

FY20 Half Year Results Investor Conference Call - Transcript

KATHMANDU HOLDINGS LIMITED

NZX / ASX / MEDIA ANNOUNCEMENT

2 April 2020

Company: Kathmandu Holdings Limited

Date: 1 April 2020

Title: FY20 Half Year Results Investor Conference Call

Time: 8am AEST

Duration: 51 minutes

Reference number: 10005263

[START OF TRANSCRIPT]

Operator: Thank you for standing by and welcome to the Kathmandu Holdings Limited FY20 Half Year Results Investor Conference Call. All participants are in a listen-only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question you will need to press the star key followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr Xavier Simonet, CEO. Please go ahead.

Xavier Simonet: Thanks very much, Rachel. Good morning everyone and thank you for joining us on today's presentation on the Kathmandu Holdings Half Year Results for the 2020 financial year, and announced equity raising.

My name is Xavier Simonet and I am the CEO of the Company. I'm joined on the call by Chris Kinraid, our Chief Financial Officer. We will be talking to the presentation slides on the NZX and ASX this morning. Most of the numbers are in our reporting currency, the New Zealand dollar, unless when it is specified that they are in other currencies.

Slides two and three include disclaimer and disclosure details which I will skip past and I'm now turning to our Group vision on slide four. This period included the transformational acquisition of Rip Curl. Having acquired a portfolio of brands we have a vision for our combined Group where Kathmandu, Rip Curl and Obōz will retain their strong brand identities and cultural values and retain operational ownership of their businesses.

These brands will leverage their respective strengths and will build on each other's competitive advantages over time.

Moving to slide five which shows the first half financial highlights. We were pleased to have delivered a 3.7% increase in Rip Curl sales on a comparable basis for three months of ownership. In our outdoor segments, which includes Kathmandu and Obōz, we were pleased to have grown same store sales, particularly in Australia and New Zealand where we experienced challenging conditions with widespread bushfires in Australia.

Obōz continued its strong performance with sales up 10.4%. Our underlying EBIT was up 46.5% to \$29 million, with Rip Curl contributing NZ \$15.7 million in the three months since the acquisition. We have benefited from operating leverage achieved through channel diversification.

FY20 Half Year Results Investor Conference Call - Transcript

Online comparable sales grew strongly over the period, up 33.1% and nearly 20%, for Kathmandu and Rip Curl respectively. The addition of Rip Curl has diversified our revenue and earnings profile with our diversification strategy showing early benefits.

Looking at our operational highlights for the first half on slide six. We successfully completed the acquisition of Rip Curl during the period. The acquisition has significantly diversified the Company to now consist of three iconic, inspirational and authentic brands.

While we are experiencing challenges now as a result of the COVID-19 pandemic, each of our brands have strong financial fundamentals, highly credible and technical products and loyal customers.

We have identified and progressed key work streams which are focused on realising synergies in sourcing, supply chain and systems over the medium term. We are also focusing our efforts on leveraging Rip Curls strengths and competitive advantages.

The Kathmandu business maintains a strong focus on sustainability, which is in the DNA of our brand. Over the period we installed solar power at our Blackburn Victoria store, demonstrating progress towards our target of net zero environmental harm from business operations by 2025.

We also contributed to the community, donating over \$100,000 to the Red Cross Australian bushfire appeal, with Kathmandu matching donations from customers. We launched our Best for the World 2025 sustainability plan to customers and staff. Pleasingly, customer awareness of the Kathmandu sustainability program has increased 9% year-on-year.

Turning to slide eight. I now want to update you on the impacts we are seeing from the COVID-19 pandemic, and importantly how we are responding as a Company and as a team.

We are certainly seeing impacts to our stores, people and performance. We are taking decisive action to address those impacts and maintain business continuity while ensuring the health, safety and wellbeing of our teams and customers, which remain our highest priority.

As recently advised, all New Zealand stores and distribution centres were closed from 24 March for at least four weeks. The Australian stores were closed from 27 March. This follows store closures for Rip Curl across Europe, North America and Brazil, where key wholesale customers have also been affected with forced store closures.

Online retail continues in Australia, in Europe and the USA, but not in New Zealand. There has been a considerable impact on our people, both retail and head office teams and crew, with staff being stood down across all regions. We are looking to access government wage assistance where applicable, which I will go into in more detail on the following slide.

