Conference Transcription

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Kathmandu Ltd

Kathmandu Half Year Result Analyst Call

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Start of Transcript

Operator: This is PGI. Please stand by, we are about to begin. Good day everyone and welcome to the Kathmandu half year results analyst call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session at which time if you wish to ask a question you need to press star followed by the number 1 on your telephone keypad. Today's call is being recorded. At this time for opening remarks I would like to turn the conference over to your moderator today Mr Peter Halkett. Please go ahead, sir.

Peter Halkett^ Thank you, Maia and welcome everybody, welcome to the call. With me today on the call is Mark Todd, our Chief Financial Officer. We're going to be discussing our results for the six months ended the 31st of January 2014. We'll be talking to the results and the half-year presentation we filed this morning on the ASX, NZX and on our corporate website. I presume most people have either got that or can access and follow me and Mark as we work through the presentation. We will be presenting the results in New Zealand dollars, a slightly different view than if we were presenting in Australian dollars given the exchange rate movement, but yes, we will be New Zealand denominated. The presentation will be approximately 30 minutes followed by 15 minutes of questions.

Let me just start by running through the contents for today; this is on page 2. We'll do a quick overview of the results no doubt you've already had a quick look at. I'll go through the key line items, the country results, our cash flow balance sheet and the dividend. I'm going to talk about our growth strategies, both update, where we're at and how we see those strategies over the next 12 months, the outlook and then we'll have time for those questions. If we could just move through to page 4, which is the results overview. We thought it was a very solid result in a relatively difficult trading environment, and something we felt worth highlighting is the growth potential Australia is really starting to demonstrate with the 28% uplift in profit, and Mark will talk to that when we get to the country section.

Our new stores are performing well; they continue to perform well, and I'm jumping the gun a little bit but you will have seen in the growth strategies that we've our store rollout up from 170 to 180, and I think we've got a lot of confidence that our new stores continue to perform very well and through various trials has allowed us to increase that further. Gross margin was at the top end of our range, probably a little surprise for some of you. We know that when we look back at the Christmas trading period there was a lot of discount activity and we can see that some reasonable sales were achieved by other players in the market, but some of that came at the expense of margin. In our case we didn't need to discount to that level so we were really pleased at that level, and it's certainly at the top end of our range.

Probably something once again that will have surprised some people is we had a very significant exchange rate impact on our earnings. In fact, it was approximately a 15% impact year-on-year. You'll see our Group EBIT was effectively reduced by $2.2 million as a result of that movement, so given the increases we delivered, taking that into account I think it was a really solid performance.

Just moving through to sales, at a constant exchange rate basis our sales grew by 10.5%. Obviously when the conversion - as we report it's only a 1% increase but on a like-for-like type basis it's 10.5%. On a same store growth basis we're at 5.4% and once again, when we report it will be minus 3.5%

and gross margin, as alluded to before, was 63.9%; that's absolutely nudging the top of what we'd ever indicate to you.

Operating costs were in line with our expectations. In some ways those costs are a little higher than some people might expect; they might have been expecting half a per cent less, but we are continuing to invest and we are in the middle of an IT transformation that's going to allow us to become a full omni-channel retailer. That doesn't come for free. So we were happy with that operating cost performance. At a profit level EBITDA was up 8.1% to 22.6% and net profit after tax was up 10.7% to 11.4% and that's at the actual exchange rate.

Just moving through to the look year-on-year, on page five. You can see sales at $167 million, that's the 1% alluded to before. We know that if we looked at it on a country-by-country basis it's a constant rate of 10.5%. There's the margin performance and 63.9% compared to 62.7% last year, so not only was it at the top of our range but we did grow margin compared to last year, and as you can the expenses are slightly up in percentage terms, but that's as a result of planned activities and the transformation taking place on our IT platforms are largely responsible for that not being in line.

EBITDA I've mentioned at $22.6 million, up on last year. EBIT $17.6 million, up 11.4% on last year and we've already talked about net profit after tax. Permanent stores are now at 130 - well, at the end of the period should I say were 139. We've subsequently opened some more stores, and that compared to 129 the previous year, 10 more. I'll just highlight the note below. You'll see that the conversion rate this year is - the rate is the equivalent of $0.91 whereas last year it was $0.79. So that's the 15%, a pretty major difference for us to absorb. Once again, if we were reporting this in Australian dollars we'd have some pretty big percentages in the last column.

