

Company: Kathmandu Ltd (EVENT)
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Moderator: Sheree Dixon
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Operator: Good day, and welcome to the Kathmandu Full Year Result Release Investor Call.

Today's call is being recorded. At this time, I would like to turn the conference over to Xavier Simonet. Please go ahead.

Xavier Simonet: Thank you, Kevin. Good morning, and welcome to the Full Year Result presentation for Kathmandu Holdings for FY17. My name is Xavier Simonet, and I'm the CEO of the company. I'm joined on the call by Reuben Casey, our Chief Financial and Operating Officer. We'll be talking through the presentation slides 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 or British pounds.

Now, if we move to slide two, financial highlights, we've had a strong year and have now delivered two years of strong profit growth and four successive quarters of same-store sales growth. So to company sales were up 4.6% at \$445 million. More importantly, since store sales growth was strong across our two core markets, plus 6.9% in Australia and plus 3.6% in New Zealand. EBIT was up 12%, NPAT was up 13.5% at \$38 million. We also are going to deliver record-high full-year dividend of \$0.13 per share, which is 18% above last year. Net debt is also at a historical low of \$6.9 million versus \$36.8 million last year.

If we move to slide five, strategy update, we defined, as a business, key growth strategies a couple of years ago. Those strategies have not changed and remain a constant focus for us. The first strategy is around product. We are a product-led company, and our core strategy is to design great, innovative, distinctive and sustainable quality products. Customer-centricity is also a key aspect of our strategic approach. We bring to market products that offer solutions to our customers who go to the outdoors and on adventure travel. Our products are technical

and serve the functional needs of our customers, but we also want them to be beautiful and stylish.

We then have two buckets of key growth strategies: continuous improvement strategies and growth initiatives. Continuous improvement strategies are about optimising our existing assets, strengthening our brand equity, optimising sales and gross profit density by square meter in our stores, improving our stock terms, engaging with our customers, particularly online and through social media and digital marketing, and driving cost efficiencies with a relentless focus on cost control. New growth initiatives are about leveraging, step by step, the international opportunity around market places and about continuing to open stores in Australasia, particularly in Australia when the right opportunity comes up.

If we move to slide six, strategy update – continuous improvement. I'm not going to go through each continuous improvement strategy as they're not new. What I would like to do is give you a few examples of how we have made significant progress on a few of those strategies. As far as our products are concerned, we have focused on creating adaptive products, which means products that are multifunctional and can be used on multiple occasions, such as the 5-in-1 Benmore Jacket. We have also continued to strengthen our Summit Club loyalty programme, with 8% more members than last year. That's 1.7 million active members – 1.1 million active members in Australia.

Engaging with our core customers and particularly our Summit Club members through social media and digital marketing is a priority for us, and we have endured a 30% year-on-year increase in social media reach, while our Net Promoter Score remains above 75%.

In terms of store optimisation, which as about being an always-better retailer, we executed successfully in FY17 the visual merchandising and product ranging trials conducted in FY16, with an improved in-store customer experience and better sales densities. We also continued to invest in a much-improved customer experience through four store relocations, four

refurbishments and two extensions. We will accelerate our store improvement programme in FY18 with five scheduled relocations and 15 store refurbishments.

With regards to pricing and promotion, offering great value to our customers and maintaining key competitive price points are a cornerstone of our customer-centric approach. We want to make the outdoor category and our great product accessible to everyone. Our average basket size also improved by 4.7% in FY17.

Moving on to slide seven, continuous improvement – omni-channel. Our ambition is to provide a channel-agnostic offer to our customers, which means that we want to offer the best customer experience online and in our bricks-and-mortar stores. In FY17, online sales accounted for 7.5% of total sales. We continue to invest in new technologies, with a strong focus on return on investment. First, we launched a responsive website that connects commerce and content, and we also deployed a digital market cloud that provides targeted email capability. The business enjoyed a 67% increase in website traffic originating from social media.

Keeping costs under tight control and improving efficiencies is an obvious priority for Kathmandu as well. In FY17 we opened our new Melbourne distribution centre, and expect efficiency benefits to be realised in FY18. We continue to drive productivity in our stores through foot traffic and conversion KPI.

Moving on to growth strategies on slide eight, I would like to give you an update on our international initiative. As announced already, we are launching Kathmandu with SportScheck in Germany and Go Outdoors in the UK, with trials that are just starting now with the European winter. We'll also be launching our global website, kathmanduoutdoor.com, with a responsive capability, and we are going to launch on Tmall Global, targeting mainland China in the coming months. Overall, our marketplace sales grew by 50% in FY17 versus prior year. In Australia and New Zealand, we will continue to open physical stores when the return on investment justifies it. In FY17 we opened four new stores.

