Company: Kathmandu Ltd

Conference Title: Kathmandu Full-Year Result Release Investor Call

Moderator:

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Operator: Good day and welcome to the Kathmandu Full-Year Result Release Investor Call. At this time, I'd like to turn the conference over to Xavier Simonet. Please go ahead sir.

Xavier Simonet: Thank you Nathan. Good morning everybody and welcome to the FY2016 Full-Year Results Presentation for Kathmandu Holdings. My name is Xavier Simonet and I am the CEO the company. Reuben Casey our CFO joins me on the call. We will be talking for about 5 minutes just to summarise what we think are the key numbers and the key results and then we will take questions. The presentation files 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. If you move to slides four and five, in a few words I'd like to highlight our key results for FY2016.

In terms of sales and gross margin, what I consider the main achievement of financial year 2016 is that we managed at the same time to grow sales and increase our gross profit margin. Gross margin reached 62.6% 110 basis points higher than in financial year 2015. The fact that our gross margins went back to normalised levels clearly shows that our customers can still see strong value in our products despite lower levels of discounting. It demonstrates that as a brand we can justify higher gross margin than if we were just selling on branded stuff in our stores. Total company sales increased by 4% on prior year with the same store sales growth of 1.6%. 1.6% is lower than what we initially planned for financial year 2016.

But at the end of the day it was last year all about finding the right trade-off between gross margin expansion and same store sales growth as we were reducing the level of discounting. From our point of view, the main priority in FY2016 was to reset the gross margin at a healthier level which we have achieved. Now if we look at costs and efficiencies because of the restructure, we went through at the beginning of FY2016, we generated cost savings across the whole year and the team continued to work hard on driving efficiencies. Operating expenses decreased by 260 basis points as percentage of sales or $3.2 million. Hence, we improved our operating leverage.

We generated strong operating cash flow and have a record low net debt. Profit-wise EBITDA was up 37.6%, EBIT up 53.3%. Net profit after tax was up 64.2% or an improvement of $13.1 million. Now if you move to slide seven and eight sales and same store sales growth, total company sales reached $425 million with Australia accounting for around two-thirds of our total business. In Australia, total sales grew 7.4% while same store sales at constant rates grew 2.6% on prior year. In New Zealand total sales grew by 1.9% with same store sales basically flat on prior year. UK sales were down 10.5% with three store closures as per our strategy. Online sales increased by 15% and account for nearly 7% of total company sales. Reuben?

Reuben Casey: Just moving on to the gross margin as Xavier mentioned earlier along the sales growth had an improved gross margin in FY2016 versus FY2015. We've got a long term [inaudible] between 61 and 63% and FY2016 ended up near the upper end of this range at 62.6% which was 50 – 50 basis points higher than we originally expected as we began the year. Key reasons for this were a greater proportion of full price or early sale price sales, which resulted in increase in average selling price of the unit and less clearance as a proportion of total sales.

And as I said at the half year, gross margins in the second half were below FY2015, but not to the extent that we had expected from the currency. Looking ahead, we do expect more pressure on margins as currency hedges roll off. So we split the year-on-year decline in gross margins for the

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first half, but relatively flat year-on-year in the second half. If we move to the cost of doing business, as promised we delivered some reduction in operating expenses. Promotional spend was reduced as a percentage of sales following the review we carried out at the start of the year. We also saw some leverage come through from investments in core systems that we've made in the last couple of years, particularly in our distribution costs and retail labour costs as well.

Xavier mentioned earlier, we carried out a structural review of our support office staff earlier in the year. Offsetting this, there is always things that go up rather than go down and offsetting this is increased rent expense from two flagship stores we opened in Melbourne and Adelaide, a new Australian DC and our flagship support office which has opened in April this year. That is on top of just the standard like-for-like store increases, which runs around – between 3% and 4%.