If we can just go through to sales breakdown, just to reinforce that we can see out of New Zealand, when we look at the New Zealand reported numbers we see the $167.6 million but if we break it into the country we see where the increases are really coming through. Australia's gone from A$81 million to A$93 million in the first half, and New Zealand got some growth, it's gone from $59 million to $62.3 million.

Just moving through to slide 8, what everybody's interested in, the same store growth, the two charts at the top, they report in actual exchange rates and so you can see Australia over the years has bounced around a little bit starting at - going back to FY10 it was at 9.9%, currently 6.6% - but a pretty generally consistently strong same store sales despite a fairly extensive store rollout. New Zealand once again bounced around, I'd say that 14% and 12% were pretty high.

I think where we're sitting now is realistically given the state and the maturity of the New Zealand business as a pretty consistent performance and are pretty comfortable with that. It does tend to bounce around a little more in the first half; as you know, it's a lower proportion of our sales so movements tend to get exacerbated. From a same store sales point of view as I said before, overall it was 5.4% but you can see Australia at 6.6% would be considered pretty good in the environment over the last six months.

I'll just move through and we'll take a look at gross margin. Once again, Australia, it's the second highest margin we've delivered in the last five periods at 67.4% and as you will be aware, Australia is growing as a greater and greater proportion of our business and therefore helps support a consistent and solid gross margin overall. New Zealand had an uptick this year; you probably would see that there was a bit of a downward trend and we'd like to think we've turned that around, and 58.6% combined with the Australian total sits pretty comfortably where we would expect it to be.

The UK, once again it looks a bit like a staircase heading downhill but the margin, this period was impacted by a lot of clearance activity as we shut some stores and you will be aware, those that follow us, that we're down to our four core stores, that's where we're going to sit and really, future growth is all around online and what we're doing with marketplaces and other partners. So I think we'll see that margin go up in the future. Overall, when we look at the share of business the only reason that Australia has dropped as a share of business is because of the exchange rate impact, otherwise it would have grown significantly again based upon the same store sales and all the new store rollout.

Cost of doing business; when it comes to spending money I like to hand that over to Mark Todd who's going to speak now. Thank you.

Mark Todd: Cheers, Peter. It was a very satisfying period as far as operating cost management goes. We were actually within 1% of our budgeted targets for the half-year when measured on actual exchange rates looked at in the individual countries. As Peter has already alluded to, because there was a 15% weakening in the Australian exchange rate, there's actually - if you compared it on a constant basis you'd have about approximately a 10% effect on consolidated Opex in sales and the like because two-thirds of the business is Australian domiciled. So other than our redirection of spend into systems platforms as we continue our rollout of the Microsoft AX project, that was the only area of significant uplift in expenses and one of the offsets this year was obviously having closed our UK stores and again because of the benefit of exchange rate our rental as a percentage of sale reduced, or not so much the exchange rate, the fact that we had a lesser portfolio of Australian stores this year.

So moving on from the cost of doing business into earnings overall, the key thing to point about here is that - obviously on page 11 - is the overall trend, apart from our stellar year in 2011, it's a strong message of consistent earnings growth, consistency in operating cost management, steady margin always within that 62% to 64% target range leading to strong year-on-year growth in earnings with an outstanding year in FY11 followed by three strong, steady years of growth [unclear].

Talking about the country-by-country results, one of the keys things to highlight is we only opened five stores in the first half of FY13 in Australia compared to nine in the previous year, and the nine in the previous year were primarily more major city stores and this year we've got two outlet stores amongst the five. So the pattern of store openings this year is actually weighted towards the second half in Australia as opposed to the first half and they were stronger set of new stores opened in the first half of last financial year. So you won't see the same aggregate growth in earnings in FY14 from new store openings in Australia as you did the previous year, simply because of the timing of new stores this year and the particular mix. But other than that, obviously it's a very satisfying result to achieve a 28% improvement in earnings in the year in the Australian market and for all the reason's Peter's already talked about, strong same store sales growth coupled with improvement in gross margins.

