Conference Transcription 18 March 2010

For

Kathmandu Holdings Ltd

Start of Transcript

Operator: This is Premier Global Services. Please stand by. We are about to begin.

Good day, everyone, and welcome to the Kathmandu Holdings Limited half year results announcement.

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.

Peter Halkett: Thank you, Maya. Welcome everybody. On the call with me today is Mark Todd, our chief financial officer. We're discussing our results for the first six months ended 31 January 2010. This is the first period Kathmandu has reported since becoming a listed company in ASX and NZX last November.

We'll be using the half year presentation that was put on the ASX and NZX website as the basis for our discussion this morning. I hope people have that. If you haven't, we'll talk in as much detail as we can anyway.

The information we've provided is in New Zealand dollars, however, there is some summary Australian dollars. Also, most of the numbers we're going to be talking today will have performance after eliminating one off costs associated with our IPO last November, unless I specifically advise otherwise.

The edited presentation will be approximately 10 to 15 minutes allowing 15 minutes of questions afterwards.

Just if you do have the presentation, we're going to look at pages four, five and six initially and then we're going to refer to slides number 20 and 22.

If I can just go to page four first of all and this essentially outlines the year on year result for the equivalent period. The sales were NZ$106.6 million. That's a difference of NZ$23 million and up 27.5% on the prior period.

The EBITDA was NZ$18.1 million, up NZ$5.3 million or 41.2% on the previous period. The EBITDA margin grew from 15.3% to 17%. The EBIT was NZ$15.5, up NZ$5.1 million or 49.6% on the prior period and the EBIT margin also grew from 12.4 to 14.6.

The net profit after tax excluding IPO costs was NZ$4.4 million. That was up from a loss of NZ$2.4 million last year and a difference of NZ$6.8 million.

There were 90 stores this year compared to 80 stores last year.

If I talk about that in Australian dollars for our Australian colleagues, that's AU$85.8 million sales in the six months, a difference AU$15.6 and an increase of 22.2%.

The EBITDA was AU$14.5 million. This was AU$3.8 million up or 35.3%. The EBITDA grew from 15.3% to 17% and the EBIT was AU$12.5 million, up AU$3.8 million or 43.3%. The EBITDA margin also grew from 12.4 to 14.6.

The net profit after tax was AU$3.6 million versus a loss of AU$2 million last year, up AU$5.6 million.

Mark's going to talk through the next slide which is page five. In our prospectus we only put in a full year forecast but we knew we were going to get lots of questions from our advisers and our investors on how we were tracking towards that so management have put together an estimate of what we believe the half year mark would be relative to the prospectus and how we're tracking against that.

I'm just going to hand over to Mark now to talk you through that.

Mark Todd: Looking at the table on page five you'll see that compared to the half year expected sales performance at NZ$97.1 million we achieved NZ$106.6 million so that's an improvement of just under 10%.

EBITDA performance compared to the forecast prospectus was an improvement of NZ$3 million, just under 20% improvement, and net profit after tax, which is adjusted for the change in the costs structure that would apply under the new Kathmandu Holdings Ltd structure if it had been in place for the full year, because Kathmandu Holdings Ltd only existed for 72 days in this half year period, and for the new debt structure associated with Kathmandu Holdings Ltd as opposed to the period of ownership under private equity in this half year, net profit after tax would have increased by NZ$1.3 million or 20.7%.

Peter Halkett: Thanks, Mark. Just moving to slide six and I guess this is what probably a lot of you are interested in, how was that result achieved? I guess the first comment would be that there's been a generally improved retail environment and we posted very good like for like or same store growth. I'll go through that in a minute.

We had a very successful Christmas sale promotion. There's a trend for people staying and holidaying closer to home and that was a result of the global financial crisis. People were more cautious and had less money to spend. I think there was a big increase in local holidays, camping, and that impacted our products like Basecamp in New Zealand. Overall, the travel and adventure is a growing category anyway as people are seeking a healthier lifestyle and getting fit and just enjoying the benefits of travel and new experiences.

Also assisting the result was all our new stores have been trading very well and trading to or exceeding expectations and we also had two more stores at the Christmas period than we expected to have. That assisted as well.

Overall there's been a very positive environment with new stores, but not only that, we've ensured that we've kept very tight control of our costs and our margins to ensure that that increase in sales and profitability flow through to the bottom line.

We have had a significant improvement in operating leverage and that's a function of increased sales, but we do have a number of savings created through our supply chain such as international and domestic freight and improved inventory management which has reduced to our lower stock level.