Xavier Simonet: Now if we move to on slides 13, 14 and 15, country results. Let us start with Australia; in Australia, gross margin improved by 70 basis points. Total operating expenses went down 280 basis points and EBITDA improved by $10 million to nearly 12% of total sales. We opened four stores and have a network of 114 stores.

In New Zealand, gross margin improved 160 basis points and operating expenses decreased by 260 basis points contributing to record EBITDA trading results with margin percentage of nearly 25% of total sales. We opened one store and have a total of 47 stores. In the UK as per our strategy to close unprofitable assets, we closed three stores in FY2016 and one more store remains to be closed as soon as possible. EBITDA loss reduced from 1 million British pounds in prior year to 200,000 British pounds in FY2016. We are continuing to trade in the UK particularly through our online shop and marketplaces, but the UK has to be profitable and the business models that we elect have to be structurally profitable.

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Reuben Casey: Okay moving on to cash flow we had a strong result with operating cash flow, which was – which came about through a decreased working capital requirement, primarily inventory, and also obviously an improvement in our profitability as well. We did have – also have a one-off benefit from lease incentives relating to the new Australian DC. We also continue to invest for the future and expand in our store network and refurbishing the existing stores. But – but a feature of the Capex spend this year was infrastructure in terms of the new Australian DC and our [inaudible] but both of those projects fell in the same financial year so had an increase in spend there.

Notwithstanding that our balance sheet ended up in a very strong position at the year-end. We communicated a targeted decrease in stock per store between 10% to 15% and we achieved 14.1% and end of the year with record low net debt levels. Moving on to the dividend on slide 19, the Board has confirmed the final dividend of New Zealand 8 cents per share, which is fully, frank for Australian shareholding and fully imputed for New Zealand shareholders. This brings the new – the full-year dividend to New Zealand 11 cents per share which is a 37.5% increase year-on-year.

Xavier Simonet: Moving on to slides 22, 23 and 24, strategy update. Designing great innovative, distinctive and sustainable quality products and solutions remains our first and core strategy. Our focus is to answer the needs of our customers related to adventure travel. By splitting the trading and merchandising functions from the design and product functions in FY2016, we forced the organisation to refocus on both the short term which is trading and promotions and the long term which is all the work our teams of designers and product managers do around product innovations and creativity.

We consider ourselves as a design product and solution-led business. Our five focuses remain the same as last year; customer centricity, creating distinctiveness, delivering great value to our

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customers, inspiring through our brand – brand and products, and cost control and efficiencies. Now in regards to our geographic focus, our objective is to protect our leading market share in New Zealand, which is a mature market for us, but also core to the story, the history and the success of Kathmandu. At the same time, we will strive to grow our penetration and market share in Australia where we have heavily invested in new stores, new shop fits and new capabilities over the last few years, investments that now need to be fully leveraged. We have enjoyed sustainable success in Australia since we started opening stores there but we can grow further. Coming back to growth initiatives, we have defined two types of growth strategies. Continuous – continuous strategies first which means doing better what we do already and leveraging existing assets. And then new growth strategies which are new initiatives the business is taking. So let's start with continuous improvement strategies; these strategies will deliver sales and profit growth in the next two years at the same time as we start executing new growth strategies which would take more time to get traction and scale. In terms of continuous growth strategies, I would like to highlight first the initiatives we're taking in cost efficiencies.

In FY2016, we invested in footfall counters for all our stores. Footfall counters are giving us the ability to track traffic and customer conversion and provide us with very much needed data to make critical promotional decisions, marketing investments and adjust trading activities. The workforce management system we are also putting in place will support our retail teams in optimising store level productivity and scheduling by allocating the right resources to the right stores at the right time. The workforce management system will also result in an improvement of our customer service. Omni-channel and online, we are continuing as a business to invest in online and digital capabilities as we expect online sales to continue growing at a much faster pace than bricks and mortar sales.