Moving on to the New Zealand result, again a steady result. More than - same store sales growth over 3%. The one store opened in New Zealand is our first small format store in New Zealand, in St Luke's Mall in Auckland and that store has gone well and is a precursor of several other stores of a similar type to come, one of the reasons why we're confident enough lifting our store network plan to 180, and earnings growth of just over 10% for the year.

Then talking about the UK, the key thing in the UK is no change in the store profile as Peter has already talked about. The sales ongoing are from the four existing stores but when we get back to growth strategies Peter will talk a little bit more about what we're doing to invest in that market in terms of growing online sales and moving into marketplace websites and the like. Clearly that's the future for that business and we're more than happy to make that level of investment at this point in time with the opportunity that the online platform provides.

Then the nitty gritty stuff around cash flow and balance sheet. We spent less money in capital expenditure in the first half of this year compared to the previous year, primarily as I've already talked about in new stores, $1.9 million this year compared to $6.4 million in the previous period, all about the fact that we opened fewer stores in Australia and two of those five stores opened were outlet stores compared to nine mainly central city and mall stores in the same period last year. Offsetting that, a significant uplift in our IT spend as we continue our rollout of all the various Microsoft AX systems applications. We went live with our new point-of-sale platform in the period between Christmas and Easter, so point-of-sale is not on retail AX and we've got further applications to roll out before the end of the financial year.

So we will expect to expend significantly more into capital expenditure in the second half of the year compared to the first, in line with our overall budget for the year, and that will primarily be driven by the fact that we will have more new store openings in the second half of the year than in the first half. It's just simply a different weighting between the years.

Then to obviously - on the operating cash flow side the main area of expenditure year-on-year increase within inventory and we'd like to flag that virtually all of this was planned investment, particular opportunities to take in key categories like insulation, wovens and fleece. A small part of it is actually due to the fact that of course we didn't sell as much because we actually improved our margins year-on-year as well, but most of it is all about the opportunity we've taken to improve core stock and the levels of clearance the business has at this time compared to last year is actually less. So we've actually up-weighted investment in key categories. We also have to reflect a degree of conservatism every year as to where our new store profiles fall and so sometimes obviously our new store openings don't necessarily fall exactly where we want to buy the stock but the key message in inventory is it's good inventory and it was planned investment in core categories.

Other than that nothing really much going on in the balance sheet or in cash flow over all for the year.

Dividend is unchanged for the period, a $0.03 interim dividend and as - a NZ$0.03 interim dividend - and as we flagged this time last year, this dividend although it's fully franked for Australian shareholders won't be imputed for New Zealand shareholders but we're fully confident we'll continue for the foreseeable future to be able to fully impute end-of-year dividends for New Zealand shareholders.

Our hedging profile going forward, the deterioration in the Australian dollar is relatively consistent into the first half of '15 compared to the second half of

'14 and you may remember we were hedging at about dollar for dollar this time last year. So we've been already able to absorb a 5% approximate weakening in the Australian dollar and our selling prices and margins in the first half of this year, with no adverse effect as you can see, and remain confident in being able to do so looking ahead into the second half of this year and into FY15. The New Zealand dollar continues to be the stronger of the two currencies and so our effective hedge rate for Kiwi against US is basically unchanged.

All right. I'll pass back to Peter to talk about growth strategy.

Peter Halkett: Thank you, Mark. If we go to page 22, the first growth strategy to update you on is our new store rollout and as I alluded to in the opening we've revised the total from 170 to 180 and that's mainly as a result of our small format stores working very well for us, working well for us, and malls working well for us in I guess what you'd call secondary mall locations and regional towns as well as small format working and strip locations in more regional towns. So we haven't discovered another major market. They're not going to be large CBD stores, these additional stores; they are going to be smaller regional towns but they are important for generating additional profit. They are very profitable because they tend to be lower rent, lower cost so we've extended that.

I would comment, as Mark has alluded to, that in the first half of this year we haven't had as many stores and they've tended to be a little smaller. As we roll through the - heading towards the 180 target we need to become more discerning, we're much more cautious around what the impact of online will be, particularly as our own only business is growing well. We're very much aware of what's happening with rents and rent structures. So in some cases we, while we make a commitment to 15 stores a year they don't necessarily always come exactly as we'd like, exactly as we've modelled. So we are determined to negotiate really well and to get the right deals and to get the right equation.