In terms of our working capital, all key suppliers remain operational. Given Rip Curl benefits from alternating seasons, we have the ability to reroute products geographically. We expect prolonged foreign currency impact on our hedge contracts that may increase the costs of products sold in FY21.

To date we have not seen any impact on our accounts receivable, with only one major customer requesting extended payment terms. We continue to actively monitor team member health with anyone showing symptoms or having been in contact with a confirmed case required to self-isolate. All major head offices are closed with staff working from home.

Turning to slide nine. I will now talk through how we are addressing the impacts of the COVID-19 pandemic. In terms of our product distribution, importantly we're maintaining delivery capacity wherever possible and are utilising initiatives such as free delivery on online orders.

FY20 Half Year Results Investor Conference Call - Transcript

Our channel agnostic approach and online fulfilment capabilities will help our brand maintain the high levels of customer service and the continuity of our distribution network.

Sufficient inventory levels are in place for the forthcoming season for all brands, assisted by the longer lead time of technical product categories and a diversified supply base. We are also delaying and cancelling existing inventory orders based on reduced expected demand level, with all brands focused on core, non-seasonal products.

We are engaging with our landlord partners to achieve a fair outcome which sees our rental costs aligned to our sales performance, and in Europe, Rip Curl is expected to benefit from force majeure clauses.

We are cancelling or deferring all non-essential operating expense and capital projects, which includes store refurbishments and planned ERP spend across the Group. This is expected to result in eight million New Zealand dollars of savings in FY20.

In terms of our teams, as I alluded to on the previous slides, we are utilising government wage subsidies in New Zealand and Europe, which are significantly offsetting labour costs. We will continue to utilise similar government schemes in other locations as they become available.

We have also implemented a number of other initiatives around people, including ceasing the use of casual staff in retail networks and warehouses in all regions and senior management across all brands have either been stood down or are taking a 20% salary reduction until further notice.

We are consulting with employees around options for team members to continue on a reduced hours and salary basis, and we are undertaking a significant restructuring program for head office functions, which is expected to result in around NZ \$15 million of cost savings across the Group based on initial estimates.

In summary, although COVID-19 had minimal impact on earnings in the first half of FY20, we expect there will be a material adverse impact to the second half earnings. While there is uncertainty around the extent of the effects of it on our business, we are working through the COVID-19 challenges as a team and responding decisively to ensure that not only do we get through this period, but also that we come out on an even stronger footing.

I will now hand over to Chris Kinraid, our CFO, to cover our financial results. Chris.

Chris Kinraid: Thank you Xavier. Just moving onto the results overview on slide 11. Our results now include the adoption of IFRS 16. For comparability, the impact of this has been excluded from underlying results. All key metrics are driven by the three month contribution of Rip Curl since being acquired. As our business has expanded, we have achieved operating leverage through channel diversification.

We delivered an underlying pre-IFRS 16 EBIT of \$29 million for the half, circa 47% up on last year, although statutory profit of \$8.1 million includes \$10.3 million of costs relating to the acquisition and integration of Rip Curl and a positive \$0.4 million impact from the implementation of IFRS 16.

Onto slide 12, our Outdoor Segment, which consists of Kathmandu and Obōz. This has delivered \$228.7 million in sales in line with our previous half, first half, while the new Surf Segment delivered \$135 million in sales for the first three months of ownership. In the Outdoor Segment gross margin was impacted by higher input costs as a result of increased clearance sales and a mix of North American wholesale sales, with EBIT for the segment of \$15.5 million. Total segment underlying EBIT was \$31.2 million before corporate costs of a further \$2.2 million.

Moving onto slide 13, the balance sheet. Our total asset base has increased significantly following the acquisition of Rip Curl and the adoption of IFRS 16, where the right-of-use assets are capitalised. Liabilities

FY20 Half Year Results Investor Conference Call - Transcript

also now include the debt used to partially fund the Rip Curl acquisition and a capitalised lease liability resulting from IFRS 16. We will talk through our financial position in more detail later in the presentation.

Slide 14, Group cash flow. We have delivered a strong result in the half of an operating cash flow of \$20.9 million after adjusting for the impacts of IFRS 16. Increases in borrowing and net interest were due to the Rip Curl acquisition and the increase in capex was mainly due to \$3.4 million for Rip Curl in the period.

