Conference Transcription

24 September 2013

Kathmandu Ltd

Kathmandu Ltd Full Year Results Release Investor Call

Time & Date of Recording:	**10:00 AEST 24 September 2013**
Subject/Title:	**Kathmandu Ltd Full Year Result Release Investor Call**
Length of Conference (minutes):	**52:35**
Turnaround:	**Same day**
Billing Code:	
Company Name:	**Kathmandu Ltd**
Moderator Name/Client ID:	**Peter Halkett / 6165976**
E-mail recipients of transcript:	
Other notes:	

Start of Transcript

Maia Thomas: This is PGi. Please stand by. We are about to begin. Good day, everyone, and welcome to the Kathmandu full year result release investor conference call. Today's call is being recorded. At this time, for opening remarks, I would like to turn the conference over to Mr Peter Halkett from Kathmandu. Please go ahead.

Peter Halkett: Thank you, Maia. Thank you, everybody, for joining the call this morning. With me today on the call is Mark Todd, our Chief Financial Officer. We're going to be going through and discussing our results for the 12 months ended 31 July 2013. I'll be talking through the results and full year presentation that we filed this morning on both the ASX and the NZX. It's also available on our corporate website. I presume most people have either got that or can access it as I work my way through. The results today will be presented in our reporting currency, which is New Zealand dollars, of course. I've allowed approximately 30 minutes for presentation, and then about 30 minutes afterwards for questions.

Just let me start by running through the contents for the day. This is slide number 2. We'll give an overview of the results. We'll talk about the key line items, the specific country results; talk money, cash flow, balance sheet,

dividend, talk and update our growth strategy and the outlook. Then, as I said before, we'll move through to some questions. So just moving through to the results overview and some of our highlights - just bear with me...

The first thing to note, of course, is that it's record sales and profit. That's not surprising given we're opening more and more stores. We'd like to think our trajectory was up, but it is a great result. It was a result, I think, achieved in a relatively difficult retail environment, so even more pleasing. Of most importance to us is our Summit Club membership base has now achieved the million mark. That's across New Zealand and Australia. We still think there's more to go. I'll talk about that later. We opened 17 new stores during the year. That brings us to a total store count of 136.

Our sales and margin - sales growth of $36.9 million. That's 10.6% above last year; and pretty good same store sales growth. It's 1.8%, but if we measure that on a constant exchange rate basis it's 5.6%). Growth profit was smack bang in the middle of the range we've talked to you about for the last four years, of 63%. So, once again, we're very comfortable with that.

Operating costs as a percentage of sales reduced by 30 basis points, so, once again, I think we're demonstrating - despite the growth as coming in Australia - is that we are controlling costs. At a profit level EBIT increased by 6.4%, 11% up on last year. Net profit after tax was $44.2 million. That's $9.3 million up on last year - 26%; which I guess those of you who have read through the presentation will see that if we exclude the tax effect of the Australian intercompany loan it's at $41.1 million, up 17.8% - still a very credible performance.

If we go into the next slide - slide 5 - we were talking about the specific result overview. We can see that sales have now reached $384 million. As I said before, that's a 10% increase. Our gross profit was slightly behind last year, at 63% instead of 63.2%. I think this reflects a, probably, slightly tougher second half for us, where we had to get a little more aggressive. Once again, that sort of difference can be as much about product mix as it can be about discounting and so forth.

Operating expenses - you can see a little bit of leverage coming through there, as I said, despite the growth of the Australian business. EBITDA and EBIT are self-explanatory. The net profit, as I said before - depending how you want to measure it - coming out at $44.2 million, we think, is a very good result. You'll also see in the notes below that, once again, due to the accounting entries, the EBIT reduced year-on-year by $2.7 million when measured on a constant exchange rate basis. In simple terms I think we probably had something slightly negative at the EBITDA line and we had something positive at the net profit after tax line, so all in all it probably balances out.

If we just have a look at the split between the first half and second half, the big picture is we probably had a better first half than a second half, although we were clearly very comfortable with the second half, with an increase of $5 million net profit after tax, an increase of $3.6 million EBITDA. Once again, they're all very good numbers, but you can see that at the sales line we had a better first half than a second half. I think that partly reflects the previous year. As you'll remember we had a slower first half and a stronger second half, so some of these things are about the year before, not the absolute terms. So, once again, the split - from our point of view there's no major concerns.

If we move through to key line items - I'm going to talk, firstly, about the sales. You can see a steady growth from $245 million back in FY10 to where we are today, at $384 million. While a number of people, I guess, talk about the volatility of our sales model and the reliance upon the three key promotions, that's pretty steady and consistent and not terribly volatile growth if you look at the last four year trend. We know things happen below the line in terms of gross margin and expenses but, overall, that's pretty steady and consistent growth. The ratio of the Australian business is growing, but it's - New Zealand's actually had a very creditable performance over the last four years given its penetration relative to Australia. So Australia's got a lot of up-side opportunity, but New Zealand's still hanging in there really, really well.