The other thing I should mention in new stores is we do have new format in terms of layout and design and we're just about in Melbourne to open a new store in the Emporium Centre. We've got new formats and various locations, prime cities, into Pitt Street. We've got new fit-outs and new market in Victoria Street in Auckland, and those new fit-outs have really calibrated the brand as well. It's all part of the investment for future growth and I guess that's what allowing us to keep moving forward when others may be struggling. We are on track for 15 this year and as I said before, small formats are working well for us; they're very efficient.

If we look at optimising the existing store network, we've obviously got a lot of existing stores, and in fact between 10 to 15 of our leases come up every year, which is an opportunity to realign with our latest thinking and our latest strategies in terms of store size, in terms of location, in terms of getting the new design into those stores. So we'll be pursuing that and making sure we improve the efficiency of the operation each year as these 10 to 15 leases roll over. But we also have - part of our investment in Microsoft AX and some of the accompanying tools, we've been able to put in place forecasting and planning and inventory management systems that allow us to better target ranges based upon store size and in time demographics and weather and that will improve the performance of stores on a sales per square metre, and that obviously supports same store sales growth.

So to date that's probably an area where we've adopted a one size fits all in terms of range planning. More and more we're getting more sophisticated. You can only do that when you have systems and you can only buy those systems if you're making good profits. So it's a bit of a cycle and we're on the front foot at the moment. I'm really pleased that we're able to afford the technology to improve our business. Talking technology, digital online, this is an area that has got a lot of focus in the Company. You'll see that we grew 49%; you'll also be aware it's now 4.7% of our sales, it's grown rapidly.

When we think about online, there's online in terms of how we can become an omni-channel retailer in New Zealand and Australia and to a degree in the UK, about how everything is integrated, online sales in the store or click and collect, all the things you've heard before, that we're moving down that track. That takes a lot of investment to have the sort of infrastructure in place to support what sounds on a piece of paper very simple to do but it's actually very complicated and you have to be able to invest a lot of money. We are part way through that investment and we've got a little bit more today but we're well down the track and we're close probably within the next 12 months to becoming a full omni-channel retailer in New Zealand and Australia.

But it's more than that; we've just launched international shipping and that allows us to start to ship to overseas markets. We're well-suited to that, we get a lot of tourists in our stores. We've already got 13,000 international Summit Club members; they are members of our database that are neither UK, New Zealand nor Australia. They might reside in Germany, they might be in Canada, they might be in the US; they could be anywhere. We've just introduced international shipping. We haven't put a lot of marketing effort behind it yet but we will be, and the intention is to grow our international Summit Club database. We've got those 13,000 without even trying; we're just about to move into a phase where we get proactive.

Clearly this is a very profitable business, we don't need staff, we don't need stores overseas and it may lead to further development of online where we put specific online offering into those marketplaces rather than just internationally ship. So really exciting, and we're doing very well with new marketplaces. You'll be aware we've launched on Amazon in the UK, we're actually on the Next website, that's been fantastic for us; our own website in the UK is growing, and we have opportunities further beyond that on to EBay and other European sites. So when you're a vertical brand of Kathmandu-ers and you are competing in a segment that's I guess generally considered a growing category globally, we are in a very strong position. We can afford the technology, we're putting the building blocks in place, and if there's a theme out of this presentation it's that we are going for that whole digital online space very aggressively and the progress we're making I'm very, very pleased with.

Having said that, if we move to page 23 it's still all about product. You can have a fantastic distribution through online and stores, you can have fantastic distribution through marketplaces but you still need fabulous product with the latest technology, the latest designs. So we are not just investing in distribution, we're investing in the core of our business which is product and brand. We've established our product roadmap for the next three years. We've recruited more resources in terms of technical resource, research and development. We've brought in a new head of design out of Germany, they'll be starting with us shortly.

We are really putting a lot more effort into making sure our product is cutting edge and could sit on a shelf anywhere in the world and hold its place. In parallel with that we're also making a significant investment in sustainability. It's become critical and in my view in two to three years' time it's going to be a mandatory. We need to begin that process now. So we have made quite a lot of investment in just sustainability and transparency. Once again, it's an investment you don't see a payback for today but it's an absolutely requirement. In fact for our category and for our type of customers sustainability and transparency is vital. So we're doing these things to make sure we're well and truly prepared to go global.

