview Investor call. All participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. If you wish to ask a question, you will need to press the star key followed by the number 1 on your telephone keypad. I would now like to hand the conference over to Mr Xavier Simonet, Managing Director and CEO. Please go ahead.

**Xavier Simonet:** Thank you, Ashleigh. Good morning and welcome to the FY19 full 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 Chief Operating Officer, and Chris Kinraid, our Chief Financial Officer.

We will be talking to the presentation filed on the NZX and ASX this morning. Most of the numbers are in our reporting currency, the New Zealand dollar, unless when it is specifically mentioned that they are in Australian dollars, US dollars or British pounds.

If we go to slide 3, financial highlights, over the past 12 months our team has delivered another record sales and profit result. We delivered record profits with EBIT up 12.7% to \$84 million and net profit after tax up roughly 13.6% to \$58 million. Sales increased 9.7% to \$545 million. The key drivers of this growth were a positive contribution from the Australian business, rapid sales and profit growth from Oboz in North America and increased penetration of the online channel in Australasia.

We were particularly pleased to grow sales in the second half of FY19 even though we were cycling stronger Australian sales growth in our key winter period last year. Same store sales in Australia were up 2.7%.

Oboz, the American outdoor footwear brand we acquired last year, was the key growth driver with sales up 30% and EBIT up nearly 39%. Oboz has clearly accelerated our transformation from being a leading Australasian retailer to becoming step by step a global brand-led multichannel business and it has enabled us to diversify our channels around product and geography.

Last, with increased penetration, online accounts for 10.1% of direct-to-consumer sales. Online sales have nearly reached a threshold of \$50 million.

I also want to highlight that we generated strong operating cash flow in the second half of the year and that our net debt level went significantly down from \$31 million in FY18 to \$19 million in FY19. A final dividend of \$0.12 NZ cents per share has been declared, taking the full year dividend to \$0.16 NZ cents per share, another record for Kathmandu.

Moving on to slide 4, operational highlights. I would like to call out a few key items on this slide. First of all - and I will start from the bottom of the page - sustainability is in the DNA of Kathmandu and we are very proud to have become a certified B Corp and pleased to have scored an A in the ethical fashion report two years running. It's a key focus for our Company.

Our loyalty program, Summit Club, which is an immensely powerful tool, continues to grow and has reached \$2.2 million active members, up 12% on last year. We continue to invest heavily to upgrade our store network and provide the best customer experience. In FY19 we spent around \$10 million in store capex.

In FY19 we also launched Kathmandu in North America through 45 doors and five online sites with a focus on building up an authentic outdoor distribution network and authenticating our brand.

Chris is going to talk about the financials.

**Chris Kinraid:** Thank you, Xavier. Just moving on to the P&L slide 6. As mentioned earlier, FY19 was a record year in terms of revenue and earnings, with sales growth accelerating with the inclusion of Oboz. Also pleasingly, costs have been well-controlled as our business has expanded and operating leverage has benefited from a diversification into the wholesale channel. Net profit grew by 13.6%; just also to caveat that there was a one-off benefit of GST tax refund of \$800,000 after-tax impact.

Moving to slide 7, the balance sheet, where we are very pleased to end the year with lower net debt, nearer to our FY17 levels, following the acquisition of Oboz in FY18. This is obviously a heavy improvement on our debt to equity ratios. Also, with the benefit of a wholesale channel, fixed charge cover strengthened to 2.3 times cover.

Moving to operating cash flow, that was a strong result for the year at \$61.7 million. I just want to highlight the strong cash generation we achieved in the second half of \$77.9 million, which led to a \$14 million reduction in debt.

Our working capital movements primarily related to inventory, which was impacted by foreign exchange, phasing of new product launches, and where we sit now with manageable clearance levels, especially following a strong August sell-through where our units are level year-on-year.

On to capex. As Xavier, previous mentioned, we continued to invest in optimising our store network with \$10.3 million capex on new stores, refurbishments and relocations, including a large portion of cost for the two new flagship stores which opened in August in New Zealand.

Growth-enabling investments include the finalisation of our online platform upgrade and a new warehouse management system going live this year supporting our digital strategy. FY20 investment is planned to be around \$21 million as we continue to invest in our systems capability to support our growth and our omni channel strategic priority as well as our ongoing store refurbishment program.

On to our dividend. The year-end dividend has been declared at \$0.12 per share, bringing the full year dividend to a record payout of NZ \$0.16 per share. This will be fully imputed for New Zealand shareholders and fully franked for Australian shareholders with an eligible record date of 30 September.