Just moving to same store growth - we've put the last four years, and we've put it in actual rates and constant exchange rate basis. There is a decline over the years, as you'd expect, as we roll out more and more stores, but we still think around that 5.6% mark - a very, very healthy level of increase. Just going back to the point before, if we look at the relative penetration of New Zealand and Australia - and I've talked on these topics in the past - we'd like to think Australia can sustain a good level of same store sales, going forward.

Gross profit margin - we can see a slight deterioration in Australia. I think that really - if you go back to the previous slide, in terms of the first half, the second half, that really reflects how tough we found it in the second half to the first. Other people have talked a little bit about a warmer winter. If we look to that performance in New Zealand and Australia as to that period, probably, New Zealand did do slightly better. Whether we'd put it down to the weather or the tougher economic environment with the election pending, it's difficult to tell. We're still very happy with our overall performance, and we clearly didn't have to aggressively discount. It was a very small amount.

In terms of the UK, that's really as a consequence of the restructure that we've communicated and been talking about for the last 18 months or so. The good news is that all that restructure is over and it's really now about trading. As usual, when it comes to spending money, I pass over to Mark Todd.

Mark Todd: Thanks Peter. I'll try and spend a little less money than normal because it's been a relatively frugal year in terms of operating costs. Basically, as you've seen in the half year splits a very flat year-on-year $84 million per half year. Increased retail rents in Australia continue to be the main driver of increasing rent in percentage of sales terms, but they're more than offset in FY13 by leverage attained in advertising spends which was reflected by same store sales percentage growth than the rate of advertising increased.

Distribution costs were down as percentage of sales. You may remember in FY12 we had a challenging year in [DC] management, but that's certainly not

repeated in FY13. Other retail costs in head office lines - most of those are improved. Some of them are up and down but, basically, the advertising and the distribution costs ensured that the reductions in those as a percentage of sales terms ensured that we actually reduced our percentage of sales operating costs from 44.1% to 43.8%.

Talking about earnings overall, earnings per share this year increased to 22.1% of the share, up from $0.174 in the previous year. I'll just talk, at this point, just specifically about the net profit, incremental benefit from the taxation adjustment on the Australian loan account. When the brands were valued in the business in 2009, at the time of the IPO - those of you who may remember that - the Australian brand was valued at AUD92 million, the Kiwi brand at $51 million in New Zealand, and the Australian brand - [unclear] [the right of use] for the Australian business. That was half debt funded, so there's an interest bearing loan between the two entities.

In the Australian company - we gained some offers on offers on that because it's New Zealand dollars nominated it flowed through the Australian P&L. The relative weakening of the Australian dollar in the last couple of months of the year meant that there is a substantial cost to the Australian business this year for that, and in the resulting reduction in the tax charge. That cost flows out on consolidation, but the tax charge does not. That's the reason why there's an effective tax charge benefit this year. In future years, should the exchange rate move around, that would reverse. So we'd basically flag that that at [$3.1] million of tax benefit is something that's going to flow in and out of the accounts on a timing basis, just depending on how the translation rate between Australia and New Zealand works year to year.

Talking then a little bit more about the country results - I flagged the specific around the Australian, but the result that you see is presented in the slides is in an EBITDA level, and that obviously happens below the EBITDA line. EBITDA in Australia grew 14%. So on a stand alone basis that was a particularly good result, highlighted by some really, really good store results from the new stores opened in FY13. The 14 stores that we've opened as new stores in Australia this last year have been a very good group of stores.

Most of those stores are small format stores in mainstream malls, and they've made a strong contribution to profit growth in Australia this year. They are obviously costly from an OpEx point of view - in particular rental costs. That's the primary reason, as well as the gross margin reduction in Australia, why the EBITDA margin, in percentage terms, is down one percentage point. We're more than happy to trade a one percentage point reduction in margin for the 14% increase in Australian earnings overall.

In New Zealand - a really good result in New Zealand, underpinned by, basically, the same store sales growth of 4.4%. Same store sales growth in New Zealand in the second half was stronger, above 6%. Australia in the second half was below 5%. So it was a better half in New Zealand in the second half that Australia, but that led to - with gross margins being flat or, actually, slightly better in Australia year-on-year - that led to an improved EBITDA result in New Zealand, up 10.7% to $34 million. A quieter year in opening stores in New Zealand, as you'd expect, now the portfolio's relatively mature. Both those two new stores were opened in the last six months of the year. They've traded really well since opening. [Actually], Pukekohe's been open a bit longer than that.

In the UK we have done a lot of work in the last year to reorganise the UK business to the model we intend to run in that country, going forwards. We have - on that basis we haven't really been focused too much on same store sales and gross margin. Given that we closed to stores in the year, we were quite - and we did a lot of clearance activity while we were shutting those stores. We were pretty happy that gross margin was only down two percentage points on the prior year.

