



Conference Transcription

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Kathmandu Ltd

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Investor Call

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Start of Transcript

Operator: Good day everyone and welcome to the Kathmandu Full Year Results Release Investor Call. 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 Mark Todd. Please go ahead.

Mark Todd: Thanks, Paula, and welcome everybody. With me today on the call is Reuben Casey our General Manager of Finance and as you are aware we are going to be discussing our recently released results for the year ended 31 July 2014. We will be talking to the results presentation that we filed this morning on the ASX and the NZX. I am presuming as normal that most of the people have either got access to that and then can follow me through as I talk through the slides. We will be presenting the results throughout in our reporting currency which is New Zealand dollars. The results presentation will be about 30 minutes and then we've got 20 to 30 minutes available for questions.

Reuben will be presenting some of the slides as well and he'll just cut in when it's his turn to talk. We'll overview the results first and talk about some of the key line items and then get into the country results and the overall cashflow balance sheet performance and then wrap up with a summarisation of growth strategy and outlook ahead.

So let's get started with the results overview and if you turn to slide 4 on the presentation talking about the highlights for the year. I think the key thing to point out as in FY13 this was a result which was impacted by translation effect of the Australian dollar's relative weakness to the New Zealand dollar. In the last couple of years the Australian dollar has weakened by over 15% against the NZ dollar. So in the year that we've just gone through we had an adverse currency impact in translating Australian dollar results to New Zealand dollars at the EBIT of \$5.8 million and were it not for that of course we'd be presenting a quite better result year-on-year than we have today.

But regardless of all that it was still a good result for Kathmandu with slight increases in EBITDA and EBIT and a slight reduction in NPAT and that was underpinned primarily by the Australian growth performance for the year with solid gross margins year-on-year and good same store sales growth in Australia and the UK in particular.

If we look at the actual individual numbers as I talked about if it wasn't for the fact that the Australian dollar was weaker in the year, if we converted it back at constant rate comparison year-on-year we would have had an EBIT improvement for the year of \$4 million a 7% increase because we basically had a \$3.1 million differential at the EBIT level from the exchange weakness of the Aussie dollar. At an NPAT level we would have actually been \$2.5 million ahead instead of a reduction of \$2 million. But putting those numbers aside we were pleased to still achieve with a relatively small sales increase for the year a slight growth in EBITDA a slight growth in EBIT and NPAT was down for the year by \$2 million to \$42.2 million. Overall in the year we opened another 13 permanent stores and we've ended up the year with 149 permanent stores as at 31 July.

Moving over to Reuben who can talk to the half year split, oh no actually I'll talk those through. We had a very good first half year but the second half year the primary change was a relatively difficult start to winter sale in the month of June. The last two years the second half year increase in sales has been 12% in FY12 and 8.8% in FY13 whereas this year we've only achieved a 3.3 percentage point increase in second half sales whilst OPEX has gone up

by 6% in the half and as a consequence operating expenses as a percentage of sales in the second half year were over 1 percentage point higher.

That is primarily a sales story when we talk about our operating leverage position for the year. We could have reasonably expected a better winter sale result than we achieved and we updated the market at the end of June after we'd had a pretty tough June period of trading which we talk about in a couple of slides' time. But we weren't necessarily confident about the growth in earnings performance year-on-year. Fortunately July was a much better for us and we did end up the year with a half year result for the second half that was only slightly down at the EBIT and the EBITDA level.

Then if we move to the next slide and talk about the actual underlying performance of the business taking out the impact of exchange gains, or exchange losses in this case, and breaking down for you further the source of sales revenue. You'll see firstly talking about sales revenue that new stores coming on stream year-on-year continue to be a significant portion of growth in year-on-year sales, \$21 million of our earnings our sales growth in the year was derived from part year and new year stores and that was despite those stores generally being later in the year than in the previous - than in FY13. So there's still a solid contribution coming from new stores.

Exchange rates as you see are really a substantial difference when looking at Group sales year-on-year 29 million reductions through translation difference on the Aussie dollar. Then talking about the underlying growth in EBIT as we've mentioned in the previous slide the \$5.8 million adverse effect in EBIT because of exchange rate. If it weren't for that the underlying growth in EBIT year-on-year was actually around 9% a \$5.6 million improvement. The other incremental adjustment in FY14 was the finalisation of our business interruption claim for the Christchurch earthquake which added \$1 million as a one-off increment to earnings in FY14. Those insurance claims have now all been settled.

Moving on to key line items and then talking in a little bit more detail about sales. We really continue to emphasise as we have done for a number of years how important our growth trajectory in Australia has been and

continues to be. Now we have grown Australian sales, we have doubled them from the first year - full year as a listed company in FY10 through to FY14. At the same time we've obviously seen substantial same store sales increases in Australia in that same period. So Australia has been and remains the growth engine for the business.