Then finally our customers, the most important part of our business in many ways. We're continuing to grow our database; it's a critical part of online. We're improving our customer experience online and in terms of our Summit Club customers. We've got new programs coming in place. It's not just about discounts anymore, it's about engagement, relationship, and a cycle of management of customers and understanding their spend and what they want from us, data mining, all of those things you've heard from other retailers, which I'm sure everybody's doing but it does take investment, it takes resources. The good thing, and the thing I'm proud of, is we're well down the track in this area as well, and our Summit Club customers, they are very loyal to us, they are a very high proportion of our spend and that's why the goal of actually growing international Summit Club membership when we get so many visitors in our stores that we can leverage is such a good opportunity for us. So a lot of things going on in Summit.

They're essentially our five core growth strategies that haven't really changed since the IPO. That's probably becoming a bit repetitious from your perspective that they're the same boxes and they're the same five strategies, but I can assure you the content and the thinking and the evolution under each of those strategies has changed quite significantly and none more so than in terms of online and what we're doing with our product.

If I just move through to the outlook, once again there's not a lot on this page because it is a very difficult environment to predict. I guess in some ways we're feeling a little more positive about what's going on in New Zealand at the moment with the economy looking strong, looking pretty robust, all off the back of milk. Whereas in Australia - there's probably a majority of people on this call from Australia- there's a great deal of uncertainty and I guess not a great deal of confidence.

It's been a little bit like that in the six months as well so I think we've shown that we can still perform in a tough-ish market and I think that's partly due to the next point, which is the outdoor category. It's a really resilient strong category both locally and globally and we've talked - in fact we talked at our last investor presentation about why that was and the types of customers and what they're doing and how lifestyles are changing and that's really helping the category. We do have a couple of big promotions to come before the end of this financial year - well, we're well and truly in, we've had a good start to the year. We do have our Easter sale and our winter sale where they're a high proportion of sale and we need them to fire. So there's still plenty of work for us to do.

So a positive start. We're determined and continuing to invest in strategies to deliver future growth and the growth we're getting today is as a result of investment decisions we made two and three years ago. You can't just flick a switch on and off and expect to get sales and profit increase. You can get sales or you get can profit; you don't generally get them both together. They happen as a result of investment and well-considered investment and we're continuing to do that. Once again we remain very confident in our business model and our growth strategies are delivering, and it's fair to say that as long as there's no further or significant deterioration in economic conditions we'd expect to deliver a strong performance for the full FY14 year.

I will now open up for questions I think. I'm passing back to the moderator who has some priority order to take the questions in. We've got 15 minutes to go, folks. Thanks.

Operator: Thank you. To ask a question please press star-1 on your telephone keypad. That's star-1 to ask a question. If you are on a speakerphone please be sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star-1 to ask a question. We will now a pause a moment to assemble a queue. We have our first question from the line of George Batsakis from Goldman Sachs. Please go ahead.

George Batsakis: (Goldman Sachs, Analyst) Good morning Peter and Mark. Just a question on gross margin. Could you expand a bit further on your gross margin comments? The very strong result there in gross margin, was it just better than expected consumer spending and you sold more at full margin or was it better mix? Could you expand on that, on those comments?

Peter Halkett: Well, Mark, do you want first crack?

Mark Todd: Yes. In the end if you revert back to the sale model on the management of our sale process George, we found our trading through our sale - key promotional period, Christmas through New Year to be very strong. So the luxury of the - the benefit of having the three key sales in the air and the control that that gives you over your pricing is we went into that event with a target to improve margins and we were able to do so. So there wasn't one absolute. Certainly some of the investment in stock that I also talked about in terms of stock categories was with better margin category groups in mind, so there was a little bit of that as well. So there's a bit of both.

George Batsakis: (Goldman Sachs, Analyst) Great.

Peter Halkett: In summary, George, we didn't discount because we didn't need to. We were comfortable with our performance. We were in a [unclear] position as we didn't have a lot of clearance stock. We didn't have a lot of clearance activity in January which we would normally have. Sales were made at full margin so we were comfortable with our level of trading and we kept our powder dry.