Onto slide 16, the Outdoor Segment. This, as I mentioned earlier, includes both Kathmandu and Obōz brands. Our result reflected the challenging conditions in retail, which Xavier alluded to, with widespread bushfires and unusually hot weather in our Australian and New Zealand markets that we're operating under. With flat year on year total growth of 0.4% when measured at constant exchange rates.

As mentioned earlier and as we have signalled to the market previously, gross margin was impacted as a result of foreign currency movements and was in line as we previously signalled. Also, the result of, as I said earlier, our clearance mix and North American wholesale contribution.

Onto slide 17, Outdoor Segment sales. Australia had same store sales growth of 2%, which was a positive result given the impact of bushfires and hot weather. In New Zealand same store sales growth was 0.5% following two years of negative same store sales. Rest of world sales are up 6.1% underpinned by a 10.4% sales growth from Obōz. Pleasingly we have seen really good strength in our online channels with online sales up 33.1% at constant currency and now comprise over 11% of direct to consumer sales over 12 months.

Onto slide 18, Outdoor Segment growth margins. As alluded to earlier, growth margin is 1.2% below the previous half due to the high clearance sales mix and impact of exchange rates. However, we remain above our long term 61% to 63% target range. Higher import cost due to the impact of exchange rates are expected to continue through to the second half of FY20 and FY21 and we continue to seek improved sourcing negotiations and stock control to mitigate that impact and have a full hedge book out for the next 12 months to cover the current impact of exchange rates.

Touching onto Obōz now on slide 19. It shows a total sales growth of 10.4% with Obōz cycling through a large Sawtooth II product launch last year. The next major product launch due to ship from Obōz is in June/July 2020 as they've got an extended product range. Operating expenses was invested in the team and into a new third party distribution facility to future proof the North American business. We have invested in brand and product development to grow the brand equity and to expand the product range we have at Obōz to fuel growth in FY21.

Onto slide 21. We have been very pleased, just on the Rip Curl P&L, we have been very pleased with the performance of Rip Curl which has performed strongly during the first three months since acquisition, contributing \$15.7 million of underlying EBIT to the Group. This included the important Christmas trading period.

Onto slide 22, Rip Curl sales. Total sales for the three months of ownership increased 3.7% at constant exchange rates over the comparable period last year and wholesale total sales increased by 1.8%. Total sales for Australia and New Zealand increased while the rest of the world increased by 4.5%, with North America performing particularly strongly. Direct to consumer sales for the full 12 weeks for the brand grew 2.7% on a comparable basis and online sales grew 19.5% in the same period.

Now moving onto slide 24 and discussing the strengthening of our balance sheet and our liquidity position. In addition to the operating initiatives that Xavier already discussed, I just want to talk through the key actions we are reasonably taking to ensure that we remain strongly capitalised in the current market uncertainties and to ensure that we have liquidity to get the business through what is unprecedented challenges and times for retail and the overall economy.

FY20 Half Year Results Investor Conference Call - Transcript

We are suspending the Group dividend until we see trading conditions improve and that includes the Group's interim dividend for the first half. We are working with our existing banking group which has provided a covenant waiver for the period ending 31 July 2020 and 31 January 2021, as well as a relaxation of certain covenants for the period ending 31 July 2021. This is subject to successful completion of at least a \$150 million equity raise.

We are executing an equity raising comprising of a fully underwritten NZ\$30 million placement and a fully underwritten NZ\$177 million pro rata accelerated entitlement offer. The proceeds of equity raised will be used to de-lever the Group balance sheet, as outlined on slide 25, and provide liquidity and funding for medium term operating requirements. Post equity raising based on the pro forma 31 January balance sheet, we expect to have total liquidity of over \$300 million and have no debt maturity prior to November 2022.

As a result of these pre-emptive initiatives we expect to have liquidity to cover payments and meet capital requirements for the Group for at least the next 12 months based on very conservative assumptions and we also expect the Group to be in a position to meet its amended covenant test for the period ending 31 July 2021.

Moving to slide 26 of the Investor Presentation. It provides a summary of equity raising details. As mentioned earlier, the equity raising is fully underwritten and will be comprised of a pro rata accelerated entitlement offer and placement. Importantly we note that all non-executive directors intend to take up their direct entitlement to the extent that they are eligible to participate in the entitlement offer, which is reflective of their commitment to the Company.