The New Zealand number, we'll talk about that New Zealand result in more detail later when we get to the country-by-country results. But we'd still highlight that even with the June adverse impact we still achieved a small sales growth result out of New Zealand for the year and we had a reasonably good year in New Zealand with the exception of the month of June. So for us in terms of growth Australia remains the growth engine of the business. It is now - it's more than two thirds of our total sales or just on two thirds of our total sales - and there's more a lot more growth opportunity to come in the Australian market.

When you move on to same store sales growth you see that accentuated in the next slide whereby we have had now four consecutive years of comfortably more than 6% same store sales growth in Australia. Second half same store sales growth in Australia was better than the first half despite the challenges we had in Australia in June. That's also supported by some really strong online sales growth across Australia and New Zealand and in the wider market globally, which we'll talk about later as well.

New Zealand's same store sale result would have been acceptable if it wasn't for June. June was the warmest June on record in New Zealand. It coincides with the start of our winter sale and it's unavoidably a month where sales under-performance has a significant impact on our overall result for the year. So we did have negative same store sales in the second half year in New Zealand and slightly negative sales overall. But in actual fact the only month in the second half year that we did have negative same store sales was the month of June.

June overall a reduction of 15.7% as you'll appreciate that's a pretty substantial number and it was pleasing to see how much of that we managed to recover through the month of July. But even with that adverse impact

good solid same store sales for the Group overall. I want to highlight the UK and we'll talk about the UK later, a same store sales result of 12.7% in the UK was a very satisfying result for us and has relevance for our future growth strategy plans in the UK and the wider global market.

The next slide gross margin I think the real summation for that is and have probably have said this before is there's not a lot going on here. Kathmandu has proven over a number of years to be pretty resilient in managing gross margins on a reasonably consistent basis. We've always flagged since we listed that we expect our target gross margins to be in the 62% to 64% range. We've achieved that again this year and it's very pleasing to have achieved the New Zealand upswing in margin despite the challenges we had actually achieving our winter sales' targets and the need to more heavily discount product in the winter season in New Zealand after that prior to June.

Okay that talks about the top end revenue, gross margin, gross profit line. I'll pass to Reuben to talk for a couple of slides now on the rest of the P&L.

Reuben Casey: Thank you, Mark. As you can see operating expenses increased as a percentage of sales year-on-year by 70 basis points. We did achieve leverage in our rental costs in Australia which is down to the fact that we have very strong same store sales in Australia. Most other costs were flat as a percentage of sales year-on-year apart from the ones which we've highlighted there which is advertising and investment in our internal online and system development capabilities.

To move through to the earnings summary on slide 13. We think this is a solid five year performance since we've listed and we would have had earnings growth in FY14 if the exchange rate impact was removed.

If we look at our country-by-country breakdown we'll start with Australia on slide 15 which is our biggest market. As Mark mentioned earlier we are very pleased with our sales performance in Australia. We delivered strong same store sales growth and earnings growth as well. That's despite the fact that the stores we opened in Australia were generally of a lower sales potential and we opened them later in FY14 than we did last year as well. We are

confident that we can get approximately 30 extra stores in Australia with our store rollout plan to come.

Moving on to New Zealand on slide 16. It's a much tougher market for us for Kathmandu than Australia has been in the past year. As Mark mentioned we did get positive same store sales in the second half in each month apart from June. We've seen Mountain Designs and Snowgum exit the market in New Zealand. So it's certainly a strong competitive market and we've seen more competition amongst relevant big box retailers. Despite the tough market we did deliver a small increase in earnings. And we also invested in our - improved some of our key stores. We did an upgrade at Petone and we'll continue to do that as we move through the network.

In the United Kingdom on slide 17. We are very pleased with our same store sales results especially in the second half and that's both in bricks and mortar stores and in our online space. We launched on NEXT UK and Amazon UK and they've been successful for us in the past year. We did an initial toe-in-the-water brand building advertising campaign and we'll talk more about that when we get to the UK growth strategy.

Moving on to cashflow on slide 19. The main talking point here is we have had a decrease in our operating cashflow which is largely down to the increase in our inventory levels year-on-year. Mark will talk to that in a couple of slides' time. The other thing to point out is we have increased our capital expenditure year-on-year by close to \$7 million and most of that has been in our core systems platform, Microsoft Dynamics AX. We've spent approximately \$10 million over the past two years on this platform and we will be writing that off over the next five years so this will lead to an increase in depreciation from FY15 onwards.

If we look at our balance sheet now on slide 20. The increase in inventory also led to an increase in our net debt. We will be renegotiating our debt facility early in 2015 and we expect a favourable outcome from that. Despite the increase in net debt we still have a very strong balance sheet.

Mark Todd: Thanks, Reuben. I just want to talk a little bit about inventory levels because I know that will be a topic of reasonable interest because obviously year-on-year inventory levels grew 30%. It's interesting to reflect back on how Kathmandu chooses to buy to - or not chooses but in the end has to buy to two seasons a year and we regularly assess our approach to investment in inventory relative to our sales opportunity and we have to plan well ahead in terms of store rollout and new stores. So we certainly over-invested in inventory in Australia in the year that we've just gone through. We wouldn't shy away from that. In a perfect world we would have had slightly less stock at the end of the year than we do.