On to sales. As Xavier mentioned previously, in FY19 total Company sales grew 9.7% to \$545.6 million, reflecting our diversification strategy. Retail stores channel grew at 1.3% across the network and online sales grew at 9.2% to now reflect 10.1% of direct-to-consumer sales. Pleasingly, our North America market grew 28.2% on a pro forma basis reflecting Oboz's strong growth path.

On to same-store sales, on slide 13. Australia continued to grow well at 2.7%. That is pleasing following the strong growth we achieved last year, especially in our winter period promotion in FY18, and New Zealand same-stores as previously flagged reduced by 3.9%.

On to slide 14, gross margin. Reported margin was 16.9%; however, this reflects the weighting of an increased wholesale contribution from North America which achieved a margin of 40.8%. Kathmandu-only margin was at 63.6% and that's maintained above our long-term target of 61% to 63%. We continue to manage our margin through designing products to achieve our gross margin requirements and through achieving sourcing efficiencies. However, inflationary pressures still remain with raw materials and labour and there are currency pressures over the near term.

Highlighting that, I guess, moving on to foreign currency hedging slide. As previously communicated in our half year release, FY20 gross margins will be impacted from lower hedging rates due to the appreciation of

the US dollar which will also affect a lot of the retail sector. USD hedging rates for FY20 are approximately 6% below FY19 and comparable to our FY17 levels.

Finally, on to our cost of doing business. We have continued to manage our cost structure well with costs down to 45.7% of sales, a strong continuing trend over the past five years for this business. Rental costs grew less than sales at 2.7% with improved outcomes we've experienced from our lease negotiations. Other operating expenses benefited from our careful management of our labour costs.

Additional or incremental operating expenses came from the North American business of \$11.8 million, which also included a \$1.3 million investment in our North American set-up for Kathmandu.

I will now pass on to Reuben.

**Reuben Casey:** Thanks, Chris. Just to move on to Australia. As mentioned earlier, we were cycling a really strong year in Australia last year, so we're really happy to get a 4.5% increase in our top line there, 2.7% on a like-for-like basis and we really are increasing our market penetration in Australia. As we've talked about in the past, this is our short-to-medium term growth opportunity and we can see that coming through with online growing strongly, particularly in the second half, and also a 14% increase in active Summit Club members in Australia, which is really underpinning that growth. We strongly believe that we need to provide a great customer experience across all channels, and part of that is our retail store network, so we continued to optimise that channel with four new stores opened, we've closed three stores and refurbished eight stores, and we'll continue to do that in the future.

In New Zealand it was a tough year. It's a more mature market for us and a more price-sensitive market as well. We did continue to grow strongly in our online channel but that wasn't matched by sales in our retail stores. As acknowledged by other retailers, it's been a late start to winter in New Zealand, which had an impact certainly on our June period, but we saw sales come back strongly later in July and definitely through August that has continued as well.

One really good thing about our result was the team worked really hard to maintain our operating expenses. We held our opex flat as a percentage of sales despite the sales decline. Also, we are still focusing on customer experience, and conversion remain key metrics for our team, and we will continue to invest in the New Zealand market. We have opened two flagship stores in Christchurch CBD and Newmarket Auckland in the last month and we will continue to try to elevate the brand experience in New Zealand.

Moving on to online. This is a critical channel for us and it remains our fastest-growing channel. Online sales grew strongly once we'd completed our re-platforming which we finalised in February of this year. We've seen increased traffic and also increased conversion, which really is supporting our online business, lifting to 10% of direct-to-consumer sales. We'll keep improving and investing in our online experience as we go forward.

Moving on to North America. As Xavier mentioned earlier, we are really happy with how we managed to successfully integrate Oboz into the Group and all the while, they still managed to deliver a 30% revenue growth on a pro forma basis, so a like-for-like basis. Oboz has got a really strong core business and they updated one of their key franchises, Sawtooth, during the year, which was a successful launch across REI and also across independents. Also, in North America we have set up the Kathmandu business, so we hired a VP Sales and Marketing, laid the foundation for the year to come, and we've got orders for 45 doors which started shipping in August this year, and then we'll build on this foundation for the year ahead. I'll pass back to Xavier.

**Xavier Simonet:** Thanks, Reuben. Moving on to slide 22, strategy and outlook. Strategically, we are on a journey of transformation. Transformation from being a leading Australasian retailer to becoming, step by step, a brand-led global multi-channel business. One key aspect of our transformation journey is our commitment to sustainability. Reuben

**Reuben Casey:** Thank you. Sustainability, we view as a thread that runs through all our business and it's just so integral to our culture. We had quite a lot of excited team members when we recently announced our B Corp certification. It's something we've been working on for some time and it's a real commitment to our

team and our customers in terms of our future of ethical practices and really is a conduit to best practice sharing as we move forward.