Slide 27, just moving to the equity raising timetable. The institutional offer opens today and our trading halt is expected to be lifted tomorrow, Thursday 2 April. The key risks relating to the equity raising are provided in the presentation and I will not walk you through it now but encourage all investors to read these carefully.

I will now hand back to Xavier to cover our strategy and close out the presentation. Xavier.

Xavier Simonet: Thanks Chris. Slide 32. While we are operating in really challenging times our overarching strategy doesn't change. Our strategic objective is to become a global outdoor and action sports company underpinned by iconic brands, technical products and a focus on sustainability. Everything we do is aimed at working towards this goal, but by adding the iconic Rip Curl brand to our Group, we have diversified our business through geography, channel to market, product category and seasonality. We have a relentless focus on our loyal customers and on offering technical differentiated and sustainable products. By doing this we will grow each brand.

Realising synergies is another key strategic priority which I will touch on in more detail shortly. Sustainability is a key part of our DNA, is integral to our culture and engrained in everything we do. We are embracing diversity and inclusion in the workplace and building strong ties with the local communities where we operate.

Turning to slide 33. There are significant opportunities for us to achieve benefits from synergies between Kathmandu and Rip Curl by leveraging shared expertise and realising scale benefits. I previously mentioned that we have identified and progressed key work streams which are focused on realising synergies in sourcing, supply chain and systems over the medium term, but we also remain focused on leveraging revenue synergies between the brands.

Rip Curl brings strong wholesale expertise and relationships which we aim to leverage at Kathmandu with around 1200 wholesale doors in North America and around 2300 doors in Europe. These represent considerable benefits from a geography diversification point of view, with Rip Curl's capabilities and relationships providing a pathway to accelerate Kathmandu's expansion into those key markets. Kathmandu, on this side, has strong online capabilities and retail expertise which can be leveraged at Rip Curl and we see the ability to further improve the efficiency of Rip Curl's store network.

FY20 Half Year Results Investor Conference Call - Transcript

Now on slide 34. We have a strong commitment to sustainability and therefore integrate circular economy principles across all aspects of our business. We are a B Corp Certified Company which demonstrates to our team and our customers our commitment to ethical practices as we move forward. It is important to us that our direct suppliers meet our minimum expectations on their social and environmental impact and we aim to achieve net zero environmental harm from our business in 2025. We have a committed team to help us achieve our sustainability goals.

The next two slides talk through the strategy for our Outdoor and Surf segments. While dealing with the current challenges is our immediate priority, it remains critical that we have in place a strategy that positions our Group for the long term. In relation to our Outdoor Segment strategy, we are on the journey of transforming from a leading Australian retailer to a brand led global multi-channel business. There are a number of initiatives we are putting in place to grow our core markets including supercharging our Summit Club, growing our summer product range and optimising stores. Product is critical to our business and we have identified high potential categories for growth including our women's product line.

We also want to continue to improve our customers' digital experience, and we plan to maximise mobile engagement and leverage digital channels to enhance our brand and products. We are focused strategically on building our brand in North America over time, leveraging strategic wholesale partnerships, and accelerating the North America direct to consumer business.

Now to our surf segment on slide 36. Our vision is to be regarded as the ultimate surfing Company in all that we do. Rip Curl has become part of the fabric of authentic global surf culture represented by world-class athletes, the sponsorship of some of the premier global surf competitions and is now recognised for content creation and distribution.

Rip Curl remains true to a set of principles and values focused on our customers, team, community and innovation. Our mission is to continue developing a brand image that truly reflects our brand values and the attitudes and aspirations of those on the search.

As a conclusion I would like to talk a bit about how I see our business once we have come back to a more normal situation. What does our business look like once the COVID-19 crisis is over? I would like here to emphasise the strength of our Company, that will help us bounce back strongly we believe after the crisis.

First in Kathmandu, Rip Curl and Oboz we have three great iconic and inspirational brands with significant growth potential and the opportunity to help each other to get more global step-by-step.