But it's very difficult to plan ahead when you've got a plan for 15 stores minimum a year and you're wanting to back same store sales opportunity that at the minimum you expect to be 5% and obviously it can be 10% better. You do also assess where your pattern of new store rollout goes and you tend to again err on the conservative. So when you look ahead into a year you'll plan and say we may open 10 stores in the first half of the year, 5 in the second and in actual fact in FY14 it was exactly the reverse. So we didn't actually have the retail network available to sell the stores.

But despite all that we did back ourselves to sell more in the Australian market by buying inventory than we actually achieved. We didn't have the retail network to sell through some of that stuff and we were affected by weather in the months of June and July. But we weren't going to basically discount excessively a lot of good season stock that can sell through in the next financial year. We've been in that situation at least once before since we listed. Those of you who have followed us since we IPO'd will know that Kathmandu is a great vehicle to be able to sell through excess stock on a structured basis where it's non-seasonal. An awful lot of our range actually is non-seasonal.

So we also have an online channel in Australia now and particularly Australia because that's our biggest online market which is the equivalent of eight average stores. So in all regards basically we tend to be a business that is willing to over-invest in inventory rather than under-invest. So as a

consequence that we were holding less stock at the end of the financial year than we - sorry more stock at the end of the financial year that we wanted and we had to take action on that to clear the stock post-winter sale. Now the key metric in that regard to identify how successful we've been in doing so is - there's two of them Number one is the fact that we've achieved same store sale performance in August of over 30% across our three markets which is a direct result of our clearance campaign for the month.

The second one is that as at the end of August our year-on-year increase in stock per store is only 11.8% overall compared to being 18.5% ahead as at the end of July. So if you use that metric and assess that we're now implementing, we've now implemented just enough our software forecast stock with new systems - new software system for forecasting and planning and we've got that impact on our operating stock planning into summer season 2015. We've moved a lot of that clearance stock through - we are very happy with where our inventory level is now six weeks after balance date.

The only thing - the other thing about valuation and the question is often asked as to whether it's good stock or bad stock is that we do a very detailed line by line item analysis of inventory at balance date and assess stock that we might have to value below cost to sell. We did that and we provided approximately \$350,000 in our end of year accounts for inventory that we plan to sell below cost. So we've had a very quick and successful clearance campaign and we have moved out of the business much of the stock that we didn't want to be holding at the end of July but we were left with because of the winter season.

Moving on from inventory to dividend and we'll switch back to Reuben.

Reuben Casey: Okay we have held our dividend at the same level as we did last year so it's a \$0.09 per share final dividend bringing the full year payout to \$0.12 per share. The dividend is fully franked for Australian shareholders and fully imputed for New Zealand shareholders. We will be paying a supplementary dividend to recompense non-resident shareholders, non-New Zealand resident shareholders for non-resident withholding tax.

If you look at foreign currency you can see here we've had some negative pressure on our margins over the past three years particularly in Australia as the Australian dollar has weakened against the US dollar. In New Zealand it's remained relatively flat over the same period. We have managed to maintain our margins over this period despite these pressures and as we continue to grow we do get more benefits from the volume buying discounts that we can negotiate with suppliers.

Okay I am going to pass back to Mark now to talk about the growth strategies.

Mark Todd: Thanks, Reuben. Those of you who have followed Kathmandu since it was listed will know that these growth strategies besides that I noted are basically very similar and have been followed through the last five years as we've grown the business in size by more than double. Focusing on them one by one.

New store rollout we've now flagged to you that we think our store rollout in Australia and in New Zealand will get to at least 180 stores which means at least another 30 stores in Australia. We can tell you virtually exactly where all of those stores should be. Compared to other mature trans-Tasman brands 180 is a reasonably average sort of number. There's certainly potential for more than that over time as the market penetration in Australia in Kathmandu continues to grow.

We expect to open most of those stores by FY17 and we expect to open 15 of them in FY15. We have eight of those sites already confirmed this year, Burwood and Miranda in Sydney, Byron Bay in New South Wales, Mt Gravatt in Brisbane, Essendon DFO and Watergardens in Melbourne and Cockburn and Joondalup in Perth. So they're all Australian stores as is most of the rest of the rollout. So we're much better placed for this year in terms of new store rollout than we were in FY14. We have more stores online quicker and inarguably they are in aggregate a better group of stores in terms of sales potential from the ones we've opened so far.

Our new stores continue to perform to expectations because in the end the business continues to grow at comfortably more than 5% same store sales year-on-year. So we're improving market penetration and we've got some metrics about market penetration to talk to in a wee while. We're introducing flagship stores throughout our prime CBD sites. We have flagship stores already in locations like Brisbane and Perth but we've got other CBD locations where we don't have a store which we consider to be a quality flagship store opportunity. Those you'll see in time as site renewals come up at the end of leases. We will continue to explore further store rollout format opportunities.