Just touching on the like for like, the same store sales overall were 13.7% and in New Zealand the same store sales were 14.1% and in Australia 9.9%. We think most of this difference was reflected in the stimulus package, however, some of it will be the fact that we had more new stores in Australia which probably led to greater cannibalisation therefore lowering the average like for like increase or same store increase.

I'm just going to go through now and just look at the future outlook which is slide number 20 if I remember rightly, slide number 20, and give you our view on how we see the balance of the year.

First of all the market conditions, overall we think retail in the wider economic environment will continue to improve. There still remains a number of uncertainties and risks. In Australia in particular we think the economy is very strong and the outlook very, very positive, however, in the short term there is some risk as the government stimulus package cycles through and making it harder for like for like or to get growth on the equivalent period last year.

New Zealand, this is certainly a case of a long, slow but steady recovery but it's very fragile and it's very fickle. It can be up one minute down the next, very unpredictable. In the United Kingdom we see that as a difficult market and we're not intending to expand in that area for some time yet.

From a forecast point of view we are sticking to our prospectus forecast. Clearly we've had a very good start and theoretically we're ahead but it's a relatively small proportion of the year. It's about 26% of our profit and 40% of our sales so we've got far and away the majority to go. That's a different trend from most other retailers. They generally have a strong Christmas so for us the balance of the year is the most critical part.

The influences for the second half will really be the success of our Easter and winter sales which are a very high proportion of our sales. Being a winter orientated brand we need a good cold winter. We have had a variety of weather conditions over the past and even if it's a little warmer than average we can still do very well, but we wouldn't like a very warm winter. We need to be cautious about just what winter may bring this year. Ultimately we need the retail environment to continue to be strong to ensure that we can deliver that prospectus.

We are ahead but, as I made the point before, it is a relatively small proportion. It's a great start to life as a public company but the prospectus forecast to us is especially critical. That's what we want to deliver and that's what we want to aim for.

As per the prospectus there is no interim dividend. However, the final dividend of $0.067 will be paid presuming the prospectus forecast is achieved.

Just one other comment before I take some questions is just updating you on our growth strategy. Kathmandu's growth over the next few years is going to be driven by a store roll out. That's going to be driven by upgrading the existing store portfolio and growing our product range.

So from where we look for this period, we did say in the prospectus we were going to open 12 stores, it's looking like we should open at least 12. We might get up to 15 stores and that will help us and that will help us grow revenue. That's on track and we already have a number of stores in the pipeline and under negotiation for the following year.

From a store improvement point of view we've upgraded our Brisbane CBD store and our Christchurch Cashel Street store and they will open in time for our Easter sale next week. We've also upgraded our Bourke Street store in Melbourne. In the next three months we'll be upgrading our Kent Street store and our Dunedin store. We've got other upgrades planned at our Wellington store and our Sylvia Park store and Auckland is expanding.

We've got a lot of refurbishment work underway and we intend overall to be upgrading about eight of our portfolio every year as well as opening new stores.

On the product side, we've got some fantastic new products coming in. Some of those products are coming in this winter. Some of them will be coming in next summer. New thermal ranges, new travel accessories, new Merino products, new fleece and we've upgraded our GORE-TEX jackets and there's some new GORE-TEX jackets coming in as well.

There's a lot of opportunity to grow our revenue based upon growing our product offer and improving our product offer as well as improving our inventory management and reducing our out of stock.

Our growth is absolutely on track and so we're very pleased with that.

I have edited the presentation as you can tell. I hope it hasn't been edited too much, but I think it's probably better that we take questions. I'll hand back to the moderator who will provide some questions back to us in some sort of orderly fashion. Thank you.

Operator: The question and answer session will be conducted electronically. If you would like to ask a question please do so by pressing the star key followed by the digit one on your touch tone telephone. We will proceed in the order in which you signal us and we'll take as many questions as time permits. If you are using a speaker phone, please be sure your mute function is turned off to allow your signal to reach our equipment.

Once again, please press star one on your touch tone telephone to ask a question.

We'll now go to our first question in the queue from the line of Chris Adams from *New Zealand Herald*. Please go ahead.

Chris Adams: (*New Zealand Herald*, Reporter) Hi there, guys.

Peter Halkett: Hi, Chris.

Chris Adams: (*New Zealand Herald*, Reporter) I was just wondering if you could explain to me that negative NZ$2.4 million and the impact for the prior period and what was sort of driving that. What caused that?

Mark Todd: Well that business is, of course, seasonally weighted to the second half but specifically the business last year operated under the debt structured associated with private equity ownership so we carried on our balance sheet last year at an average debt of around NZ$180 million, so it's the interest costs servicing that debt.