Reuben Casey: Moving on to slide nine, sustainability, this is a core part of how we think about our business and runs right through our company culture. We want to demonstrate leadership in Australasia and some of the progress we made during FY17 was in the use of sustainable materials. Some examples are 3.9 million plastic bottles were recycled in to Kathmandu products, we increased our use of sustainable cotton to 74 and we saved 8.5 million litres of water through using a more efficient dyeing process in the production of some of our products. We were honoured to be recognised by the Banksia Foundation, Australian Packaging Covenant and the Textile Exchange for our efforts, but to be honest, winning awards or rankings is not the reason we do it. It's really about improving our sustainability efforts because it's the right thing to do.

Moving on to slide 11, just the results overview, you can see we managed to deliver sales growth, but crucially it was profitable sales growth. And despite some headwinds for gross margin, good control of operating expenses meant that our net profit growth of 13.5% was higher than our 4.6% top-line sales growth. And I'll just hand over to Xavier to talk a little more detail about sales.

Xavier Simonet: Slide 13, sales. In FY17, total company sales grew 4.6% to \$445 million, which is plus 7.9% in Australia and 3.3% in New Zealand. Online sales continued to be the fastest-growing channel for us, and account for 7.5% of total company sales. Sales in our core business, which is Australia and New Zealand, increased by 6.4% at constant currency.

Moving on to slide 15, same-store sales results. As a business we have put an immense focus on leveraging our existing stores, optimising the investments we have made in store openings, driving sales and gross profit density and increasing same-store sales. What I consider the main achievement of FY17 is that we managed to grow same-store sales in both core markets, Australia and New Zealand, despite New Zealand being a more mature market for us and despite a challenging Australian retail landscape. In FY17, same store sales grew by 5.5% at constant rate, driven by Australia at plus 6.9%. That's also with a strong performance in New

Zealand at 3.6%. Same store sales growth in our bricks and mortar network reached plus 4.7%, while our online sales increased 16%.

Reuben Casey: Moving on to gross margin on slide 16, gross margin did provide some challenges for us in FY17 due to the currency headwinds, particularly in the first half. In the second half we actually – our gross margin was – was flat year on year with FY16, and over the full year Australia was level with FY16, which was a great result and reflected the success of the work we've done on simplifying promotions and also driving improved full-price sell through. New Zealand was more challenging as the currency had a greater impact and we had a slightly higher clearance mix over the full year. But when you look at the total result, we have a long-term target of 61% to 63%, and for the full year we ended up right in the middle of this target.

And when we look at operating expenses on slide 17, we also think this was a positive feature of our result. We continue to get smarter about where we spend our promotional dollars and also had positive improvements and store productivity, as Xavier mentioned earlier. We were also slightly in the structural changes in FY16, so that provided some year-on-year benefits, particularly in the first half. But overall, it's very pleasing to see operating expenses as a percentage of sales reduce, which is of course something we said that we would – we would do.

And then when you look at the earnings summary on slide 18, you can see there's a – see the recovery and earnings made since FY15.

Moving on to the segment results starting with Australia on slide 20, as Xavier mentioned earlier, it's very encouraging to see the same-store sales achievement come through as it was something we were trying to deliver. We opened four new stores during the year and relocated our Parramatta store into the Westfield mall. There was a little bit of movement in our Queensland store network with Logan and Southport stores being closed as we opened or invested – invested in better locations close by.

Looking at New Zealand now, slide 21, we returned to same-store sales growth following a strong second half. And operating expenses were again well controlled, partially offset by the reduced gross margin, but overall, we still drove an improvement in our EBIT margin. No new stores in New Zealand as we – it is a mature market for us, but we will continue to invest in refurbishments for the year ahead.

Xavier Simonet: On slide 22, international, in FY17 we cycled the closure of three UK stores during FY16, and we still have one store in London to be closed. We also started executing our international capital light strategy, with start-up costs limited to \$0.5m incurred in FY17.

Reuben Casey: Moving on to cash flow on slide 24. Again, a positive, with healthy cash conversion, which was supported by a further reduction in our inventory levels, and also, we did invest more in our store network in FY17 versus last year, but spent less on CAPEX overall as we cycled the completion of our Australian distribution centre. But looking ahead to FY18, we do expect CAPEX to return to more typical levels, around that \$20 million mark.

And then if you look at the balance sheet on slide 25, we did strengthen our financial position further during the year. As I said, we were able to reduce inventories and pay back debt. We ended this – the year with almost no debt and our lowest stock-per-store in five years. Didn't quite get stock turns to 2.00x, but that still remains our target.

And moving on to the dividend on slide 26. Our year-end dividend has been declared at NZD\$0.09 per share, which brings our four-year dividend to a record high of \$0.13 per share. This dividend is fully imputed for New Zealand shareholders and fully franked for Australian shareholders with a record date of 13th November 2017.

Moving to foreign currency on slide 27, we do expect hedging rates to improve slightly in FY18, which should give us some upside in gross margin, but importantly the rate is still slightly below FY16 levels.