Our ambition remains for online to generate 10% of total company sales versus nearly 7% currently. As an example of the significant investments we're making later this year we will launch

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a responsive website which will integrate inspirational content and e-commerce leveraging our brand and product assets, delivering stories and videos with a commercial objective in mind. Moving on to brand and customer, I have touched base already on the focus we're putting on the Kathmandu brand. More than just a retailer, Kathmandu is a great brand. We plan to increase this year our communication and engagement with our customers particularly by bringing to life through digital and social media channels, distinctive and inspirational stories about our heritage, roots, values, our products and our expertise in adventure travel.

Store optimisation; we can certainly improve ourselves and gross profit densities in both Australia and New Zealand and hence the profitability of our stores. A critical aspect is the optimisation of space allocation to products that deliver high densities and product range optimisation. Some serious testing has been conducted in FY2016 and we will start applying in FY2017 the lessons we have learned. We will also pay more attention this year to our Capex spend per square metre. Sales and gross profit densities as well as Capex per square metre will be clear metrics of performance for the team in FY2017.

Pricing architecture and promotional model, the high-low model has been very successful for Kathmandu in Australasia. The under-performance we experienced in FY2015 required an adjustment to the model. We will continue the work that we initiated in FY2016 defining a more efficient and clear promotional calendar, adjusting our price point, updating our promotional messaging, making our promotional mechanisms more interesting and surprising our non-believers that the company will pull this year.

Now that I have covered continuous improvement strategies I want to say a few words about new growth initiatives; they are new strategies, which we have started to implement. As we are starting from scratch and in some cases have to evolve our pure own retail model, these strategies will require a bit of time before they deliver scale and traction. Initially, we want to show

that based on a capital launch approach we can define and execute profitable growth business models behind which we will be able to invest as soon as we identify the opportunity to accelerate.

I would like to particularly mention our international approach, which has two big pillars. The first one is a direct to customer online strategy. We will revamp in FY2017 our transactional website for international further to the full implementation of the responsive website we're putting in place. The upgrade in international website will not be based on a high-low model, that is to say discounts and promotions, but we'll leverage our inspirational brand and our great products. Basically, a very similar approach to what other global brands do; it's all about inspiring and being distinctive.

The second pillar is a wholesale strategy; we've discussed about it already. We're going to engage in a few months' time with a selected number of potential customers in Europe and North America whether they're department stores, sports chains, outdoor multi-brand retailers or special - specialty stores, and we are – we will seek their partnerships. We will update the market in due time on our progress. As part of our international growth strategies, we will continue to partner up with marketplaces to make our products available in selected countries around the world.

In regards to store expansion in Australasia, our objective of 180 stores has not changed. However, we are not setting ourselves any specific target in terms of store openings for FY2017. Pace of expansion will be guided by the ability to meet our profitability criteria. The need to not cannibalise existing stores, the requirement to deliver the right return on investment for our shareholders and to find the appropriate balance between large destinational stores where we can display our full breadth of offer and shopping malls that drives enormous footfall.

Now moving on to slide 26, outlook; it's really early to comment on trading particularly considering the changes in timing of our promotional calendar and that the fact that we just started the new year about six weeks ago. Very clearly, our strategy is to maintain a strong and primary focus on Australasia by leveraging the investments the business has made of the last few years. While we start opening up to the world and implement new growth initiatives. Okay so we're going to move on to questions Nathan. Thank you.

Operator: Hi there. Thank you. If you would like to ask a question, please signal by pressing *1 on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again press *1 to ask a question. We will pause for just a moment to allow everyone an opportunity to signal for questions. Okay we have our first question from Chelsea Leadbetter from Forsyth Barr. Please go ahead, your line is open.

Xavier Simonet: Good morning Chelsea. Morning Chelsea.

Chelsea Leadbetter: Good morning guys, thanks for taking my questions. Just firstly a little bit around the divisional mix between Australia and New Zealand; obviously New Zealand back in line historical earning levels or probably even better, but Australia is still well below where you have been historically. I would kind of provide a bit more commentary around kind of the two markets. I mean obviously I understand the cost differences but maybe the opportunities particularly in Australia.