Now that we've realigned the stores to have three, now, fully rebranded stores in the UK - we've just finished the Spitalfields store, and it's reopened in the last couple of weeks - so we have Spitalfields, Covent Garden and the new store in High Street, Kensington, all in prime locations for outdoor travel and adventure retail, and all property branded to represent Kathmandu brand overall, as well as the Bristol store, which runs our support services.

That's the store network we intend to run in the UK to support what is, primarily, an online offer in the years ahead. So our focus definitely switches in the year ahead to same store - trading activity rather than reorganisation of the business. That reorganisation of the business - because it, obviously, resulted in removing a number of costs from the business that we had previously being incurred, and loss making stores, has meant that we actually had an improved result in the UK, albeit still a trading loss of just over GBP1 million.

Cash flow and balance sheet - if we move on to that - a 40% improvement in operating cash flow year-on-year of over $13 million. The primary reason for that, obviously, were the underlying trading performance and a really good result in terms of capital expenditure compared to our expectations. We've signalled in the past that we've been working hard to get better fit-out contributions from landlords. That reflects, certainly in part, in the capital expenditure outcome for the year.

The other reason is also we've just got a lot better at the construction and set up of new stores. So an efficiently run store roll-out program this year - a little bit of timing and benefit to us, year-on-year, in terms of what we did spend in fit-out this year for stores - last year, sorry - for stores that opened this year. In the end the CapEx was down compared to the previous year as a consequence of the dividend flows being flat year-on-year and improved operating cash flow from trading that we actually improved down the debt position to be debt to debt plus equity ratio and the end of the year of only 12%.

Then, on the balance sheet, the other thing that's relevant to cash flow management for us, obviously, is the good efficient management of working capital. That's reflected in our inventory levels. We're quite comfortable with the level of inventory that we're sitting with at the end of the year; a small reduction on a per store basis - even more so when you actually exclude the effect of goods in transit for the summer season; a very clean profile of stock at 31 July, as was reflected in our winter clearance, that we've been selling

through in the last couple of months trading. Nothing really too much else to talk about in our balance sheet other than that.

Dividends; we will be increasing our dividend payouts this year to $0.12 per share so that's a 20% increase on the prior year. Final dividend is fully franked and fully imputed. Just to reiterate what we said at the half year, that in future in New Zealand interim dividends are unlikely to be imputed due to insufficient imputation credits being generated in the New Zealand business. But we'd expect all dividends in Australia to remain fully franked for the time being. So that payout ratio continues to be within the 30% to 60% range that we've operated with since the time of the IPO.

Hedging? We have a hedge rate for FY14 which covers the entire forward order for FY14 in terms of US dollar denominated purchases at almost exactly the same rates as those achieved in FY12. There will be, as we know, a little bit of a deterioration, particularly in the AU/US dollar FY15 but at this point in time we don't see that as being particularly significant when you measure the rate of the production at the moment, what we're covering at $0.91 cents versus $0.98 cents. And with input costs being no more than 30% of the total cost of [the other product relative for each] - dollars of sales.

Okay, that's enough on numbers for me. Back to Peter.

Peter Halkett: Thanks Mark. No doubt we'll come back with some more questions on the numbers later. I'm going to update the growth strategy and once again it's very similar to the structure we've used since IPO time for those investors that have been with us over that journey. There's nothing hugely radically changed in our growth strategies. There are some really interesting things happened within them, and mainly positive, so I'd just like to update where we're at.

I think we've communicated fairly clearly for the last 12 months or so that we saw with the introduction of some of our new formats that the target store numbers across New Zealand and Australia would increase to our next target of 170 stores, new stores as Mark's alluded to in our finance

presentation. Certainly as the group we've opened in the last 12 months have performed really, really well, so we're remaining very confident that the rollout remains on track, new stores are working well. Fifteen is our target for this year.

I have signalled in the past our flagship program. This was very important to establish really high quality stores and prime locations with high footfall to start changing some of how people perceive the brand: more about brand than necessarily pricing. We've got a lot of those stores in place. They are working very well.

We're very happy with what's happening with our brand tracker. That program is almost complete. There are a couple of markets we're working on. So the emphasis is really about the rolling out, you know, regional stores, small format stores and, once again, I'll just highlight the sexiest of our new small formats which has really been the majority of what we've been opening over the last 18 months.

When we talk store network we need to recognise we've got 136 stores. Some of them are quite old now, so we can go back and if we bring forward what we've learned over the last few years and the new small format, there remains a very opportunity to maximise and improve our performance of our existing portfolio, particularly as the leases expire. So what our various formats allow us to do is to adapt the right size store for the market, whereas in the past I guess we've pretty well had a one size fits all certainly if we go back seven or eight years.

So as these leases come up we can both target the offer right for the market as well control our rent bill going forward, which as you know in an online digital world that becomes increasingly important.

The other thing we're doing that you may have picked up in the presentation is you'll see that we're implementing new systems across the business. These are new forecasting and planning systems. They'll be new point of sale systems, new finance, new warehouse management systems. All of

these things are sort of being put in place to have a platform that can allow us to move to a fully integrated online store-based retailer.