Xavier Simonet: Slide 29 is a summary. I would say that, as in any industry, the outdoor industry is and will remain immensely competitive. At Kathmandu we believe with passion than more than just a retailer we are a great brand. Our own in-house design and product team in Christchurch designs great, innovative, distinctive and sustainable quality products. As a business, we remain committed to continuous improvement, with key focuses on same-store sales growth, particularly in Australia, strengthening the Kathmandu brand and customer engagement, connecting with customers through social media and digital channels, cost and control – cost control and efficiencies. We are up to the challenge to compete not only in Australia and New Zealand, but also internationally. The international wholesale business is a developing growth opportunity with a strong focus on profitability. We're starting a journey that's going to take some time, with three key channels of growth: wholesale relationships, a direct-to-consumer global website and Tmall Global targeted at China.

Thank you very much for joining the conference call this morning, and we now invite questions.

Operator: Thank you. If you'd like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please ensure your mute function is turned off to allow your signal to reach our equipment. Once again, press star one if you'd like to ask a question. We'll take our first question from Chelsea Leadbetter with Forsyth Barr Investments. Go ahead, please.

Reuben Casey: Good morning, Kelsey.

Chelsea Leadbetter: Thanks moderator, and hi guys. If I can just pick up on a couple of comments you made, Reuben, regarding the stock turn target of 2.00x. Can you give us a bit of an understanding on, you know, I guess the pathway to get to that point, and I guess what the inventory mix is looking like at this point in time going into FY18 with respect to clearance stock versus, you know, your current levels?

Reuben Casey: Yeah, sure. So, clearance stock going into FY18 is around about 40% below last year. So, we did a good job at moving through what we carried into FY16. And so that really helps. That really provides the opportunity to do – to drive that stock to a number higher. We hold our stock per store at around current levels we do expect to get there over the year – of the next 12 months.

Chelsea Leadbetter: Okay, and I guess to that point, obviously, where the gearing has got to in the business, I mean, how should we be thinking about the dividend policy? And you know, appreciate you do have a bit higher CAPEX year ahead, but still, you know, the business is obviously done very well with getting that debt level down. So, what should we be thinking about from here?

Reuben Casey: We don't have an official dividend payout policy and we will continue to invest in the business as we see our ROI justify the infrastructure needs required. But we still do carry debt throughout the year. I mean, our year end position is very much a low point, but we still look to repay probably another \$10 million over the course of the year.

Chelsea Leadbetter: Okay. And I guess just picking up on some of the earlier comments around the DC efficiency benefits for FY18, you know, I guess, how should we be thinking about the materiality of that? And should we – will we be seeing it all in FY18 or is it sort of staggered until you get to full efficiency?

Reuben Casey: It's probably more of a staggered to get to full efficiency, but the way we think about it is it just enables us to grow without really adding much cost, as opposed every extra sale coming with a variable cost of DC labour. So, we should let it be more productive but still grow our – our sales.

In terms of the materiality of it, I – yeah, I'm loathe to put a number on it at this stage.

Chelsea Leadbetter: Okay. Thank you. And just last question from me. Xavier, just trying to understand a little bit more on the international sort of strategy - and appreciate it's really early days, but just kind of what we should be thinking about for the year ahead from, you know, some of these trials, and maybe what the gross margin profile may look like from the wholesale segment?

Xavier Simonet: Yeah, so we are ready for European winter, or winter in Northern Hemisphere with the three channels I was talking about before – online, Tmall Global and our wholesale trails in Europe. So, what we're going to focus on is sell throughs, and I suppose what we expect is getting a bit of traction through at least one or two other channels. And traction that could accelerate if we then invest a bit more time and money. So, at this point in time, the measure of success is really getting tractions through good sell throughs.

Chelsea Leadbetter: Okay, that's all from me for now. Thank you very much.

Xavier Simonet: Thank you, Chelsea.

Operator: Once again, if you'd like to ask a question press star one on your phone. Again, star one for questions. And once again, star one if you'd like to ask a question at this time. All right, next we got to Wayne Ma with Morgan Stanley. Please go ahead.

Wayne Ma: Hi guys.

Reuben Casey: Good morning.

Wayne Ma: Just wondering if you can comment on how trading has been since the end of the financial year.

Xavier Simonet: No, we can't.

Reuben Casey: No, we don't give specific numbers at this – for such a short period, but it's pretty much on track with the expectations.

Wayne Ma: Okay. Thanks.

Operator: And once again, press star one on your phone if you'd like to ask a question. At this time, it appears here are no further questions from the phone audience.

Xavier Simonet: Thank you, Kevin.

Operator: You're welcome.

Xavier Simonet: Have a good day. Thank you for joining.

Reuben Casey: Thank you very much.

Operator: Ladies and gentlemen, this does conclude today's conference. Thank you for your participation, you may now