Rollout really remains the driver of core growth in the business for the next three years. But it will continue to be supplemented by same store sales growth for much longer for that as our market penetration improves.

Summit Club loyalty program, well basically we've still got at least in the Australian market alone we certainly think we've got at least an opportunity to increase current member numbers by a third of 50% in the next three financial years. The key thing about the Summit Club program is it can now turn to being a true loyalty program not just a discount club. We have it now sitting on Microsoft's Dynamic CRM and we've got the opportunity and have started to dissect our customers in terms of activity and high value so that we can enable ourselves to do target marketing and range alignment and range offers to those people.

We basically are starting the journey on presenting the opportunity to Summit Club members to buy what's appropriate to them, the deals they want that recognises their status as a member and creates more one-on-one direct relationships with those customers. They are already great - they are a core of our business they are well over 50% of our total sales, they shall only grow as being the most significant part of our customer base.

It's also relevant to highlight that in the UK one of the metrics around the UK performance was - in terms of the year's same store sales was one but growth in active Summit Club members was a number and we are pleased to see good growth in Summit Club membership in the UK in FY14.

The product offering one of the key messages around product offering for us in the years ahead is sustainability. We have talked about sustainability and the critical importance we view that that has to our customers and our own brand ethics and we'll continue to focus on improved sustainability practices in terms of our supplier relationships, our fabrication choices and our packaging and collateral material around it. We cannot emphasise enough that we think there's a core advantage in our category as being a leader in the sustainability area.

Going on to online and international. Well online now has exceeded 5% of Group sales in the current financial year and we continue to see 10% as a realistic expectation with the Group the way it's currently constructed. International shipping is being launched and international Summit Club membership is now available and we ship to more than 100 countries globally and we start this Christmas with our first effective campaign through Summit Club members to customers in terms of international shipping. As Reuben has already mentioned we started our first international marketplace sites in the year that we've just gone by and we've got further coming up in 2015 with a UK Europe focus in the first instance.

Optimisation of the store network I just mentioned a little bit earlier on about flagship stores in the CBDs. It needs to be recognised that Kathmandu has gone through a considerable transformation in store location and layout and set up since even 2009 when it was bought by private equity from our original owner. So, many stores that Kathmandu holds today in 2015, 2014 going into 2015 are not necessarily representative or applicable to the way we want the network to look like when we're a fully mature business. We've got a much enlarged brand product range offer since then. We've gone into range extensions. We've rebranded so it continues to be a key opportunity for us to optimise our stores by optimising their location, ranging to the right stores. Improving our return on each square metre or each dollar invested in the store in terms of inventory and just being smarter with that.

That's one of the key focuses that we had when we went with our new software platform for the business. So continue to expect to see our

investment in store optimisation even as a significant portion of our capital expenditure and development activity once our store rollout in the current sense starts to drop away a little.

Then just to talk about on - talking about systems a second ago and talking about our enablers. The key things about enabling these growth strategies to be continued are investment in systems. We can't - you cannot aspire to be a top notch retailer in Australasia and then with a global growth objective if you don't have effective CRM product forecasting and planning, service capability for online across the world with a top tier system platform. So that's been what our investment in Microsoft Dynamics AX has been in the last two years and will continue to be in the year head.

That's what it's all about for us. At the same time we've got to basically create efficiencies out of that exercise so that we have an end-to-end capability to plan and forecast and deliver to customers off a single platform with a single set of data to use to do so. So efficiency is a driver in that requirement as well and enabling our people to work smarter because we've got some very capable people, they just need better tools. At the same time we want to put them in the right work environment.

Our major project for this year coming up as we recently announced is a new office for the 160 plus people who work in Christchurch. Nearly half of whom are our product team, we've got to create a top tier work environment for those people because they are effectively the core to our success. Product is how this business will grow, best designed product leading in an outdoor market internationally needs a good work environment. So that's a major focus for us in '15 and '16.

I want to then just talk a little bit, accentuate a bit more about Australia because I come back to this point it's not about store rollout. Again we've been mentioning that and bring people back to our five year growth profile and what's gone on in the last five years. If you look at the metrics that are sitting on slide 27 you will see that most of the metrics show that this business has doubled or more than doubled in the last five years. Most of

these metrics support that the business will double, will actually grow by at least 50% in the next five years.

That will come from store rollout, it will come from improving sales per capita and market penetration. We talked a lot about the fact that even in the first year of listing that over time the New Zealand sales, the Australian sales per capita should be at least 60% if not at the very minimum 50% of the New Zealand market. That's what every other trans-Tasman retailer would expect as a minimum. We've pulled that number up so that in the end we've grown on a compound annual growth rate in Australia by 16% per annum whereas in New Zealand it's going up by only 9% per annum since listing and that growth rate will continue.