Two, we've got a very aligned management team across Kathmandu, Rip Curl and Oboz and a great culture. When we acquired Rip Curl there were concerns from some of our shareholders around the potential cultural gap. We all know that most acquisitions don't succeed because of cultural misunderstandings and gaps. Well, working with the Rip Curl crew and management team has been a fantastic journey. Great level of interaction, great alignment, high level of collaboration. All these will help us accelerate on the implementation of synergies and go through this difficult period.

The third point I want to make is obviously our travel related business for both Kathmandu and Rip Curl is going to be suffering for some time as people are not travelling anymore, particularly internationally. However we believe that once the restrictions have been lifted there is an upside opportunity for our businesses with our core customers, Australians and New Zealanders. In our core markets of Australia and New Zealand where our brands are very strong in terms of brand awareness and preference.

Those customers are not going to travel internationally for some time, for months and potentially for a year or more. As I said before, that they're going to spend time and holidays in their own backyard in Australia and New Zealand. On the beach, in the mountains and the outdoors. There is certainly a sales upside

FY20 Half Year Results Investor Conference Call - Transcript

opportunity for Kathmandu and Rip Curl and Obōz to answer the needs of those core customers through our extensive distribution network in Australia and New Zealand.

The last and fourth point I want to make is that we have over two million Kathmandu Summit Club members, which account for around 70% to 75% of our sales. These key loyal customers are a real asset for the brand. During the current crisis although our stores are closed, except our online shop, we are continuing to engage with our customers, with our Summit Club Members, and to deliver inspiring content which we believe will deliver sales momentum when our store network reopens.

Last but not least I want to say a few words about our teams. The total focus of our Board and Management Team is and has been to protect the health and wellbeing of our teams and customers, but also to ensure business continuity. I am very grateful to all our teams around the world for their resilience in this situation of uncertainty and challenges. It is a heartbreaking and distressing time for many of our team members, and I want to acknowledge it.

This now concludes the formal part of today's presentation. Thank you for taking the time to join us. I would now like to open up the call for questions. Rachel, back to you.

Operator: Thank you. If you wish to ask a question please press star-one on your telephone and wait for your name to be announced. If you wish to cancel your request please press star-two. If you are on a speakerphone please pick up the handset to ask your question.

Your first question comes from Julian Mulcahy from Evans and Partners. Please go ahead.

Xavier Simonet: Julian, good morning.

Question: (Julian Mulcahy, Evans and Partners) Hi Xavier. So just to summarise, have the banks held a gun to your head, or are you just being really conservative?

Chris Kinraid: No, we are being conservative to a degree. There is a lot of uncertainty in the market of how this kind of situation is going to play out. We are doing the right thing for our Group to ensure liquidity long-term, for liquidity, and long-term strength on our balance sheet. So that's been our approach.

Question: (Julian Mulcahy, Evans and Partners) But in the statement you've said, the banks have given you a waiver subject to a minimum capital raise.

Chris Kinraid: Yes, that was part of our negotiations too - as doing this exercise for the capital raise. But no, they haven't held a gun to our head.

Question: (Julian Mulcahy, Evans and Partners) Who are your bankers?

Chris Kinraid: We've got a syndicate, a wide-ranging syndicate involving most Aussie majors and some overseas banks as well.

Question: (Julian Mulcahy, Evans and Partners) So with Rip Curl and you're in this predicament because of the Rip Curl debt, and given the price has skyrocketed on for existing shareholders, what can you do to prove that this whole exercise was worth it? Can you accelerate the tapping into their wholesale network, can you drive the business faster? How do you answer that?

Xavier Simonet: Yes, that's right, there are a couple of aspects there. The first one is that we want to activate synergies throughout the Group. Particularly in sourcing supply chain and IT. So that's one of our priorities. It was one of our priorities when we acquired the business. But the current situation for sure is going to push us to accelerate on developing and executing those synergies.

FY20 Half Year Results Investor Conference Call - Transcript

The second aspect is to leverage the strengths of Rip Curl and Obōz internationally to launch Kathmandu, and the strengths of Obōz - of Rip Curl to launch Obōz internationally as well. That's our second focus. Obviously we need to be realistic in the context of the current crisis, but it still remains on our road map.

Question: (Julian Mulcahy, Evans and Partners) You haven't given any guidance-type comments. I assume the stores will be open within two months. Can you put a percentage on what sort of a hit...