But not only do they support that, they are also going to support physical stores in terms of having the right range for the demographics, the climate and the store size. So that is another future opportunity which will improve our sales per square metre, our sales per density. Obviously, in an online business you don't have sales per square metre but it will improve the profitability of lines, whether they be online or in the store.

So assortment range planning tools that we're implementing at the moment are going to be a big part of improving our business as we know it today as opposed to the store rollout.

Online and digital: we've decided that we'll start to be more specific about what we are achieving. Our online sales grew 55% year-on-year. These online sales primarily cover New Zealand and Australia and from a total group point of view they are now four per cent of our sales. While that number in itself doesn't set the world on fire, we're very pleased with it and we think it's established a really solid base which, to be frank, we're only just starting to build upon now.

So we think that's creditable. There's been a lot of hard work to that in place. It's a very profitable part of our business but there's a long way to go but it's a good entry into this space.

Talking further, there are a number of enhancements we're doing. We're just about to launch our mobile optimised site. We're about to launch international shipping. We have a Kathmandu app. So there's a lot going on in the digital space. We have just launched - and we're still at that early phase - onto Amazon UK. That essentially links in with our UK website and Amazon UK have a customer base of over 3.8 million customers, so we think that's going to give exposure to the brand or outlet to the brand.

Just being on the site alone doesn't guarantee you success. It doesn't even guarantee you a single sale. There's a lot of work you need to do around that to ensure that your products come up in any search. But we've sorted

out the technical. We're on their site now if you were to look for us now. It's about marketing within that site; it's very much about being in a massive department store and being stuck in the corner at the moment. We've got to get ourselves on the aisle but we have a program and we have ideas who we're going to do that. So once again, that's all part of the UK and future growth opportunities for the business.

Just to confirm that we are moving towards being a fully integrated retail offer and the term used for that is omni-channel. You can't really become omni-channel until you have the system to support that, which is why we're investing particularly into Microsoft AX and having an all of business solution.

Just moving through to product, we are nothing without our product. You can have fantastic stores, you can have a great online site, you can have the best operating efficiency but funnily enough if people don't want to buy your product you go nowhere. We've invested a lot in our product team. We've grown the size of the team, we've brought in new skills. We've brought in increased investment and research, product development, fabric technicians, government technicians - we've really grown it - as well as specialist designers. We've just bought recently another designer in terms of our active area so we're always building our skills and capabilities so that we can compete, not just regionally but globally with the sort of products we present to our customer.

We've introduced best in field testing programs so that we have a very high end technical range that you could be involved in a really serious technical outdoor activity such as climbing, et cetera. Once again, to assist our product team and to get better profitability from our products, the new forecasting and planning system that's part of AX or sits on AX, which is called JustEnough that's just about to be launched in the next week or so.

So once again, it's all about understanding what's going on, better tools for our team, better efficiency, better insights and better management and more profitable appropriate product offer.

The final growth strategy I'll talk about which I touched on in our highlights is our Summit Club Loyalty Program. We think it's critical we continue to build and enhance our relationship with our core customers. We want to grow that base beyond the current million. We think that's just a starting point, particularly in many ways in Australia, where our penetration is a very small portion of what we achieve in New Zealand.

I've mentioned that that growth is likely to be Australia-centric and that will tend to grow with the store numbers as brand awareness, and I guess the realignment of some of our products that are more related to Australia than historically in New Zealand. We introduced an accumulated spend initiative last year. I think I've referred to that in the past. That's going really well and the customers are responding positively to that. I hate to say it again but our new platform will allow improved CRM, or customer relationship management, giving us both better ways to segment our customers, better information and insights into what they're buying and what they want from us and, of course, that has a very good and important fit with what we're doing in online and digital.

So just moving through to a more shorter term focus now, the outlook for FY14, our store rollout's on track. We've already got seven sites in the bag. We've got Westlakes and Adelaide, Northland and Melbourne. We've got a couple of outlet centres and they sort of target a different part of the market and for us they are an important part of our overall profitability.

We've got another flagship store opening in the Emporium in Melbourne. we'll be sitting alongside some of the best retailers in the world so we need a great site there; opening in Indooroopilly and also we have just opened in St Lukes in Auckland and it's only been open a week but that seems to be going very well. I'm happy with that. There's a small format store for New Zealand so you imagine that if that goes well there'll be other opportunities for us in New Zealand.

Online: I've talked a lot about that today already and it really does provide a new way for a vertical retailer, a retailer that owns their own brand. It gives us opportunities not available to I guess more traditional retailers who are

selling other people's brands. I think the market is slowly starting to really understand the difference between vertical retail and the opportunities they have and traditional retailers.

The UK, as Mark's alluded to, the pain and the hard work is behind us. Now it's actually about trading. It's about getting in and getting the product offer right, the promotions right, Summit Club membership right, leveraging the Amazon relationship. We've just launched a brand campaign in the UK so it's really the beginning of hopefully the turnaround in the contribution of the UK. Kit's worth highlighting that the work we've done there is not just about I guess tidying up what's been a loss making part of the business, and sort of staunching the flow of losses. This is quite different. This is about implementing the model we see as appropriate, not just for the UK but potentially other markets on a go forward basis.