Chris Adams: (*New Zealand Herald*, Reporter) Okay, cool. Thank you.

Operator: Our next question comes from the line of Carrie LaFrenz from *Australian Financial Review*. Please go ahead.

Carrie LaFrenz: (*Australian Financial Review*, Journalist) Hi there, guys. Just a quick question on the UK. I'm just wondering if you remain committed to remaining in that market given that you said that you're definitely not planning on expanding there any time soon and you plan on expanding significantly on Australia?

Peter Halkett: Well it's fair to say there's a few question marks over the UK because it's a pretty difficult market at the moment and there's not that many New Zealand and Australian retailers that have succeeded in that part of the world.

However, we're doing well enough that we think there's a possibility of success and we're putting a lot of effort into developing the model and seeing whether we can get the economics right. We're really part way through that process at the moment so it would be certainly too early to say that we're going to go or stay.

The word you use is committed. One thing we are is we're committed to giving it a very good go but we're not committed, we do not want to put a lot more capital investment and long term leases in the place, into the UK, before we're confident that it can be a profitable business.

But we are very determined to make it work but we're also sensible that we're not going to put in a lot more capital.

Carrie LaFrenz: (*Australian Financial Review*, Journalist) Okay, thanks a lot.

Operator: As there is only one further question in the queue, as a reminder if you would like to ask a question, please press star one on your telephone at this time.

We'll now go to the next question in the queue from the line of Warren Head from Headliner Publishing. Please go ahead.

Warren Head: (Headliner Publishing, Managing Editor) Good afternoon, gentlemen.

Peter Halkett: Hello, Warren. How are you?

Warren Head: (Headliner Publishing, Managing Editor) Good, thank you, Peter. I'd just like to congratulate you on the depth of the detail in the presentation document. As a first start of a new company it's great to see.

Can I just ask for a little bit of help, however, on pages 12 and 13? They refer to New Zealand and they refer to Australia. The sales are up to NZ$42.8 in New Zealand. They're up to AU$47 in Australia. The variance in the number of stores, however, you've got 51 stores in Australia and 33 in New Zealand and the EBIT lines are not too different.

Is there a fundamental reason for that? Is the store size smaller in Australia or is the success rate higher in New Zealand? Is there a...

Mark Todd: There are a couple of fundamentals for a New Zealander looking at the comparison to Australia, Warren. You've pretty much hit one of them on the head. The stores portfolio on Australian stores are smaller so you don't replicate some of the stores you might be familiar with in Australia and it's simply a more costly place to do business from the perspective of occupancy cost and salaries and wages in particular.

Warren Head: (Headliner Publishing, Managing Editor) Right, okay. Now as we drive forward into the second half, do you expect New Zealand as a more winter oriented company to perform more strongly than Australia or is that not the case?

Peter Halkett: Well New Zealand in relative terms performs better than Australia through winter but of course our budget and our forecast reflects that anyway, Warren. I guess you could say that the point I made around risk, the exposure to a cold or a warm winter, is probably more related to New Zealand in the southern areas and Australia in the southern areas. Not all our stores would suffer if it turned out to be a warm winter.

Warren Head: (Headliner Publishing, Managing Editor) Right. My third and final one is the degree of what some people are calling the fiscal fade in Australia. I think a lot of people put their hands up to say that they got some benefit from it. Sky City Casino remarked upon receiving some benefit. Fletcher Building of course got the benefit of the insulation spend, so the 900 bucks went quite a way.

Have you got any feeling for the degree of impact of that fiscal fade or is it just very unclear?

Peter Halkett: It's very, very difficult to tell. You'd have to interrogate each customer as they were coming in the store or undertake some other sort of research. The best guide we have is the like for likes in Australia were 9.9% and in New Zealand, where we really didn't have much of a stimulus package, it was 14%. There was a little bit of stimulus I guess you'd say in New Zealand but overall I'm not sure that it impacted us greatly.

I think the main issue for us is Australia because there's been billions and billions pumped into the economy to fuel it. How much our category got and then how much our business got is difficult to tell, but the 4% like for like difference explains some of that although we did open more stores in Australia so therefore there'd be greater cannibalisation which could also be a reason there's a difference in same store sales.

For us, given that we've already absorbed some of the impact of the stimulus we're probably being a little cautious about what we expect through April and May in Australia but we think it's better to be cautious, particular as it's our first year as a public company, than to be overly confident and then find we get ourselves into trouble because we overestimate what we're capable of achieving.

Warren Head: (Headliner Publishing, Managing Editor) Thanks, Peter.