Chris Kinraid: No, I think to give any guidance comments right now, it's pretty difficult for anyone to do. No-one can with accuracy say when they expect stores to open. We're all hoping for as soon as possible, but to give any guidance on that I think would be very difficult.

Question: (Julian Mulcahy, Evans and Partners) Do you have a feel for how much of sales are related to people actually travelling internationally?

Xavier Simonet: Julian, it varies from season to season and month to month. We don't have an exact number. What we know is an important level of sales during the Christmas period is related to people travelling to the Northern Hemisphere, and going to North America, Japan and Europe. In winter, sales are very much connected to our core customers in Australia and New Zealand who need products because of the weather conditions and particularly need our winter jackets.

Question: (Julian Mulcahy, Evans and Partners) Okay, thanks guys.

Xavier Simonet: Thank you Julian.

Chris Kinraid: Thanks Julian.

Operator: Thank you. Your next question comes from Marni Lysaght from Macquarie. Please go ahead.

Chris Kinraid: Hi Marni.

Xavier Simonet: Morning Marni.

Question: (Marni Lysaght, Macquarie) Hi, good morning gentlemen, thanks for taking the time and answering my questions. Just to make a start I just would like to get some insight into inventory. So obviously winter is a big time for Kathmandu within Australia and New Zealand. How do you manage to - I know you've cancelled inventory orders. But just managing it given that the stores are closed, and yes, it's just what is your inventory exposure coming into winter?

Also in the Northern Hemisphere going to summer and if you're unable to sell through winter, can you put it into the Northern Hemisphere quite successfully at the end of this calendar year?

Chris Kinraid: Yes, it works for both brands in a slightly different way I guess. But for Kathmandu we're actively pushing out orders as well as much as possible. Naturally if you're not selling inventory, balances will increase. But throughout this period we're doing as much as possible to move, lift and shift orders out as far as possible. As well as cancel where we can where that makes sense and materials aren't committed.

Effectively as a Group this will take time to wind through. We are targeting stock for a 31 July 2021 stock target knowing that we will - throughout that period all buys are currently cancelled. In effect we will be reducing buys significantly for the rest of the period to hit that stock target. So we expect as stores are closed we can't move the stock. But we will be working with both brands to hitting a stock target at the end of July 2021.

FY20 Half Year Results Investor Conference Call - Transcript

In terms of the product seasonality and being able to use it. Rip Curl is in a great position, they're a beach, summer, a beach-focused product and a surf-focused product range. That still sells strongly in Australia in the winter months, especially through Queensland et cetera and being counter-seasonal with the Northern Hemisphere, and we've got a really strong ability to move the stock to suit the seasonal requirements of the Group. So that's in quite a good position.

Kathmandu, it's not a fast fashion business so our significant sellers throughout the year are still through our insulation and rainwear product categories, and as well as our hike and activewear products. So for us it's these are - aren't fast fashion categories which are cycling through every three months. We get a lot of core products which we can carry through and remain relevant to our customers. So they won't - it still will be challenging for our teams to manage throughout the period. But we're confident with the quality of our product and the longevity that we can navigate it.

Question: (Marni Lysaght, Macquarie) Another question I have it's just around obviously there's no travel going on so that's kind of dried up some demand for the traditional products in your business. But are you thinking about, I've noticed you've got products that are - so activewear, it's like a particular technology that is good for when people are doing cardio. Do you see more about tailoring your product to different needs in the near-term given what's going on?

Xavier Simonet: Yes, we are a travel brand in a wide context. Travel adventure, it's not just travelling internationally and travelling to exotic destinations. You can actually travel and do an adventure in your own backyard. So I think that's what the Australians and the Kiwis are, and our core customers internationally for Rip Curl are going to do. They're going to stay home and they're going to continue travelling in their own backyard once restrictions have been lifted.

So there's a negative aspect for sure to our business in the sense that people are not going to travel internationally. But there's a positive potential upside as well in the sense that we are very strong brands in our key markets of Australia and New Zealand. We believe there's an upside opportunity based on the distribution network we have.

Question: (Marni Lysaght, Macquarie) Okay, and I guess just a final one from me, just more about the discount and how we should be thinking about this moving forward. I've noticed the autumn sale and there's some additional discounts over the past fortnight, but what can the consumer expect and given the sales are online now?