So this is about implementing our ideal model not about making cuts here and there and ending up with something that's not exactly the shape we believe is sustainable. We have taken the pain to get it exactly how we would go about it if we were to start with a blank sheet of paper.

Our operating expenses, all of these things happen with a very close eye and attention on how much we're spending and our ratios. Looking at the wider market, clearly, the current economic conditions are still, you know, we say it every time. I guess it's repetitive but there is a lot of uncertainty. Things are very volatile. From a day-to-day trading point of view it is up and down and all over the place but as you can see over a 12 month period, and in fact in our case over a four year period, it's actually been relatively stable. We tend to take those bumps and [unclear] out of it. A very volatile, very sort of challenging environment but one where I think we've proven that we can cope well.

The outdoor category itself, both locally and globally, is very resilient and continues to attract investment and interest and hence the competition continues to increase, whether it be local, whether it be global, whether it be online or physical stores. Everything is quite keen on the space but once again we've taken on a lot of competitors over the last three years and I

think we've shown we've got our own plan, we've got our own customers and we've found a way forward.

So in summary, the Board and the management team remain confident in our business model and our ongoing growth strategies. They haven't really changed in the last four to five years. Providing there's no further deterioration in economic conditions we'd expect a pretty solid performance in FY14 again.

I think we've reached question time so I'm going to pass back to Maia. I think you are chief in charge of controlling questions, Maia.

Maia Thomas: Thank you, sir. The question and answer session will be conducted electronically. If you wish to ask a question please press star one on your telephone keypad and wait for your name to be announced. If you're on a speaker phone, please be sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star one to ask your questions.

We have a question that's come through from the line of Chelsea Leadbetter from Forsyth Barr. Please go ahead.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Thank you. Hi guys. Just a couple of quick questions for me. Firstly, just you've talked a bit about the new systems that you're implementing in FY14; what sort of CapEx is involved with those and are there any additional costs expected going forward?

Mark Todd: So the aggregate CapEx spend for business, Chelsea, we still continue to budget around $20 million a year for CapEx, give or take a little bit, up and down. The driver as to whether it hits above or below is usually related to store roll out as opposed to systems. We've got a systems budget that's not dissimilar to the numbers you've seen in the last couple of years.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay, thank you and then I guess looking at online sales, is it fair to assume the divisional breakdown there as similar to that of the group?

Mark Todd: Online sales are stronger in Australia than they are in New Zealand. Historically that's been the case probably since we started doing both gross and net, reflects as much brand accreditation as anything else, is more suitability for the Kathmandu brand in the New Zealand market in regional locations and main cities than there is in Australia.

Peter Halkett: I think the answer to that is more or less, but we haven't disclosed that. We thought we were doing quite well by starting to disclose the total, but I think that's a reasonable assumption you can make.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay, thank you and I guess you've mentioned the competitive landscape continues to increase in the outdoor market, would you be able to give a bit more colour around in particular New Zealand and Australia and what the competitors are doing?

Peter Halkett: Well in our space, what's really happening is that outdoor adventure gear, particularly in apparel, is very much in vogue at the moment. You see a company like North Face, most of their growth they're getting is in apparel and it tends to be more in the adventure travel gear. Some might say that it's coming into more the everyday space, into the urban space, people are wearing Gore-Tex down jackets, they're wearing I guess gear with technical fabrics, more and more appealing for everyday use. So I guess you could say lifestyle.

Lifestyle seems a bit too much like fashion to me, we need to be careful, but within our space, the growth is coming from apparel, it's coming from more the travel and urban sort of gear, but has the technical attributes of traditional outdoor gear. So as people see that trend occurring, brands like Adidas have got an outdoor range, Nike are looking at this area, you've obviously got a lot of things happening globally with M&A activity.

Locally we've got companies like Supercheap Retail, talking more about the space in apparel and whether it be in their Ray's or BCF, have opened chains in Australia - sorry, in New Zealand, [SCO] designs continue to open lots of stores, Macpac are opening stores and they're well entrenched in New Zealand and they're trying to break in and become more successful in

Australia. There's obviously a lot of online activity, you can get outdoor gear from a number of sites and bring it into New Zealand and Australia very competitively.

So some of the reason why probably hasn't come out in this presentation, but why we're so focused on building our brand and building our product offer and remaining very relevant to our customers and understanding them, particularly through our Summit Club program. I'm not sure if I specifically answered your question except it's a great space and everyone's pouring into it and there's lots of names you could list.

Mark Todd: Chelsea, just in the localised New Zealand scenario, the Warehouse and Torpedo7 and the latest acquisitions they've done, they're all talking outdoor adventure because for exactly the same reason; everybody's doing the same thing.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay, great, that answers my question, thank you. Just really one more final question, looking at the UK division, when are you expecting to break even there?