But at the moment we are still not even a third so Australia - the Australian sales per capita is not even a third of New Zealand. So that's where you will see over \$100 million worth of sales growth come from in the next five years ahead or slightly longer if it takes further than that time for market penetration to improve. But that will sustain core same store sales growth for a number of years to come in Australia.

The other driver of that will be a further half a million Summit Club members. We've grown Summit club membership in Australia by more than half a million in the last three financial years. We expect to grow it by another half a million in the next three. There's nothing in any metric around our Australian performance since listing that says we won't achieve that.

One of the key things we've talked about in terms of our growth strategy going forward is our aspirations to grow the Kathmandu brand globally. We started that process, our foundations for that process a couple of years ago by re-organising the UK business which we have now completed. We said to ourselves in FY14 we wanted to see target milestone performance and same store sales, brand awareness and Summit Club membership. We met those milestones and so as a consequence one of the key investment decisions made by the Board and the Executive Team is to continue to invest in the UK and the wider Europe business.

To grow the UK business and improve our sales performance primarily through online and marketplace channels. This remains not an exercise around store rollout, it remains an exercise for people to find the Kathmandu brand and the Kathmandu product either by our own websites or other websites or arguably even wholesale as well as through our flagship stores. So we move to our first European marketplace listing in 2015 in addition to NEXT and Amazon, eBay we come to quite soon. We are following other sites we've recruited a UK Europe GM to help us in that business development role.

We are going to spend a - we are following a structured three-year plan the first of which involves us spending approximately \$5 million primarily on brand development and advertising to support growth of Kathmandu sales in the UK Europe and to some extent also internationally through our Kathmandu websites given that we can now market into multiple countries.

We're going to monitor sales performance country-by-country and over time look to where we direct further resource to support the brand in markets where there's obviously a demand for Kathmandu. So that's one of the major and new for us a more aggressive and a quite exciting opportunity for us in the years ahead. But it's definitely worth a crack when you look at the investment that's being made relative to the underlying growth potential that still exists in the Australasian business and the profitability that we are confident of in Australia and New Zealand over that period of time.

So, in summary on the growth strategies before going onto the outlook. We're very clear about what we're doing in Australia and New Zealand and we are very confident about earnings and sales increases in the next three years in this market. Given that it's definitely the right time to pursue growth outside Australia and New Zealand to build the credentials for the Kathmandu brand globally. It's already a well-recognised brand informally in the market outside of our home countries with support and investment we have real confidence that it can become a global brand.

We're doing that though on a basis that remains relatively small in dollar terms compared to the overall Group activity but relatively low risk and with

clear performance targets and outcomes that we can measure year-by-year relative to same store sales, Summit Club and brand awareness. They're our key metrics and drivers in that regard.

The online channel remains our priority for that exercise. I think the key thing to highlight for everybody is that there's real long term upside and opportunity if we get positive earnings three or four years down the track from global growth. We accept that we're not going to achieve that probably in the next couple of years but we definitely see a future to a profitable, global business for Kathmandu if not necessarily in the same form as the current Australasian business.

Okay final slide before questions is just to do a brief update on the trading update and the outlook with more of a focus on Australia and New Zealand again. I think we're all very aware and I could keep saying this forever but the global environment is uncertain it doesn't get any better. Certainly we have to continue to flag the risk that outbound travel in particular an uncertain global environment has some potential downside risk.

Economically though both countries are in reasonable shape. Australian growth prospects are somewhat subdued. New Zealand may slow down but generally speaking the election result on the weekend has to be viewed as a positive for New Zealand confidence over the next two to three years.

It's really interesting that the outdoor competitor mix is changing and Reuben has already talked about the loss of competitors in the New Zealand market, the Australian direct competitors moving out of New Zealand as our own market share has improved, as you've seen big box retailers start to compete. You've got the Warehouse who now own Torpedo7 and R&R Sport as well as FCO competing as big box retailers. So we can't step away from the fact that we must continue to maintain and grow market share in both of our markets and New Zealand has been quite challenging in that regard.

Over and above all of that in terms of the local sense there's more available international brands either being on-sold through those big box retailers or being sold directly online. There's the growth that they're taking is growth

that they're generally taking off local second tier brands who have in some instances as we've already said slowed down or exited the market completely. That isn't going to change. We have to look at it the other way and say well as the best and strongest brand in the marketplace it's our opportunity to do the same thing globally and that's the opportunity we're going to actually continue to pursue.

I've already talked about the fact that since - or up till the 14th of September last Monday week same store sales were up 30% because of a very successful clearance campaign we had over winter. I just - everybody will ask the question as to the recruitment process to replace Peter Halkett when Peter leaves in November. We have engaged an international recruitment firm to do a global search for a new CEO for the business.