George Batsakis: (Goldman Sachs, Analyst) Great, thanks for that. Just a question on Capex. Mark, you mentioned Capex will be higher in the second half of the year. So full year, would it be in that range of $20 million to $22 million, somewhere...

Mark Todd: Yes, it will. Yes.

George Batsakis: (Goldman Sachs, Analyst) Great. Thank you.

Operator: Your next question comes from the line of Sandra Ulrich from First NZ Capital. Please go ahead.

Sandra Ulrich: (First NZ Capital, Analyst) Morning guys. Just a couple of admin questions just to clarify. In the full year result outlook it says our trading performance, we are targeting an improve profit outcome in FY14 after adjusting for the effect of the exchange rates, just if you could clarify that comment. Secondly, you also say that Opex over - as a percentage of sales in FY14 higher than FY13. Can you just provide a bit more information around those two? Thank you.

Mark Todd: Yes. The first point Sandra is that it's highly likely that the full year New Zealand dollar-denominated result will be a worse exchange rate for Aussie dollars barring some miracle strengthening of the Australian dollar between now and 31 July than it was in the previous year. So as we've already highlighted, on an EBITDA level it had over a $2m effect in this first half. The Kiwi dollar only started to strongly appreciate against the Aussie dollar in the last couple of months of the last financial year. So we were around $0.84 I think at 31 July and we're at $0.94 today. So you're going to see that continue in the second half. So that's that point. What was your second - I didn't really quite understand what your second question was.

Sandra Ulrich: (First NZ Capital, Analyst) Just so I can clarify that. So what you're saying is that maybe a couple of - will be - just in terms of the seasonality, if you say a couple of million negative impact on let's just say 30% of earnings, would that be $4 million impact on...

Mark Todd: Yes, yes.

Sandra Ulrich: (First NZ Capital, Analyst) Would that be right, on the second half?

Mark Todd: Yes, that's right. Yes.

Sandra Ulrich: (First NZ Capital, Analyst) So $2 million potentially and then $4 million?

Mark Todd: But entirely dependent on what the exchange rate is and when it falls because it's an [unclear] full year.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, so overall that could be $6 million. The second one was just - it said here, the full year operating cost as a percentage of sales are expected to be slightly higher than FY13. So that was on the...

Mark Todd: As they were for the first half, so the first - the key thing at the moment is in the system space we're basically running software and development costs and the like for two separate platforms in a number of areas. We've got quite a substantial uplift in systems costs, licensing and people year-on-year. That's the primary reason.

Sandra Ulrich: (First NZ Capital, Analyst) Yes, okay. That's okay, and...

Mark Todd: It's not - it's only 30 basis point this year. We're not talking a significant number.

Peter Halkett: Sandra, I think as you can see, it's a little higher but it's not a lot higher.

Sandra Ulrich: (First NZ Capital, Analyst) No, that was okay.

Peter Halkett: The new system is to become an omni-channel retailer to build the things we've talked about in our growth strategies, including Summit Club stuff, those systems are a lot more expensive than our old systems. So there is going to be a step change in costs, plus for a period of time we're running our old systems and our new system in parallel.

Sandra Ulrich: (First NZ Capital, Analyst) Yes, crossover.

Peter Halkett: So that's the nature of that. As we continue to roll out more stores that sort of cost, that higher IT-related cost will come down to a similar percentage as it was in the past, but at the moment that transition is a little painful for us.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, and just the last one. Again, George asked you about Capex but I just missed that in terms of your FY14 target. Did you say - can you just reiterate that one?

Mark Todd: We continue to expect to spend more than $20 million for the year.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, thank you. Thank you very much.

Peter Halkett: Thanks, Sandra.

Operator: There are no further questions in queue, but as a reminder if you would like to ask a question please press star-1. Okay, we now have a question from the line of Chelsea Leadbetter from Forsyth Barr. Please go ahead.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Hi. Morning guys, a very good result. I just wanted a quick question really about what you've seen in the competitive landscape over the period and perhaps a bit of commentary around market share and how you - it appears you've gained some share. Is that correct?