Xavier Simonet: Yeah sure, sure in terms of market share penetration and level of maturity the opportunity is in Australia for sure. And if you step back a bit we have opened many stores in Australia over the last three to four years and now is the time to leverage these assets and drive penetration market share.

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Reuben Casey: The other thing to note Chelsea is the – in terms of gross margin we've had a – if you look back over the last five years we've actually ended up with a decline in Australia whereas New Zealand we've grown slightly, particularly in the last year so.

Chelsea Leadbetter: Anything going forward that's probably kind of about where [inaudible] for the business to trade, for the gross margin?

Reuben Casey: Probably depending on how well we can mitigate the impact of currency yeah. And we're still [inaudible].

Chelsea Leadbetter: Sure, and I guess a little bit further to that sort of obviously given us a bit of guidance around the currency pressure and the headwind particularly in 1H 2017. I mean is there some things that you're doing to offset that? Should we expect more strategic change benefits around cost efficiencies as well?

Reuben Casey: We've always done – done things as we've talked about last time we met, in terms of supply negotiations and change in some of the locations of manufacturer for some of our key products so that’s – that – that work really starts to bear fruit in the first half of this year. But equally the currency is probably at its most impactful the first half of this year as well. So let's say sort of balancing act.

Chelsea Leadbetter: So your guidance includes both the benefit of what you've done behind the scenes and the currency headwind itself?

Reuben Casey: Yes, yes.

Chelsea Leadbetter: Right and just last question, I mean you've obviously made a few comments around increasing competition in the retail environment; is there anything in particular that we should be aware of? Is it – is it sort of different between the two core markets?

Reuben Casey: It's – in New Zealand it's pretty, pretty stable. I mean Macpac and Torpedo7 are the main competitors there. In Australia, we are still waiting to see what Macpac decide to do with – in terms of their Australasian expansion or Australian expansion. So we expect them to start opening stores at some point in the next 12 months. So that should be an increase there and also there is also this new, obviously, the more mainstream retailers are, you know, the likes of Uniqlo and H&M, they all do down jackets and some of the products there.

Chelsea Leadbetter: Okay great and thank you very much.

Reuben Casey: Thank you.

Operator: If you find that your question has been answered, you may remove yourself from the queue by pressing *2. We will take our next question from John Stavliotis from Morgan Stanley. Please go ahead, your line is open.

John Stavliotis: Good morning guys.

Xavier Simonet: Morning John. Morning

John Stavliotis: Just first question on just the initial trading, you mentioned just a change in the promotional calendar timing. Can you elaborate on what – whether it's something you've changed the timing or whether it's just – just by chance?

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Reuben Casey: No, we changed the time so we had that clearance that was slightly later last year than versus this year. And also we've changed the – the structure of the members – members kind of month type period and the spring sales was a different – a slightly different promotion as well so, but it's timing and structure of the promotions that we've offered.

John Stavliotis: Okay and maybe just elaborate on this that you're thinking like behind the structural change in the timing of the promotion and what we should expect this year? Like are you going to start reducing promotional periods or – or just moving them around, can you just talk about that?

Reuben Casey: Probably don't want to discuss that on public forum, John.

John Stavliotis: Yeah.

Reuben Casey: Yeah.

John Stavliotis: But still–

Reuben Casey: I don't want to give away – give away our business plan.

John Stavliotis: Yeah, so still sticking to this high-low model –

Reuben Casey: Yeah.

John Stavliotis: [Inaudible].

Reuben Casey: Yeah, principle is still high-low model for sure.

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Xavier Simonet: We're not changing the model John. I mean as we discussed last year we're adjusting the model and optimising the model based on what we realised was not working.

John Stavliotis: Yeah okay. In terms of the reduction in the promotional spend as a percentage of sales, can you talk about any impact that's had, or how you have achieved that without having top line – major top line impact?