So it remains a really exciting time for Kathmandu in summary. This year, the coming year will be the first year, the first phase of a three-year global brand investment. Our initial focus is in the UK and Europe and we're going to give it a pretty good crack. We are confident that we can do that knowing that our Australasian sales base will continue to grow. We expect growth at similar rates of sales to FY14 and we do expect improved earnings can be anticipated from the Australian and New Zealand business. But the overall outcome in FY15 will be reduced, will be impacted primarily by the UK investment.

So that is really the summation and I'm happy to open it now to questions.

Operator: Thank you, I will now begin the question and answer session. If you would like to ask a question please press * followed by 1 on your telephone now. I will present you in the order I which you signal. If you find that your question has already been answered you can remove yourself from the queue by pressing *2 at any time. Once again if you would like to ask a question it is * followed by 1 on your telephone keypad.

The first question comes from the line of Sam Teeger from Commonwealth Bank. Please go ahead.

Sam Teeger: (Commonwealth Bank, Analyst) Hi Mark, just a couple of questions from me. What were the dates of the winter sale this year compared to last year? I'm just trying to see whether this year if the winter sale was extended into August which means the trading update to 30% comp might have included some more significant sales than otherwise?

Mark Todd: I think there's one day extra in August there, Sam, yes but it wasn't anything that was material to the overall same store sales result.

Sam Teeger: (Commonwealth Bank, Analyst) Okay great and look it's good to see inventory per store levels falling to only around 11% 12% at the end of August. But just wondering as we've moved through September have you seen them fall substantially further? Are you able to provide a bit more colour in terms of which product categories and which Australian regions have seen the highest inventory per store levels?

Mark Todd: Well the per store level on a regional basis probably isn't too accurate because of course we centrally distribute to all of our stores in response to demand. But in terms of the categories the approach taken to clearance is that you've got to actually look at the product groupings that will sell at the time of the year. So we have if you like aggressively moved obviously on winter gear in the southern states, ACT, Victoria, Tassie in particular through August September. Whereas you tend to hold your powder a bit on categories like wovens and look to sell those through from now on in the northern states. So there's a couple of answer to that question.

That's one of the reasons why we're not - we don't get too hung up on trying to drive all of the stock out of the business immediately because some of it just is better to sell later in the season in certain parts of the country. But it generally is held centrally in the first instance to respond to demand because most of our stores are small format stores and don't have a lot of storage capacity anyway.

Sam Teeger: (Commonwealth Bank, Analyst) Okay and a final question in terms of the additional \$5 million you are planning to invest in the UK and

Europe how should we be thinking about the split between CapEx and OpEx and on a Group basis what are you currently budgeting for CapEx for '15?

Mark Todd: It's primarily OpEx, it's nearly all OpEx that's the signal out of this. In respect of the CapEx it will be another year, this year and the year ahead of it where we'll spend more than \$20 million in CapEx in the business. You can expect levels similar to those of FY13 and FY14 and the variable usually in that is actually the amount of store rollout that goes on. The level of IT spend in FY15 is probably slightly less than FY14 but the CapEx level overall is still higher is still above \$20 million.

Sam Teeger: (Commonwealth Bank, Analyst) Great Thank you.

Operator: Thank you the next question comes from the line of George Batsakis from Goldman Sachs, please go ahead.

George Batsakis: (Goldman Sachs, Analyst) Good morning just a question on the clearance activity in August. Was the margin on that significantly lower than expected and will it have an impact on first half results, negative impact?

Mark Todd: Yes so the margin was lower. The margin was relatively in line with our expectations. Given the sales growth at this moment it actually wouldn't have a negative impact it arguably would have a positive impact. Because 30% same store sales growth is not to be sneezed at. But, George, as you'd well know it's probably not the key driver in the result for the half. The driver for the result in the half will be Christmas.

George Batsakis: (Goldman Sachs, Analyst) Great, just a question on the UK \$5 million OpEx for 2015. What sales do you need to breakeven on that expenditure? Would you need - assuming a gross margin of 50% over there you'd need \$10 million in sales?

Mark Todd: So we wouldn't look to be breaking even in FY15, George. It's not a short term game it's a long term game. So if you think about brand building and brand awareness it's - we're not looking to break even out of our investment in year one.

George Batsakis: (Goldman Sachs, Analyst) Okay and just a further question on the UK. The second half loss increased on the first half despite much stronger like-for-like sales. What was the reason for that? I think you had £1.5 million loss for the full year I think the first half was about £600,000.

Mark Todd: Yes most of it - most of the advertising spend was in the second half of the year.

George Batsakis: (Goldman Sachs, Analyst) Okay and just a question on the Australian business. The operating expenses as a percentage of sales increased slightly year-on-year despite very strong like-for-like sales growth. What's going on there in Australia? I would have thought there might have been some positive leverage in the Australian operations?

Mark Todd: Well the key thing around that is the response to the market in winter and our advertising spend in the winter campaign. So advertising was a key driver and a lot of our investment in people in the onlines team and the trading team are sitting in the Australian office as well. So those areas of expenditure that we talked about are primarily there. The other thing about it is that most of the incremental expenses in stores were second half not first half because the stores were second half.