Peter Halkett: I'm not in a position to tell you that. We'd like to - if all went to plan, we'd like to think within a couple of years. But it's really a matter of we're beginning the journey now. We've obviously upgraded our stores, we've got our website, we've put in place our new web team, we've got the Amazon. We'd like to think there was no more than a three year horizon, but we really need to see now that we're just leaving the starting block as to what happens over the next three to six months.

This year's really important because unlike this side of the world, the peak trading in the UK for our category happens in December because you get both winter and you get Christmas trading. So we really need to see how we trade with our new proposition, what happens with our own site, what happens with Amazon, what happens with our stores, as we go through the next six months. Maybe at the half year we can probably give you a better prediction of when we might get to the breakeven point.

Chelsea Leadbetter: (Forsyth Barr, Analyst) Okay, great, thank you very much.

Peter Halkett: Thank you.

Maia Thomas: Your next question comes from the line of Sandra Ulrich from First NZ Capital, please go ahead.

Sandra Ulrich: (First NZ Capital, Analyst) Morning guys, just a couple of questions. Actually I'll just start with Mark, if I could just ask you in terms of - just want to get my head around the currency, just in - the NZ/Aussie cost rate, if you were looking at, for argument's sake, an $0.89 NZ/US for FY14, is that…

Mark Todd: Did you mean US?

Sandra Ulrich: (First NZ Capital, Analyst) Sorry, Aussie, NZ/Aussie, would that have a meaningful impact on you guys? Because it doesn't seem to, if I look at the differential between FY13 and '12, it doesn't really - I mean it has small impact, but not too meaningful.

Mark Todd: No, it would have a meaningful impact by the time you got to the second half of the year, yes, Sandra, simply because most of the currency depreciation of the Australian dollar happened in the last quarter of the year, but also that coincided with our trading for winter, which is our biggest period of the year. So it won't have a huge impact on the first half of the year, because we don't make much money in the first half of the year either way.

Sandra Ulrich: (First NZ Capital, Analyst) Yes, so we're talking about the NZ/Aussie, sorry I was…

Mark Todd: Yes.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, but in terms of - I mean I guess the next question is just around, would it be fair to say that Kathmandu is perhaps a less seasonally exposed business now? Because you seem to be the one who, the one company, out of pretty much all Australasian exposed, seasonally exposed companies that have blasted

through winter without - notwithstanding the warm weather conditions, can you talk about how you thought you did that and why?

Peter Halkett: Well I think we've provided the split between the first half and second half. I think I'd alluded to the fact that we felt Australia was probably a little tougher to period than New Zealand. I guess you can also see that the second half sales increase was less than the first half sales increase, so you could say that yes we did well getting through winter, but we were still impacted by what occurred in both terms of the economy and the weather. So we blasted our way through, we would have liked to have got through with a bit more energy behind us as well. So we were impacted.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, well I think you actually had a fantastic second half result given the weather. Anyway, that's my thought. Just in terms of - I just want to get my head around the cost of doing business, because that seems to have changed a bit regarding your discussion around moving further into Australia, higher overheads, but that seems to have changed tack a bit now. So if I were to look at operating expenses as a percentage of sales, whether it be rent and SG&A for a start, how should I be approaching that now? Should I be approaching that at a - let's just think, for example, rent at 11.4%, should I keep that 11.4% in place, or how should I approach that?

Mark Todd: So the answer to that is that it's still the same message really, Sandra, as we gave you last year that we expect it to be there or thereabouts in terms of total opex as a percentage of sales with increasing Australian retail costs, primarily rent or rents but also overheads and salary and wages in retail, then offset by savings in other areas which is distribution and head office overheads, within some respects advertising being the swing factor and the actual underlying sales performance as well. So those two things are the ones that kind of really swing it. So if we have an above average same store sales performance which is 4% plus, well we're going to get operating leverages, would be your general expectation and most retailers should and that's really what happens.

Sandra Ulrich: (First NZ Capital, Analyst) So if I were to - outside of operating leverage this year, if I were to look at leveraging advertising and distribution, would most of the gains in terms of the leverage in FY13, have they been had? Should I be looking at - in other words, is there something in FY14 that can kick in that I haven't thought about?

Mark Todd: Advertising's always discretionary. We've always said we'd spend 5.5%, 6%, so that number moves around as much as we'd like it [unclear].

Peter Halkett: I would sort of say Sandra, we control the dollars, we don't necessarily control the percentage. The percentage is a function of what the total sales increase was, which is ultimately a function of how the new stores perform and a function of same store sales. Our costs are going up every year and the weighting towards Australia makes it more and more difficult. But if we have good same store sales, as Mark said, above 4%, we get operating leverage. If we have same store sales below 4%, it's going to be incredibly difficult to get it.

Sandra Ulrich: (First NZ Capital, Analyst) Yeah, okay.

Peter Halkett: So I think the scenario is, if you're asking what should you expect for next year, I think you'd take a view on same store sales and you could probably calculate it. We'd like to think that roughly where we're sitting is roughly where we'll continue to sit, because it was a fractional movement, really.