We've also reset our sustainability goals in line with the UN 2025 framework. I won't go through all of them but one of the areas which the team is really excited about is things like circular economy principals. It's a really big challenge for brands and retailers to extend the life of their products through either reuse or recycling.

No one is really nailing this at the moment so we're really excited by the challenge to see what we can do here. As we've often said, we always want to keep improving our efforts in sustainability. Internally, we talk about not being the best in the world but being the best for the world.

**Xavier Simonet:** Thank you. Moving onto slide 24 and 25, Kathmandu's competitive advantages. I'd like us to step back for a minute and highlight in a nutshell Kathmandu's competitive advantages. Over the last four years, we have demonstrated our ability to deliver sustainable sales and profit growth and create value for our shareholders.

In terms of sales, our four year sales CAGR has been strong at 7.4%. EBIT four year CAGR has been 26.2%. Throughout this period, we have maintained strong growth margins through balanced promotional activity.

In regards to cash flow, we have delivered over \$250 million of operating cash flows and over \$100 million of dividends have been distributed to shareholders. Last but not least, the acquisition of Obōz has provided a pathway for sustainable international growth.

I'd also like to emphasise that Kathmandu is before all a product, and brand-led business. Our mission is to design original sustainable engineered and adaptive products. As a brand, we have the strongest brand preference and awareness in the Australia and New Zealand outdoor consumer markets.

On slide 25, well our loyalty club, Summit Club, has been over the years a key asset in terms of customer penetration, engagement, and retention. Summit Club has now more than 2.2 million active members and accounts for 70% of Kathmandu sales. Summit Club members are aligned with our key values of sustainability and they're passionate for travel and adventure. They spend around 30% more per transaction than non-members.

The significant sustainable growth we have enjoyed as a company also reflects the success of our omni channel approach. For the first time, the online channel accounts this year for 10% of our direct consumer sales, up to nearly \$50 million. Our strategy is channel agnostic and customer centric. Through our 165 bricks and mortar stores in Australia and New Zealand and our online shops, we give our customers the choice of channel and offer them the opportunity to engage and transact with Kathmandu 24 hours a day seven days a week. To achieve a successful omni channel strategy and enhance customer experience between all channels, we continue to have and invest year after year in new infrastructure and systems.

If we move onto slide 26, strategy for the next three years. Moving forward. Our two overarching objectives are to continue driving sustainable profitable growth but also to diversify our company.

So, we've articulated our four key growth strategies on page 26. Our first strategy is to continue driving sales and profit growth in our core markets, Australia and New Zealand. By supercharging Summit Club, which means building a highly engaged membership club. By becoming the preferred destination for summer outdoor products. By elevating key metro markets where we see significant potential for growth and by enhancing store optimisation. Which means maximising gross profit per square metre.

Our second strategy is to acknowledge that we are a product and brand led company. With the requirement to win with distinctive products. We'll be executing on three strategic initiatives related to product. First, extend leadership in key product categories, especially through innovation and sustainability.

Second, accelerate growth in high potential categories and hence, diversify business. Last, scale the women's opportunity. We have indeed a position to take as a leader in empowering women to live a life of travel and adventure.

Embracing the digital opportunity by enhancing the customer experience through digital is our first strategy. It means the following; making it easy for customers, particularly in terms of fulfilment and payment options. Leveraging digital media platforms to enhance the impact of our brand and product messages. And maximising mobile with customers and bridging the online and offline experience.

Our fourth ambition and strategy is to become step by step, a more global business. And we have a dual challenge there which is to build the Kathmandu brand, equity, and awareness in North America and internationally as well as opening routes to market through two commercial channels, wholesale, and direct to consumer online.

In order to achieve our strategic objectives, a fundamental enabler is our ability to inspire and empower the Kathmandu and Oboz team by being the best possible employer, and by having a great culture focused on our key values.

Moving onto Slide 27, key strategic priorities in FY20. We have articulated our key strategic priorities for the current year, FY20, and these key priorities are all connected to the strategic plan we have defined. I'm not going to go through the whole slide. I'd like just to particularly call out the investment we're making in FY20, to implement a merchandise planning system, and a warehouse management system that will enable future store optimisation.