George Batsakis: (Goldman Sachs, Analyst) Great, thank you very much.

Operator: Thank you, the next question comes from Sarndra Urlich from First NZ Capital. Please go ahead.

Sarndra Urlich: (First NZ Capital, Analyst) Good morning, guys. George has actually asked most of my questions. Just I guess the one that hasn't been touched on Aussie versus US, Kiwi versus US the potential impact on gross margins. I've looked over the last two years and there hasn't necessarily been a correlation between the Aussie US in particular on gross margin. But can you just comment - given the extent of the decline in those currencies can you comment on how you think that's going to play out on GM, gm-wise?

Reuben Casey: Yes as I mentioned earlier we have managed to maintain our margins over the period that's largely through pricing strategies and also as

we get bigger we can negotiate better deals with our suppliers. So we don't see that having an impact.

Sandra Ulrich: (First NZ Capital, Analyst) Yes and I guess the other thing just in terms of - actually I think I'm the only person who buys when it's not sales' season so you're just going to have to help me here. But with the clearance activity - do you think you potentially went too hard giving the 30%. I mean sometimes 30% is too good to be true. Do you think that can impact consumer psychology if you are discounting to that extent? They think "oh well I won't wait for the clearance". I understand the sales program and how that works but did you potentially go too aggressively and therefore is the consumer psychology now "oh we're just going to wait for the clearance activity given the prices were so good"?

Mark Todd: The answer to that is it's possible, Sandra, because it's always possible. But the nature of the clearance activity dictates whether that becomes the norm. I think most people and this wouldn't be unique to Kathmandu regardless of our sales' strategy versus others. This was a winter phenomenon that a lot of retailers just had to deal with. So I think you've just got to put that aside and go - I mean let's be honest. I'll tell you yesterday in New Zealand that one day yesterday was a fantastic sale day yesterday because it was really, really cold. It still drives people's behaviour just as much as anything else at this time of the year. So if it's cold people will buy if it's not they won't.

Sandra Ulrich: (First NZ Capital, Analyst) Yes and actually I guess just one last question have you seen - I mean as you said Mountain Designs and Snowgum and I guess there might be some stress with regards other competitors. But have you seen any other competitors particularly in the Australian space pull back their store rollout program or shut down sales there? What are you observing in terms of competitor activity in the Australian market?

Mark Todd: In the Australian market well the one that people comment to most obviously is what Super Retail do with the aggregate of Ray's, BCF and FCO and they've flagged reviews of the Ray's and the FCO businesses at the

moment. So it's not an easy market to be in in either country. It's just that there's if you like the competitor set in New Zealand and the smaller market probably got very much more aggressive much quicker with FCO, the Warehouse buying Torpedo7 and there's a lot of stuff gone on in New Zealand quite quickly. Whereas in Australia the bigger market hasn't moved quite as much as fast and it's not been as - it's not an obvious way just because it's a really acceptable and attractive category because the outdoor category, travel category remains profitable and attractive to get into. It's not that easy to execute.

Sarndra Ulrich: (First NZ Capital, Analyst) But do you still maintain that - and I guess those Australian same store sales numbers and your comment that you expect similar performance in the year ahead, that's what David Kirk said. But do you still believe that this is a - this trend that this category is still on trend relative to other categories particularly in the apparel space?

Mark Todd: Yes.

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

Operator: Thank you the next question comes from the line of Wassim Kisirwani from Deutsche Bank, please go ahead.

Wassim Kisirwani: (Deutsche Bank, Analyst) Yes hi the answers to my questions have also been answered. But in terms of the UK investment and the outlook there, what are you - are you looking for any specific KPIs or markets over the next 12 18 months that will determine where you take that investment, that level of investment in '16 and beyond?

Mark Todd: Yes we've flagged to you, I think we're quite open in general to how others might answer the same question. You've got those metrics that we're really most interested in which is all our brand awareness surveying that we do. Our Summit Club membership activity level and membership growth and our same store sales so those are the drivers.

Wassim Kisirwani: (Deutsche Bank, Analyst) Do you have a specific sales target in mind for FY15?

Mark Todd: Not that I would disclose to the market.

Wassim Kisirwani: (Deutsche Bank, Analyst) Okay and in terms of the guidance that cautions about the impact of the UK investment being a key driver of the Group. Are you - is there a potential there in that statement that we could see further - more than a \$5 million investment in terms of if the business performs in line to expectations? You'd expect under normal circumstances that they've some pretty good earnings growth even with that level of investment or is there potential that that investment could increase?

Mark Todd: Probably not increase in the year it more comes into what we think because we've set budgets and we've set plans and we have a lot of planning for a good portion of the year already in place. So maybe we could signal something that might change in the second half but it would be dependent on performance and I don't think that's likely.