Sandra Ulrich: (First NZ Capital, Analyst) Okay and I know it's a non-seasonal, or it's not a key seasonal period, but the last - we're almost - July, August, September, we're almost two months into the first half of this year and I know you're going to mention Christmas, but in terms of trading year to date, is there anything noticeable?

Peter Halkett: Well we had a very strong start last financial year and this year, to be frank, has been less than exciting. That's not terrible, by any means, but it's pretty flat. But as you've just alluded to, the first six or seven weeks of our new financial period in the context of even the first half are

quite meaningless, so - but we haven't found it easy, but then we had some stellar increases last year.

We lead off this year with a couple of campaigns. First off all we lead off with our August clearance and that's a function of how much clearance stock we have, so if we have very little stock, we can't achieve really high sales. So is that good or bad? So we finished the year in a really healthy position, so we didn't have a lot of clearance, so we can't have certain sales targets. So it's sort of good that that wasn't stellar performance. Since then we've launched our new range, we've had very, very positive feedback, but the numbers we achieved during that period are quite small.

Sandra Ulrich: (First NZ Capital, Analyst) Okay.

Peter Halkett: So I think I'd say to you it's more or less in line with our expectations if we weighed everything up. I don't think there's a terrible economic situation out there. I don't think the world's on fire, positively I'm talking.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, just one last question, I know I'm hogging. When you said another solid performance FY14, is there anything to be read into that? You said a pretty solid performance.

Peter Halkett: Well we're not giving any guidance at all. So we're really saying that we remain confident in the business model. Clearly the growth strategies have worked for a number of years now. We've got a lot of really good new stores to come on board. There's a lot of things happening with our new systems, so everyone hedges around this topic because we really don't know what we're going to encounter, Sandra. But in the main, if the environment were to stay pretty similar to what it is now, I'd be disappointed if we didn't have a really strong result.

Sandra Ulrich: (First NZ Capital, Analyst) Okay, no, thank you very much. Thanks guys.

Peter Halkett: Okay, thanks Sandra.

Maia Thomas: With one further question in queue, as a final reminder, if you would like to ask a question, please press star one on your telephone

keypad. That's star one to ask a question. Your next question comes from the line of George Batsakis from Goldman Sachs. Please go ahead.

George Batsakis: (Goldman Sachs, Analyst) Good morning guys. Just a question on the EBITDA margin trend in Australia falling from 19% to 18.1% as you pointed out. Could you just expand on that? Do you feel now it's going to stabilise around that 18% level or is there more cost of doing business increase coming through over the next couple of years to lead to further decline in EBITDA margin?

Mark Todd: Well if you take the Australian business on its own, George, where gross margin obviously was a major factor this year and we'd talk to gross margins and say they'd be there or thereabouts and a lot of that's just simply down to sales mix or product mix, that's as big a question as the question of cost. Because on the cost side, retail rents and rates will go up in percentage terms, yes that just continues to be and other costs within Australia are apportioned to offset that, but a lot of the head office and operating costs are to New Zealand as opposed to Australia.

So yes, it should be there or thereabouts, but again and the same answer really to Sandra's question, it's basically more around the sales outcome as opposed to the cost equation side and the gross margin associated with the sales outcome.

George Batsakis: (Goldman Sachs, Analyst) Because from a quick calculation, the gross margin in Australia didn't really come off that much, maybe 20 basis points from…

Mark Todd: Sixty, 60 basis points.

George Batsakis: (Goldman Sachs, Analyst) Was it? In Australia?

Mark Todd: 66.9 to 66.3.

George Batsakis: (Goldman Sachs, Analyst) Okay. Then the other question is, on the cost of doing business in Australia, your total labour cost across the group pretty much increased a little bit ahead of group sales growth, so I think total labour costs across the group were up about just over 11% and your total sales were up 10.6%. How do you see labour costs going forward?

I'm just really in particular interested in labour costs in Australia, with the award modernisation and under the Fair Work Act. Do you see a big step up in labour costs for Kathmandu in Australia over the next couple of years?

Mark Todd: Not as big as the above, but very hard to get better. A little creep year-on-year. Obviously operating in more locations it's more costly in percentage terms because of the opening hours and so forth and there's no flexibility in Fair Work related structures. So yes, labour costs as a percentage of sales in Australia have crept up slowly at the retail sense and they would keep doing so. But I mean, incrementally, when you've already got 80 stores in the portfolio, the next 10 stores are only 10 out of 80 - so not spectacular.

Peter Halkett: Yes. George, as a function of how many people we have and how much we pay them seems blindingly obvious. But from a productivity point of view we have several initiatives to improve the productivity; in other words, [less] FTE per store, that we're working on, including some of the things that we get from our new Microsoft system, new point of sale, technology, we have things we are doing around our stockrooms and product labelling and all sorts of things that we have, that will assist. But the big driver in Australia is ultimately the wages that are dictated to us at a central level, as well as the fact that a lot of the stores we're opening tend to be a little smaller, as Mark has alluded too, and they have a slightly higher percentage cost.