So on Slide 28, as a summary, I'd like to say that our entire team is very proud to have delivered four years of innovative products, sustained sales and profit growth, strong operating cash flows, and significant value for our shareholders. In Kathmandu and Oboz, we have two distinctive brands, with strong fundamentals, and significant international growth potential.

As a conclusion - I want to give a trading update, and I'm pleased to report that we have experienced a strong start to FY20. For the first seven weeks of FY20, ending on 15 September, same store sales growth at constant exchange rates has been 6.1% for our Group, with both Australia and New Zealand performing well. Australia tracked 4%, and New Zealand at +11.7%.

I need to say, though, that this initial seven-week period of FY20 is not a meaningful period of trading in the context of the first half of the year.

So thanks very much for joining the conference call this morning, and I now invite questions. Ashleigh, back to you.

**Operator:** Thank you. If you wish to ask a question, please press star one on your telephone, and wait for your name to be announced. If you wish to cancel your request, please press star two. If you're on a speakerphone, please pick up the handset to ask your question. Your first question today comes from Andrew Steele, with Jarden. Please go ahead.

**Xavier Simonet:** Morning, Andrew.

**Andrew Steele:** Good morning, guys. The first one from me is just on the wholesale orders you've got into the FY20 year. I guess it's a little bit hard to get a sense as to the potential sales impact from that. Can you give some sort of steer as to how we should think about the potential quantum from these orders for the period?

**Reuben Casey:** Yes, we haven't disclosed the actual number, and it's fair to say, it's 45 doors so it's not hugely material. But the key thing is it's a start, and typically what we're trying to do is drive sale through and get repeat orders, so that could obviously - the amount could grow through replen or at once orders throughout the season, and also build on those initial sell-through to get repeat orders for the subsequent seasons.

**Andrew Steele:** I'll just throw out some numbers, less than \$10 million potential impact at this stage? Or greater than that, or you still don't want to comment on that?

**Reuben Casey:** Yes, as I said, we haven't disclosed it, but it's not material.

**Andrew Steele:** Okay, great. Thanks, Reuben. Is there further investment required to support this business next year, in terms of P&L impact?

**Reuben Casey:** Potentially, as the business grows, there might become the need for more resources to support the business. But we've set it up with a sales rep structure, so it should be scalable from that point of view. But yes, certainly as the business grows, there's always probably some need for extra support.

**Andrew Steele:** Okay, that's clear. Just on the New Zealand market, I guess, I'm sure from your perspective a little bit disappointing, the negative same store sales result two years in a row, and there has been I guess some impact from reduced discounting activities. Do you feel that you've sufficiently reset the price-point in the New Zealand market, and we should be returning to growth this year? Or is there other dynamics at play which could weigh on potential sales performance?

**Reuben Casey:** I think it's fair to say we're always trying to drive growth in New Zealand. That's not something we are shying away from. Yes, you're right, it is disappointing not to get that growth coming through. Yes, we feel we have done what we can on price-point, and we'll certainly be trying to drive growth this year. Really, it always comes down to focusing on things that we can control, so elevating our brand experience, making better product. We have a better, not cheaper, type of mantra. So those are the things that we can control, and we'll continue to focus on that.

**Andrew Steele:** Okay, great. Just the last one from me, it's just on currency and gross margins, you've helpfully provided the hedging rates into the year ahead, and highlighted I think roughly 7% lower rate than last year. Could you provide some sort of context of all else being equal, the potential gross margin impact from that sort of currency shift?

**Chris Kinraid:** Yes, you get the impact of the, it's Chris here, on the foreign exchange rates, but equally, we do have some offsetting activities to partially mitigate that, in terms of driving better sourcing from our suppliers, and our product creation, to manage that. But I guess the hedging rates are similar to FY17, so that's a reasonable guidance towards - so that we're heading towards those levels.

**Andrew Steele:** Okay, and so you know you would expect in terms of the gross margin result then on the retail business to be similar to that year?

**Chris Kinraid:** Potentially.

**Andrew Steele:** Okay, great and then sorry just one final one from me I guess if you produce a similar level of cash generation in the FY20 period, you're going to be looking at pretty much being close to debt free or you know very close to net cash. You know, what is your thinking as the management team as to how you would like to deploy balance sheet capacity? Are you on the lookout for further bolt-ons? Is the return of capital to shareholders something on the radar as well as we go through the course of the year?

**Reuben Casey:** Yes, I think as we've talked about in the past, we don't have a specific M&A strategy, but certainly if there was some M&A that came up that was a good opportunity we would look at it provided it made strategic sense and added value for shareholders. In terms of the capital management question that's really, we have options open to us so we'll explore those as they become relevant.