Chris Kinraid: Yes, I mean those additional discounts are part of the usual sort of weekly promotional deals that we run throughout our sale period. It's going to be - we expect there might have to be some level of discounts for some clearance products, but we've learned from past experience that it's pretty important for the brand to maintain integrity and pricing for the long-term.

We will be monitoring our competitors and how the market's reacting, but for us, we'll want to be maintaining discounts at an appropriate level for both brands.

Question: (Marni Lysaght, Macquarie) Thanks for your questions, that's all from me.

Xavier Simonet: Thank you, Marni.

Chris Kinraid: Thanks Marni.

Operator: Thank you, once again, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced.

Your next question is from Katie Thompson from JBWere. Please go ahead.

FY20 Half Year Results Investor Conference Call - Transcript

Question: (Katie Thompson, JBWere) Good morning, guys. Just there's been a - can you hear me?

Chris Kinraid: Yes.

Question: (Katie Thompson, JBWere) You can. Good, okay look, just wouldn't mind a couple of comments around the big shift in the US currency because obviously you're hedged at the moment...

Chris Kinraid: Yes, I can comment on that. Yes, I mean for us, we are fully hedged out for one year at this stage, so we expect as signalled in my previous commentary, there will be some impact in the second half and continuation of what we've seen in the first half from FY19.

Look, our hedge rate, we've got - we expect there may be some slight deterioration due to FX during FY21, but yes, we're working through that in terms of - we're always dealing with our source and supply chain teams and the ability for us to produce product to suit our GP requirements of the Group. So we'll be looking at all those avenues to mitigate where possible.

But that's helpful being vertical brands, both Kathmandu, Oboz and Rip Curl to be able to do that.

Operator: Thank you. Your next question is from Ray David from Schroders Investment Management. Please go ahead.

Question: (Ray David, Schroders Investment Management) Thank you for the...

Chris Kinraid: Good morning.

Question: (Ray David, Schroders Investment Management) Good morning, thanks for the question. I have a couple of questions. First one is on just operating costs and run rate. You talked about employee wage costs and government wage subsidies and then also on rent relief. I'm trying to understand what is the operating cost run rate for those two lines in the next six months based on those moving parts?

Chris Kinraid: Yes, I'm not going to go into - on this call into specific details of every operating cost lines, but across our labour, there's a few - as Xavier mentioned, with largely the teams in the US and Europe and in Australia stood down, there is a significant portion of that cost reduced, as well taking advantage of subsidies in New Zealand whilst as Xavier mentioned, where subsidies are available and they're coming available, we'll be looking at utilising those to offset those costs.

I guess in terms of rent, that's going to be interesting to know how that's going to play out and we're working with our landlords on that. Our initial view is where our stores aren't open, it's - we'll be taking a line in line with sales performance as Xavier mentioned, but this is going to be - we've got to work with our landlord partners to come to appropriate commercial terms that suits all parties.

Question: (Ray David, Schroders Investment Management) Okay, because those two lines will dictate the amount of cash burn in the second half just given the rapid decline in sales...

Chris Kinraid: Yes and I guess you can - work in the labour has been reduced significantly and the - in terms of rent, that's - there's still a lot to be played out in that space at this stage.

Question: (Ray David, Schroders Investment Management) Okay and my second question is just along the cash that's being raised; \$86 million is being used to repay your revolving multi-option facility. Is there any restrictions on the remaining cash that will sit on the balance sheet? So are the lenders - is there any kind of cash sweep arrangements where the remaining \$228 million is required to be paid to the lenders over the next 12 months?

FY20 Half Year Results Investor Conference Call - Transcript

Chris Kinraid: No, we are holding the cash for liquidity for that period. We can then if we have to then draw back down on the revolver, so for us is to maintain that liquidity.

Question: (Ray David, Schroders Investment Management) Okay and you did say the covenants have been waived, so clearly the second half EBITDA which will probably be loss-making, is that effectively saying that that EBITDA covenant is no longer in place for the remaining six months?

Chris Kinraid: Yes, so it's not in place. That's waived for 31 July 2020 - 31 January 2021 and then remeasured at a relaxed rate at 31 July 2021.

Question: (Ray David, Schroders Investment Management) Okay, and just last one from me, so obviously you've got significant employee costs coming out of the business, but just on an ongoing basis, are you looking to reduce the store footprint?