So from a productivity point of view underlying, we think we are doing a good job. But some of that good work is being offset by above, certainly above New Zealand rate salary increases and wage increases in the store.

Mark Todd: And just the way [structures in general].

Peter Halkett: But we think we're about right, the number of sales people we have store, to provide the right level of service verses obviously, losing sales for not having people there. But it's always a close run thing, as we know from other retailers. Sometimes they go a little far and sometimes not far enough.

George Batsakis: (Goldman Sachs, Analyst) Okay, that's great. Thank you very much for that.

Peter Halkett: Thanks George.

George Batsakis: (Goldman Sachs, Analyst) No worries.

Maia Thomas: We have a remaining question in queue from the line of Ken Wagner from the line of PhillipCapital. Please go ahead.

Ken Wagner: (PhillipCapital, Analyst) Yes, good morning. Just a question on the store rollouts. Given your current run rate of expansion, you'll be hitting your 170 target within - over two years. Can you just remind us what your thinking is in terms of perhaps increasing that target or perhaps moving internationally or with the smaller format stores allow you to put more in? Can you just give us some detail around that please?

Peter Halkett: Well, there are number of things. First of all, clearly we see a lot of potential for online across New Zealand and Australia still, as well as international shipping, to provide us growth beyond the target number we've talked about to date.

We think that as we rollout stores also over the next two years, we'll discover tools that we have from assortment range planning and other observations. But that probably - rollout may be able to extend to things like airport stores and one or two other locations. We're probing that a little bit in New Zealand at the moment with St Lukes, where we probably wouldn't factor in the previous rollout a whole bunch of mall stores in New Zealand, sitting in the [long site]. So that's unproven. But there are possibilities in that area; but probably the biggest thing that's going to extend growth, rather than thinking about rolling out stores or even optimising the existing store portfolio. It's looking at our penetration rate in Australia.

We sell approximately one-third per head of population to Aussies, than we sell to Kiwis. Some of that is in relation to where our store network is and how big our store network is. But a lot of it is simply about brand maturity, brand awareness and our product range selection. So we think it's going to

take more than two years to get the penetration level of Australia, even to 60% of New Zealand.

We've talked about this in past presentations, so for a lot of you this is not new. But it's just reinforcing the fact that there is one measure which is about how many stores and when does that rollout and then there is another measure about well, what's the sales per customer and what are the opportunities to increase that?

We've seen in New Zealand that everybody keeps saying you've hit 30 stores, you can't have any more. We're up to 44 now and we keep increasing our same store sales as well. So we think it's about velocity through the store, not just the number of stores, how much you can sell from a store, is where we've got to put out effort in. So from a growth strategy point of view, there are things we're doing beyond the rollout, in terms of optimising stores. We've obviously got the UK. We've got a lot of work we're doing on online. There are new formats we're working on for New Zealand and Australia.

So Ken, I'm not sure if that's answered your question. But there are obviously other more strategic ideas we have, but we're clearly not in a position at this point in time to talk about those and we do have a reasonable amount of time up our sleeve to ensure that we continue to grow at a rate that our investors would expect, beyond what would be the 170 rollout.

Ken Wagner: (PhillipCapital, Analyst) No, that's very helpful. Thanks very much. Just one last question, if I could. Looking ahead to '15 and the lower currency against the US, I was just wondering whether you could comment if you remain confident that you will keep your gross margin in that 62% to 64% range, given the potential increase in import costs.

Peter Halkett: Well first of all, our input cost, given that we've got a very high gross margin, even a 5% or a 10% movement at a retail price point is a 2% or a 5% movement in the retail price and, to be honest, we [flex] our prices by more than that on a pretty regular basis.

If we get the product right people are happy to pay a certain price and if we get the product wrong, we've got to discount it more heavily. So a lot of it is still within our control and the actual movement in the exchange rate, it's less about what we are paying for things and more about what we're selling things for, if that makes any sense. That's about the brand, the marketing campaign, the products we've selected and design.

So we're not concerned that our gross margin would come under pressure because of the cost of goods. We'll become more concerned about gross margin coming under pressure because people don't want to buy our goods.

Ken Wagner: (PhillipCapital, Analyst) Right, okay. That's useful. Thanks very much.

Peter Halkett: Thanks again, Ken.

Maia Thomas: Can we have allowance for one more question? If you would like to ask a question please press star one on your telephone keypad, that's star one, to ask a quick question.

Peter Halkett: I like the result that doesn't get too many questions.

Maia Thomas: Gentlemen, there appears to be no further questions at this time. I'll hand the call back to yourselves.

Peter Halkett: Yes, I'd like to thank everybody for joining the call. I really appreciate your time. I know for many people, we are going to see you over the next four days and I look forward to catching up and I guess going through the result and getting a few more questions.

So thank you everybody for joining. Bye.

Maia Thomas: This does conclude our conference for today. Thank you for participating. You may all disconnect.

END OF TRANSCRIPT