Peter Halkett: Well, our business - part of our business competes in what we'd call the traditional outdoor area and when we sell hiking boots and backpacks and sleeping bags, and then part of our business, things like our wovens and our clothing compete more in the wider lifestyle space where we're competing against more mainstream players. So if you were to talk the outdoor category we've certainly seen companies like Snowgum, they have gone into receivership. We don't really know how other direct players like Macpac and Mountain Design are trading. I really can't talk for them. Clearly on the fringe, and we consider them fringe, people like Supercheap retail, they have the BCF, the Ray's and in New Zealand they have FCO. Their results have been published and I think you can draw your own conclusion but certainly our same store sales are higher than theirs.

I think generally within our space I would imagine we're probably taking share and doing a good job, but the key really is about our success in apparel in the wider space. That's why we are opening smaller format stores and putting them in malls so we're getting our technical apparel offering in front of people that otherwise mightn't travel to a technical destination hiking store, if I can put it that way. That's really where we're growing and that's where we're continuing our efforts as well as obviously online. So I think we are taking some share. We don't know that, we don't know the performance of our more direct competitors but we can tell from the retail stats our total growth and our same store growth we're taking business from someone somewhere.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, thank you. Then I guess just a further question, on those small format stores. I just wonder if you could remind me on the split between the apparel and the equipment in those stores?

Peter Halkett: Well, I think we've published recently that we're about 70% apparel and about 30% equipment, depending upon where you put footwear. If you put footwear into apparel as we tend to. Whereas I think that percentage probably is another 5% at least higher when you go into a small format mall store. We just don't sell tents, we don't sell technical hiking packs, we don't sell the same degree of hiking boots but we sell a lot more wovens, we sell a lot more fleece and those sort of clothing categories. For our space, once again if you look globally, the growth is coming from apparel in our space.

That might be the difference between us and other players who are still trying to sell lots of camping gear and folding chairs; that space isn't growing as rapidly as technical outdoor gear moving into the mainstream. Most of you have heard me talk about the reasons for that, which is both a combination of product and the customers who are buying those products and the money they've got to spend, which are those baby boomers looking for experiences in travelling and hiking and they're doing the trail rail and they're going to France. They're doing all sorts of things which are not necessarily what would traditionally be done in our space and then they're buying the associated gear with it.

Mark Todd: If I just add one little thing too about effectively the competitor space. One of the clear benefits in the product area is Kathmandu's scale of business where it's substantially larger than the direct competitors. So if you think about a category like apparel, which is all around design and development and R&D and all those things, there's a huge capability that Kathmandu has to invest, and rework and improve in that space. So it's hard for the competitors to do because they haven't got the same scale, same thing that applies in the system space.

Peter Halkett: For some of our smaller competitors the level of investment required to become an omni-channel retailer - I should say, an efficient omni-channel retailer. You can do these things off the back of fag packet but you'll never be able to scale it up. The fact of the matter is it requires millions and millions of dollars, which we have spent and are spending, to make sure the brand is well-positioned as online grows and grows and grows, and we're almost demonstrating that. When you're a smaller player that funding and that capability to employ the resources and employ the teams to run these things is very challenging. Anyway, we can talk about more of that on our upcoming road show, those that would like to find out more about what we're doing.

Sandra Ulrich: (First NZ Capital, Analyst) Thank you very much, guys.

Peter Halkett: Thanks, Chelsea.

Operator: Your next question comes from the line of Adam Simpson from Macquarie. Please go ahead.

Adam Simpson: (Macquarie Group, Analyst) Hi guys, a good result. A couple of questions just on the inventory if you don't mind. Firstly, with the weakening of the Aussie dollar, is that inventory increase a little understated? I presume you're translating your inventory position back into - the Aussie dollar inventory position back into New Zealand dollars at a lower amount. Then secondly to that, should be expect to that inventory per store level come down in the second half at full year?

Mark Todd: Well, to the first point, Adam. There's another way of also measuring it, which is the unit investment. Because when I talked about it before, most of the investments we chose to make were in high unit dollar cost categories. So on a unit basis the increase is nowhere near as substantial as it is if you measure it on constant currency basis. But you're right, on a constant currency basis it would be higher. The point is we made some very specific choices around investment in certain categories and yes, they're slightly masked by the New Zealand Australian dollar conversion, but on a unit basis they're not out of the ball park with the year-on-year growth. The answer to the end of the year question is we would expect an increase in level of inventory per store, not quite as high as we're at right now but it would still be up.