Reuben Casey: Well we – this time – this time last year we did a benchmarking exercise and it showed that we had room in our – in our spend to reduce as a percentage of sales, so – so we did that and really just looked at where we didn't get a return on that spend. Particularly – it's particularly outside of major sales, we didn't – we didn't see the benefit from the spend that we were – the investment we were making there. And also just a different mix of media channels that we targeted instead of sort of full mass market media channels, so we went slightly differently and we just pruned it where we could.

John Stavliotis: Okay and in terms of pricing you mentioned I guess less discounting last year is what helped the gross margin. Did you also put through any sort of, you know, retail price increases to offset the currency?

Reuben Casey: It's not really retail price increases that's important for us, it's more about the level of discount we offer, so the sale price we offer. So I mean you can call it either way, but it's the same end result.

John Stavliotis: Yeah and just last one; inventories come down quite a bit, [inaudible] inventory there's no issues there, that's also come down and you're happy with that?

Reuben Casey: We got probably slightly more clearance than we than we would like at the year-end, but not – not significant enough to have an impact – major impact.

John Stavliotis: Okay thank you guys.

Xavier Simonet: Thank you John.

Operator: Thank you. We'll take our next question from Adam Simpson from Macquarie. Please go ahead, your line is open.

Xavier Simonet: Good morning Adam.

Adam Simpson: Morning guys. Good morning Xavier. Just a question, I'll maybe get you to comment a little bit on how you saw the sales profile of the business flow through that June-July period. I mean looking at that update again, so it looked like the comp sales slowed a bit towards the last part of the – of the sale period. But interestingly you finished with, you know, almost your lowest average inventory for the last, you know, three years or so. So is that, did that inventory constrain your sales – low inventory constrain yourselves to the end of that period or I guess just talk us through that.

Reuben Casey: We had a strong – it's different in each country, so in New Zealand we – we had a slow start and a kind of mediocre finish you might say. In Australia we had a – had a strong start and it faded towards the end, but really the pattern changed across the sales, so we had more sales in the earlier part of the sales than the end. There's probably a few key products which maybe we had less inventory than we would have liked, but again that's not significant.

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Adam Simpson: Right, so is that you're saying that level of the inventory per store now is sustainable under your new sort of DC and stock flow sort of processes?

Reuben Casey: Yeah it should be, although, we have still got work to do in terms of our stock clearance. I mean it ended up 1.5 which is still – it's too low, so we should be able to more out of it than that.

Adam Simpson: Okay, and sorry just clarify your point there, so you – even though your inventory is lower, you said your clearance levels are what, higher than they were at this time last year?

Reuben Casey: Slightly higher, yeah. But last year we did – we – I mean in FY2015, we had – we had quite a focus on clearing our clearance so it's not unusual.

Adam Simpson: Thank you.

Reuben Casey: Thank you.

Operator: We will take our next question from Andrew Steele from First NZ Capital. Please go ahead.

Andrew Steele: Good morning Xavier, Reuben.

Xavier Simonet: Good morning.

Reuben Casey: Good morning.

Andrew Steele: Good morning Xavier, Reuben. Most of my questions have already been answered; but I guess a quick follow up on the inventory point; is there a specific target you are looking for in terms of inventory return going through into this year? I guess especially taking to account any sort of benefit of the new Australian Distribution Centre.

Reuben Casey: Overtime, we would like to get it north of two. But whether we can do that in one year, I'm not – I'm not sure that's completely possible so – because we've got to be careful about how we move through it. But, that's our long term – long term target is north of two, so probably over the next couple of years.

Andrew Steele: And just to clarify on for a per store constant currency basis you anticipate being at a similar level in FY2017?

Reuben Casey: Yes.

Andrew Steele: A bit of improvement there as well?

Reuben Casey: Similar level.