Chris Kinraid: That'll very much depend on the long-term view on how this COVID-19 situation impairs retail performance. Rip Curl own brand stores are highly profitable in the US and Europe. Oboz doesn't have any stores, but for Kathmandu, our general stores have been, under pre-COVID-19, they were profitable in Australia and New Zealand, so for us, it obviously it depends on how significant and long the downturn will be for and we'll be analysing the store portfolio on that appropriate basis. But we'll be...

Xavier Simonet: Also - sorry, Chris for interrupting, also, we have as a Company a channel-agnostic approach. We are not trying to drive the online business at the detriment of the store network or the other way round. We want to offer a great experience to our customers whatever their journey is. So we then adjust our store network and our channels to the needs of our customers and how we see profitability. So we keep that flexibility as much as possible and that's always been our strategy.

Question: (Ray David, Schroders Investment Management) Okay, and the debtors of \$81 million I presume the majority of that is Rip Curl and you talked about there hasn't been too many cases of extended payment terms, but could you just talk to - is there a significant concentration risk in that debtor book and is that balance likely to come down or increase over the next six months?

Chris Kinraid: Yes, so there's not for Rip Curl in the markets as far as Europe and US, we've got to remember that. They have not a single customer concentration risk within the global Rip Curl Group, so reasonably well dispersed.

Oboz is a portion of that. They have one larger customer being REI which is not a concern. It's early days, we expect wholesales sales – that's in line with retail sales as other retailers will be shut, keeps flowing onto wholesale.

We expect that - that balance to collect- we expect that to reduce over the medium term until markets open up again and we collect during that period.

Question: (Ray David, Schroders Investment Management) Okay, thank you.

Operator: Thank you. Your next question comes from Weimin Xie from MX Capital. Please go ahead.

Chris Kinraid: Good morning.

Question: (Weimin Xie, MX Capital) Good morning, just basically one question, to get an idea of your conservative assumption, you're assuming that the cash will last for more than 12 months, especially just comment about like is revenue have a rough target and are you paying cash rent as well?

FY20 Half Year Results Investor Conference Call - Transcript

Chris Kinraid: Yes, I mean I guess there's a lot of variety of targets or scenarios you could play with and as a business, we've looked at a range of scenarios varying the length of store closures and ramp up from that point in time. So for us, obviously we're taking a look at some conservative positions and...

Question: (Weimin Xie, MX Capital) So what's the worst-case scenario looked at? You have cash for 12 months, what's your worst-case scenario?

Chris Kinraid: I mean you could go to scenarios where stores are closed all the way through to July as a worst-case, and a reduction over 12 months beyond that, but obviously we're taking what is - we consider a very conservative view on that to ensure that on the other side of the COVID-19 situation, the Group's in a great strong position to take advantage of that and to either take advantage of the opportunities out in the market or drive our own performance across global markets we operate under.

Question: (Weimin Xie, MX Capital) Okay and do you assume paying cash rent within the 12 months or you're going to not pay them?

Chris Kinraid: Yes, we still assume we - we still assume where our obligations are due, but however, as mentioned, we'll be working towards better outcomes in that space.

Question: (Weimin Xie, MX Capital) Okay, yes.

Operator: Thank you. Your next question comes from Mike Younger from Rest Super. Please go ahead.

Chris Kinraid: Good morning.

Question: (Mike Younger, Rest Super) Morning. Sorry, further to Weimin's question, so on the comment that you've made that the liquidity of \$315 million should provide for more than 12 months of operations, how many months of store closures is that specifically assuming?

Chris Kinraid: I mean look, again that's talking about some worst-case scenarios I mentioned earlier. If store closures are through to the end of July as an example, but again, this is very hard to forecast how long this will last. We're expecting it will be shorter than that, but we've got to take scenarios, assumptions and looking at different scenarios to get to a very conservative view to take that comment.

Question: (Mike Younger, Rest Super) Right, thank you.

Operator: Thank you. That does conclude our conference for today. Thank you for participating, you may now disconnect.

Xavier Simonet: Thank you, Rachel.

[END OF TRANSCRIPT]

For further information, please contact:

Media

Helen McCombie

Citadel-MAGNUS

Tel: +61 2 8234 0103

Investors

Eric Kuret – Market Eye

Tel: +61 417 311 335

eric.kuret@marketeye.com.au