Adam Simpson: (Macquarie Group, Analyst) So up relative to last year but potentially down from the current law on a dollar per store basis?

Mark Todd: Yes, slightly.

Peter Halkett: Just remember, Adam, we didn't quite have the store opening profile, and had less stores at the last year than we otherwise would have so you would have had another multiplier effect, plus the sales from those stores. The other thing I'd highlight is that 4.5% of our sales in the first half came from online. We don't even count that as a store in those traditional stats. So if you were to say those sales were the equivalent of five or six stores and divided that again your stock per store would come down and be I guess more in a range that people would expect. But in the future we'll need to think of a way to show you efficiency of stock, not just store numbers, because online as it grows and grows [and essentially] our business doesn't fit into that traditional evaluation methodology.

Adam Simpson: (Macquarie Group, Analyst) Okay. I guess that's one of the beauties of online though is you're probably trying to hold less inventory to support the online sales than you would for the same in a store. Can you talk about that?

Peter Halkett: You don't have the same display stock but you've still got to have the same stock to sell to have the numbers. So you don't have floor stock but you need selling stock.

Adam Simpson: (Macquarie Group, Analyst) Yes. All right, that's great. Thanks guys, well done.

Peter Halkett: Thanks, Adam.

Operator: Your final question in queue comes from the line of Ken Wegener from Phillip Capital. Please go ahead.

Ken Wegener: (Phillip Capital, Analyst) Good morning Peter and Mark. Just a question on online, whether you're able to comment on the relative profitability of online relative to your bricks and mortar stores, and in particular on the I guess gross margin. I would be thinking that apparel would be a greater proportion of online sales and as such you'd have a higher gross margin. I wonder if you'd just comment on that please.

Peter Halkett: Well, we fully cost our online business so we can track the profitability of our business. At a gross margin level, it's generally the same as our business because we have - for online we have an integrated pricing policy. When you're an omni-channel retailer based certainly in New Zealand and Australia the price is the same. We don't offer different prices just because you buy it online. We have the odd online only special. We also offer clearance online. The product mix is a little different but not radically different. Funnily enough we sell a lot of tents and camping in summer because people actually don't want to have to pick those up from our stores, they want it delivered to their doorstep. So from a gross margin point of view it's not radically different and from a profit point of view, because it doesn't have rent and it doesn't have staff but it does have IT cost and it has the direct online team, it does have some operating cost and delivery cost but it's still hugely profitable. The EBITDA percentage would be higher than for a store.

Mark Todd: Certainly it's not as strong as our best stores, Ken, but it's certainly better than the average.

Ken Wegener: (Phillip Capital, Analyst) Yes, but you'd expect that to grow over time as you leverage the fixed cost component within that...

Peter Halkett: The higher sales you can do the more you can spread the IT costs across it and also a lot of the management team. We've got an acquisition manager, we've got a social media manager, we've got a trading manager, we've got a fulfilment manager. We've got all those roles within that team that if you do twice as much you don't need to double the team size. Whereas in a store when you double the sales you generally have to put a lot more sales people on.

Ken Wegener: (Phillip Capital, Analyst) Yes. No, that's fine. Just one final thing on - just wondering about your new stores that opened in the half. Were they skewed towards the end of the half? I'm just trying to reconcile that inventory number as well. I'd appreciate...

Mark Todd: Yes they are. They are skewed towards the second half, the last quarter of the year, yes.

Peter Halkett: That's why there's quite a small gap between same store sales and total sales increase directly. It would have been a bigger gap because we would have opened - well, as we said, nine stores, and if you open them in September that's quite a difference than when you open then in December and January, and that's partly the answer to Adam's question before about stock is that we'd have had nine stores and they'd opened in September we would have had less stock than opening four stores in January.

Ken Wegener: (Phillip Capital, Analyst) Yes. No, that's how it looks. Thanks guys.

Peter Halkett: Cheers, thanks. I think that's time, moderator.

Operator: Yes sir, I'll hand the call back to yourself for any additional closing remarks.

Peter Halkett: Well, thank you everybody for dialling in. I know we're going to meet up with several of you over the next three or four days. I'm looking forward to that and thank you once again for dialling in and appreciate your support and interest. Thank you.

Operator: That does conclude our conference for today. Thank you for participating. You may all disconnect.

END OF TRANSCRIPT