Andrew Steele: Okay, while you are not giving specific store rollout guidance for Australasia, can you give some sort of indication as to expectation for Capex spending for FY2017?

Reuben Casey: So financial year 2017 will round about 18 million.

Andrew Steele: And just finally following on from, you know, exit from the UK, which, you know, whilst it is only one store, do you anticipate any meaningful non-recurring costs coming out of this exit and any store relocations within Australasia?

Reuben Casey: In terms of the UK, no, we – we have provided for anything that we need to provide for in our – this year's result related to exit costs. In terms of Australia, no, there is nothing – nothing in terms of major cost. Is your question, are there costs associated with relocations or?

Andrew Steele: Any sort of abnormal that should come through.

Reuben Casey: Oh right. Yeah. No, Nothing significant.

Andrew Steele: Okay thank you very much. That is all from me.

Reuben Casey: Okay thank you.

Operator: If you find your question has been answered you may remove yourself from the queue by pressing *2. We will take our next question from Maurizio Viani from AMP. Please go ahead. Your line is open.

Xavier Simonet: Good morning.

Maurizio Viani: Good morning. Good morning. Could you speak about your – how you see the growth trajectory for the business because from what you reported and what you're talking about, the way you're talking about the future, it seems that you've stabilised the business, slammed a break on costs and reduce the inventories. And now you're saying we are testing – you're still testing overseas expansion and we don't know what is going to work. Once we know we're going to invest in it. So should we see fiscal 2017 as a lull for the business where your – your store expansion is – has been extensive in the past and you're – you're signalling perhaps a lull there too. You're not too – not too far from your target and you're not saying how many you're going to

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open this year. So is fiscal 2017 a lull until you work out how to best approach the overseas market? And the second part of the question, is the brand strong enough for the – for the international markets and what kind of investment do you need to make to make it strong enough?

Xavier Simonet: Yeah I mean if – if the question is about whether we expect scale and significant profit from international this year in FY2017, the answer is no. We do not expect to actually invest too much money because it is a capital light model we are testing. Therefore, growth and profit growth for the business is not going to come from international in FY2017. You're right, we're not going to open many stores in Australasia, but to step back a bit we've opened 15 stores a year over the last few years except last year. So, we really expanded very quickly with a very strong focus on opening stores. I think the right time has come to now leverage our assets and we know we can drive more profitability by store and drive like-for-like sales growth and densities. So, there is a big opportunity there.

Also, as far as the brand is concerned, in Australasia and products we're trying to move from just offering discounts in terms of value to our customers to, yes, we're giving value, but we also want to excite people around the brand and around products and we could see some traction at the end of last year in FY2016 on new products and people ready to pay more for products that they thought would be great and more inspiring to them. So there's still potential to grow in Australasia, but it's more focused on driving densities and same store sales growth and leveraging our existing assets and all the investments the business has made over the last few years versus continuously opening stores across the country.

Reuben Casey: We still have a target for five new stores in FY2017 in total.

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Xavier Simonet: As far as the question around the brand is concerned, we have done a lot of work as part of our international strategy. We have done a lot of work on distinctiveness; what is the distinctiveness of the brand, what are our distinctive products versus competitors? From what angle should we approach international? What would make us distinctive? So yes, we are not, I mean we are not global for sure; absolutely, the brand is not global. But initially it's not really about spending millions of dollars in building up the brand equity. It is about defining what aspect of this distinctiveness we think we have in terms of our brand, in terms of the products, and driving that, and making sure that we can drive traction and when we get traction, accelerate and invest on the back of it. Does that answer your question?

Maurizio Viani: Yes, thank you.

Operator: It appears there are no further questions at this time. Mr Simonet I'd like to turn the conference back to you for any additional or closing remarks.

Xavier Simonet: No, I think we – we are done. Thank you, Nathan. Thank you everybody. Have a good day, thanks for joining us.

Operator: This concludes today's Kathmandu Full-Year Result Call. Thank you for your participation. You may now disconnect.