**Andrew Steele:** That's excellent. That's all from me thanks guys.

**Reuben Casey:** Thanks Andrew.

**Operator:** Your next question comes from Guy Hooper with Forsyth Barr. Please go ahead.

**Guy Hooper:** Yes, good day guys. Just a couple of questions from me. The first one, could you give a sense of what was I suppose the key drivers of the underlying Oboz, or the pro forma Oboz performance?

**Reuben Casey:** Yes, Oboz has a really strong core business, so they've got two key franchises and they re-launched one of those franchises this year so that provided some good growth. They continued to grow really strongly with REI but also actually they grew stronger with customers outside of REI particularly through the independent outdoor channel.

One channel they've been developing over the last two or three years is shoe stores. So you get independent or chains of shoe stores who sell an offer of outdoor footwear, so they've been growing into that channel as well quite strongly during the year. Lastly, they've had some good success with diversifying their product range into things like insulated products which have gone really well for them and actually helped them expand their share of women's business.

**Guy Hooper:** Yes, great, thank you. Just on, I suppose the guidance for FY20 capex around \$21 million, can you just provide any breakdown on what this is earmarked for and I suppose an update on the store portfolio mix or store count targets for the next couple of years.

**Chris Kinraid:** Yes, in terms of that mix it's relatively even weighted between stores and systems or retail store network and systems. As we mentioned earlier, there's some investment going on continuing with WMS and a merchandise planning system and looking forward to ERP system opportunities as well. In terms of store targets, yes, we don't from this point have a defined store target. I guess it's where the opportunities exist, we'll look to do those if they arise. Also, we have a defined program of stores which are rolling off their leases, where we look to refurb those at that point in time.

**Guy Hooper:** Yes, great. I suppose just one last kind of general one from me, there's pretty strong trading into the beginning of FY20. I suppose with where consumer confidence levels are and wage pressures and I suppose increasing competition, can you give us a sense of how you're feeling heading into FY20 just generally?

**Reuben Casey:** Yes, well we don't give guidance obviously Guy, but it's a small period of the year, so we're talking about seven weeks and our smallest quarter so we've got to make sure we context it in that light. Yes, happy with how it's started which is - so it's a positive start and we'll look to build on that as far as we can. I mean looking out the window right now in Sydney it's pouring with rain so it's going to be good for rainwear sales today.

[Laughter]

**Chris Kinraid:** Yes, I think we're pleased with the new range and product for summer has performed - early indicators are they're performing well.

**Guy Hooper:** Alright thanks, that's all from me.

**Xavier Simonet:** Thanks Guy.

**Operator:** Once again, if you wish to ask a question, please press star, one on your telephone and wait for your name to be announced. Your next question comes from Samir Patel with Askeallden, Please go ahead.

**Xavier Simonet:** Morning.

**Samir Patel:** Hi guys. Thanks for taking my question. Shareholder from the US here. A couple of questions. So one is, is it too early to talk about sell through data from North America or do you not have that kind of stuff yet?

**Reuben Casey:** Yes, it's too early. I mean we just shipped them over August and so it's, I mean there's some anecdotal feedback I can provide but it's too early really.

**Samir Patel:** Okay, fair. On Oboz, do you guys have a sense for where Oboz is and its growth trajectory? I mean do you expect it to continue to be able - I know you don't give guidance but just generally speaking, do you expect to continue to be able to drive double digit growth over the near to medium term?

**Reuben Casey:** Yes, we do. It's been growing strongly for the last five years. I mean the pro forma growth was slightly lower than what it was in the prior year but we do expect that to kind of gradually moderate over time but certainly we think there's opportunity to keep driving double digit growth for sure.

**Samir Patel:** Okay, cool. Then final question, in the core Australian/New Zealand business, I know you guys had previously talked about the currency and some other kind of cost headwinds affecting the gross margins, do you have a sense for kind of where those end up in fiscal 2020? Or is that again something you're not going to give guidance on?

**Chris Kinraid:** Yes, we don't normally give specific guidance on that.

**Samir Patel:** Okay. Thank you, appreciate it.

**Reuben Casey:** Thank you.

**Xavier Simonet:** Thank you.

**Operator:** Once again, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced. I will now give you a short moment to register your questions. There are no further questions at this time. That does conclude our conference for today. Thank you for participating, you may now disconnect.

**Xavier Simonet:** Thank you.

**Chris Kinraid:** Thank you.

**Rueben Casey:** Thank you.

ENDS

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