Operator: We'll now go to our next question in the queue from the line of Ben Heather of *The Press*.

Ben Heather: (*The Press*, Reporter) Good day, guys. I was just wondering, it's probably been reported somewhere but I couldn't find it in the presentation, what were the full year results for the last year?

Peter Halkett: They're in the prospectus, Ben, an EBITDA number of around NZ$50 million in the previous year.

Ben Heather: (*The Press*, Reporter) Thank you.

Operator: Again, as there is only one question left in the queue, if you would like to ask a question please press star one on your telephone.

We'll go to our next question from the line of Theresa Ooi from *The Australian* newspaper. Please go ahead.

Theresa Ooi: (*The Australian*, Journalist) Hi, guys.

Mark Todd: Hi, Theresa.

Theresa Ooi: (*The Australian*, Journalist) I'm just wondering, do you see your growth, where you're going to put in more stores is that going to be concentrating on Australia rather than New Zealand?

Peter Halkett: Over the next three years we'll be putting in approximately 50 or 40 more stores in Australia relative to, say, 17 more stores in New Zealand. Ultimately we think we're going to get to 150 stores, 50 in New Zealand and 100 in Australia. Certainly proportionately there'll be more in Australia.

If you look at the turnover we generate out of each country, I can't remember off the top of my head, but on an annualised basis Australia is 55% of sales and New Zealand 40%. Proportionately given the population you'd see a lot more opportunity in Australia as well.

Theresa Ooi: (*The Australian*, Journalist) Okay, do I understand from what you are saying, you might pull out of UK?

Peter Halkett: No, no, you shouldn't read that at all and I'd be very concerned if that was the message. What we're really saying is we haven't got that business to profitability yet. We're still working on developing the product offer, the marketing and exactly the right store model. We don't want to continue to increase our investment there. We've got six stores which is enough to get the model right. It may prove that we can't succeed, but we certainly haven't given up at this point in time.

Theresa Ooi: (*The Australian*, Journalist) Is that because UK is going through, still, the downturn of the GFC and do you see some light at the end of the tunnel?

Peter Halkett: Yes, I think we'd say that a) it's not a very good time to invest in the UK because it's still very difficult, although the medium term prognosis looks like they're going to start slowly moving out of it. The other one is we just haven't got our business in the right place yet to consider putting more investment in.

I think you should see Kathmandu UK as a development opportunity and we're still developing that and getting the business model right.

Theresa Ooi: (*The Australian*, Journalist) Are most of your stores in UK in London or are they spread?

Peter Halkett: We've got four stores in London, one in Brighton and one in Bristol.

Theresa Ooi: (*The Australian*, Journalist) Okay, so then no further expansion in Europe?

Peter Halkett: We only operate in the UK. We're not in wider Europe. We don't wholesale. We're vertical. What I would say is there's no more stores in the UK this financial year. Given that the financial year ends in July it's not that far away. We're not saying that we wouldn't open them beyond that point. What we're saying is within the next four to five months we're not intending to open or commit to anymore stores in the UK. That's not that long a time frame.

Theresa Ooi: (*The Australian*, Journalist) Okay.

Peter Halkett: I don't think people should misread that and assume that we're going to exit or that we've got a problem there. We're very happy with the way it's progressing.

Theresa Ooi: (*The Australian*, Journalist) Alright. When are you going to make a decision with regards to UK? I mean you're right now working on the model, you're not going to put anymore investment, you're going to keep the six stores.

Peter Halkett: It's probably not a decision that's based upon time. It's a decision that's based upon confidence. I guess we would make a decision about the UK when we don't believe that there's a long time business there.

I think that's probably going to take a couple of years to do all the things we want to do to answer that question, but it's certainly not a function of in 12 months we will decide. Not at all.

Mark Todd: Theresa, one metric around the UK, too, is that we've had consistent same store sales growth in the UK throughout the last two to three years. We've always been looking at it as a business where we continue to grow the sales performance. When you're a start up business you're always going to start off a low base.

Theresa Ooi: (*The Australian*, Journalist) Right, but you're talking about same store consistency, same store growth. How many per cent are we talking about?

Peter Halkett: As you see in the presentation this time it's 13% I the last six months and we've had good same store sales growth. The previous details I think are in the prospectus. 13% is a very positive trend for us which gives us...

Theresa Ooi: (*The Australian*, Journalist) But it's still not delivering a profit, is it?

Peter Halkett: I wouldn't expect six stores in the UK to deliver a profit anyway. We need a portfolio of stores north of 10 before you could make a profit because of the amount of overhead you've got in place. The question is whether the individual stores are meeting their financial milestones so that you then say at 10 stores we would make a profit.