Wassim Kisirwani: (Deutsche Bank, Analyst) Okay thanks.

Operator: Thank you the next question comes from the line of Chelsea Leadbetter from Forsyth Barr please go ahead.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Morning guys, just another couple of questions around the UK Europe strategy. I mean you comment a lot about the fact that you're happy with where brand awareness already is in those markets. I wonder if you could give us a bit more detail around where the brand is tracking against some of your global competitors?

Mark Todd: No I'm sorry actually regrettably, Chelsea, I couldn't. Basically I mean we have brand tracking that goes on in all three countries and we do it regionally within and that just gets into too much specifics.

Reuben Casey: Yes I think to say we're happy with where it is currently is probably not accurate. We're happy with how it's tracking.

Mark Todd: Yes, I mean in the end we're a very small fish in quite a big pond.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay thank you. Then I guess that \$5 million spend is that 50/50 between the first half and second half?

Mark Todd: Probably slightly weighted to the first half.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay.

Mark Todd: Winter season in the UK carries a lot more focus because it coincides with Christmas. Because it is so - yes if you're asking what impact might it have on the first half versus the second half yes it's going to be a larger fixed cost impact probably in the first half as a constant.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay and then I guess if I'm looking at the overall strategy you know you...

Mark Todd: We'll be - sorry, Chelsea, can I just interrupt. We'll be quite transparent about that one aspect as to what money we have spent in that market because we think it's really important for people to understand, so.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Yes, no definitely, thank you. Then sorry just moving on to strategy in that market and I mean price point versus Australasia I assume you won't be doing a similar sales strategy to what you do in Australasia is that right?

Mark Todd: We haven't done that for several years, correct.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay and I mean you've got some flagship stores in the UK so will we be expecting any in Europe?

Mark Todd: Not in the immediate future no.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Just one last question from me shifting tacks to the inventory planning and the new systems you've implemented are they all on board now and all progressing well?

Mark Todd: We have a big phase two but we put in point of sale and merchandise forecasting and planning earlier in the year and they're working well. We go live with phase two we expect in a couple of weeks' time which is inventory allocation and our financials and warehouse management. They're the key modules going in place in late October.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Great thank you very much for that.

Operator: Thank you the next question comes from the line of Sam Teeger from Commonwealth Bank. Please go ahead. Hello, Sam?

Sam Teeger: (Commonwealth Bank, Analyst) Yes sorry the phone was on mute. Of the 15 new stores you're targeting in '15 I presume the majority are weighted towards Australia but do you have a breakdown between Australia and New Zealand?

Mark Todd: These days we basically only budget one new store in New Zealand a year.

Sam Teeger: (Commonwealth Bank, Analyst) Okay great and in terms of online sales what are your top three countries outside of Australia and New Zealand?

Mark Todd: Singapore, US and Germany I think.

Reuben Casey: Germany yes.

Sam Teeger: (Commonwealth Bank, Analyst) Is it in that order?

Mark Todd: That's too much detail I actually don't know off the top of my - I know what the order was a few weeks ago I don't immediately know what it is today, so yes but they're the big three, yes.

Sam Teeger: (Commonwealth Bank, Analyst) Great, thanks very much.

Operator: Thank you at this time we have one remaining question in the queue. If you do want to ask a question it's * followed by the number 1. Our next question comes from the line of Adam Simpson from Macquarie. Please go ahead.

Adam Simpson: (Macquarie, Analyst) Hey guys, I just want to clarify that \$5 million you're flagging that's not a net number that's a gross investment and you expect some revenue or profit offset to that. Obviously it's still a long...

Mark Todd: Correct yes.

Adam Simpson: (Macquarie, Analyst) In terms of if we were to look at the underlying trading result you're already spending a fair bit there already. Is that \$5 million on top of what you're investing there to date?

Mark Todd: No some of it was spent the previous year like we flagged that \$0.25 million as being incremental so you can certainly take that off.

Adam Simpson: (Macquarie, Analyst) Ah okay yes sorry. Then finally just in terms of how you think it's going to hit your P&L next year will you be able to get the tax offset for those losses next year?

Mark Todd: Only where they're global contract relationships primarily, Adam. Most of it is directed - most - a lot of it is simply direct advertising in direct markets and that's hard. So no it's generally speaking no.

Adam Simpson: (Macquarie, Analyst) Yes okay thanks.

Operator: Thank you at this time we have no remaining questions in the queue. If you do want to ask a question it is * followed by the number 1.

Mark Todd: Okay.

Operator: Mark, we have no questions at this time.

Mark Todd: Thank you very much. All right, well thank you very much all for your attention for those of you I will catch up and see in the next few days look forward to seeing you. You can by all means give us a call on mobile if you've got any other questions that come to mind that we have missed today and I'll try and pick up and answer them for you. Talk to you soon, cheers.

Operator: Thank you this concludes today's conference. Thank you everyone for participating.

END OF TRANSCRIPT