What I don't choose to do is to open another four and hope that that gets to that point.

Theresa Ooi: (*The Australian*, Journalist) Okay, how many per cent of your revenue is UK?

Mark Todd: Less than five. Just under five.

Peter Halkett: At the moment, technically it's a loss so it's a drag on profit so it's factored into the valuation already.

Theresa Ooi: (*The Australian*, Journalist) Loss of how much?

Peter Halkett: £0.2 million.

Theresa Ooi: (*The Australian*, Journalist) £200,000 then?

Peter Halkett: £200,000 in the half year.

Theresa Ooi: (*The Australian*, Journalist) Can I just clarify what was your cost of the IPO?

Mark Todd: Yes, the total cost of the IPO was approximately NZ$21.3 million and the meeting of those costs was met from the proceeds of the share issue before the rest of the share issue proceeds went to the existing shareholders. It wasn't a cash cost to the business. Effectively it was a deduction from the money raised from the share issue.

Peter Halkett: Ultimately there's no burden or no cost, or not significant cost, to the new shareholders in the company, new investors in the company.

Theresa Ooi: (*The Australian*, Journalist) If we include the IPO costs you would have reported a loss?

Mark Todd: Correct, yes, and we have. From a technical accounting perspective the costs actually flow through the income statement but the actual proceeds that we got back from the share issue to pay for those IPO costs flow through the value of equity. They're in two different places within the financial statement.

Theresa Ooi: (*The Australian*, Journalist) Sure, and that would mean a net loss of NZ$11.3?

Peter Halkett: That's right. I think the point is, Theresa, we can't lift if we didn't incur IPO costs.

Theresa Ooi: (*The Australian*, Journalist) Sure.

Peter Halkett: And you can't account it any other way so it was there disclosed in the prospectus from day one. It's not a surprise to anybody.

Theresa Ooi: (*The Australian*, Journalist) Okay, you seem a bit more upbeat in your forecast. You said that you will meet your prospectus guidance. You think that Australia seems to have made the turn and things are looking a bit rosier. New Zealand is still a bit uncertain.

Peter Halkett: Well as I said in my update I think Australia, the medium to long term prognosis is very, very good. The economy is looking very strong. There's a short term cycling out of the stimulus package that is some risk which is why we're a little conservative in the second half of our reporting period.

The New Zealand economy isn't as strong as Australia. It's a longer, slower, but it is a steady climb but it's very fragile, too. One day good news can affect customer sentiment and then the next day bad news will come along and knock that sentiment.

I think it is two different economies but the good thing is they've probably proven through the global financial crisis to be performing economies coming out of the global financial crisis.

Theresa Ooi: (*The Australian*, Journalist) Not much of your - in the last six months was a lot of the sales driven by discounting?

Peter Halkett: That's a relatively complicated topic because Kathmandu and our business model is actually a promotional company and it's driven a lot by our sale model; our Christmas sale, our Easter sale and our winter sale are sales phenomenon and customers wait and hang on for those.

It's fair to say that a fair amount of our activity is achieved through our sale promotion. The term discounting often means that you have to sell it cheaper than you otherwise would. The answer to that is no and hence the reason you'll see in our financial pack that our gross margin is still very, very healthy.

Theresa Ooi: (*The Australian*, Journalist) But is it still driven by sales and sales as in slightly cheaper offers?

Peter Halkett: Yes, well it's been driven by sale for 11 years.

Theresa Ooi: (*The Australian*, Journalist) I don't understand. If it's driven by sales for the last 11 years and you said that it's not actually discounting.

Peter Halkett: Well discounting often refers to what is your margin expectation and did you have to give a further discount off that. For a topic on the conference call today, Theresa, I'm not sure it's the right thing we should be discussing in this sort of forum.

From our point of view our Christmas sale, which is an event that offers tremendous value to customers and as off full price, was very successful and helped drive this result.

Theresa Ooi: (*The Australian*, Journalist) So when you're talking about your Christmas sale you're not talking about discounting prices, you're talking about that period of sales over Christmas which was very strong, is that right?

Peter Halkett: I think this is more of a topic off line to be honest. I'm not sure how the other people are feeling on the line.

Theresa Ooi: (*The Australian*, Journalist) Let me pursue that when I talk to you later.

Peter Halkett: I think that's probably the better place.

Theresa Ooi: (*The Australian*, Journalist) Okay.

Operator: As there are no further questions in the queue, that concludes today's conference. Thank you all for your participation.

Peter Halkett: Thank you.

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