

Kathmandu Holdings

NEUTRAL

Outback Outpacing

Kathmandu (KMD) provided a positive trading update, with a strong finish to FY19 despite warmer weather through the key Winter trading period. Strength in its Australian business was a highlight and more than offset a challenging period in New Zealand. A material reduction in debt levels was also a standout. Looking forward, we see the risk/reward as balanced, with headwinds domestically (cost, competition) albeit potential upside should execution on its International expansion be faster/stronger than anticipated. **NEUTRAL**.

- **Earnings:** FY19/FY20/FY21 NPAT +4%/+1%/-1%
- **Target Price:** Up +2cps to NZ\$2.65
- **Rating:** NEUTRAL

FY19 guidance ahead of consensus

KMD provided first time FY19 guidance, ahead of market consensus and our forecasts, signalling a strong finish to 2H19. KMD expects NPAT to be in the range of NZ\$55.5m to NZ\$57.0m, with the mid-point implying growth of +11% on the prior period.

FY19 net debt guidance of NZ\$19.2m (FY18 NZ\$31.4m) highlights the strength of KMD's operating cash flows in the period (2H19E NZ\$79m vs NZ\$74m in 2H18), reducing gearing to ~4%.

Australia the stand out

KMD's positive trading update is particularly encouraging given a tough seasonal and economic backdrop. Australia was the key stand out, reporting SSS of +2.7% despite cycling a tough comparable, and implying a pick up in growth in the second half. New Zealand was more challenging with SSS declining -3.9% as warmer weather across the country impacted the key sales window for seasonal product.

FY19 group revenue growth of +9.6% was primarily due to Oboz, given (1) KMD ownership for a full 12m in FY19 (vs 3m in the prior year) and (2) solid revenue growth for the brand. We estimate sales growth for the Kathmandu brand was broadly flat in FY19.

Outlook and earnings revisions

Whilst recent trading has held up well, we remain cautious on the medium-term outlook for the core business given increasing wage costs and heightened competitive pressures. Acknowledging possible upside to forecasts, should execution on its international expansion positively surprise, we currently view the risk/reward as fairly priced.

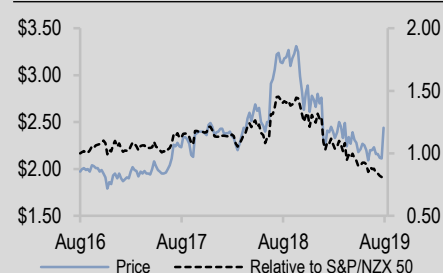
We have lifted our FY19 NPAT assumption +4.0%, consistent with KMD's guidance. We have also made minor revisions further out as a result of a slightly lower FY19 revenue base and expected margin pressure. Our target price lifts +2cps to NZ\$2.65 on the back of forecast changes and a revision to our WACC estimate.

Investment View

KMD has a strong brand and market leading position in Australasia with its loyalty database and vertically integrated model also key strengths. KMD operates in a competitive sector and earnings are seasonal. The core business is in good shape, with focus now on the opportunity for the brand further afield. International is the key area of focus, with material capital committed to accelerate growth plans. Our rating is **NEUTRAL**.

NZX Code	KMD
Share price	NZ\$2.44
Target price	NZ\$2.65
Risk rating	High
Issued shares	226.2m
Market cap	NZ\$552m
Average daily turnover	182.8k (NZ\$470k)

Share Price Performance



Financials: July	18A	19E	20E	21E
NPAT* (NZ\$m)	50.5	56.4	57.1	59.6
EPS* (NZc)	23.9	25.0	25.2	26.3
EPS growth* (%)	28.0	4.3	1.1	4.4
DPS (NZc)	15.0	15.0	15.0	16.0
Imputation (%)	100	100	100	100

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	6.4	5.9	5.7	5.6
EV/EBIT	7.7	6.9	6.9	6.6
PE	10.2	9.8	9.7	9.3
Price / NTA	17.1	10.1	7.1	5.4
Cash dividend yield (%)	6.1	6.1	6.1	6.6
Gross dividend yield (%)	8.5	8.5	8.5	9.1

*Historic and forecast numbers based on underlying profits

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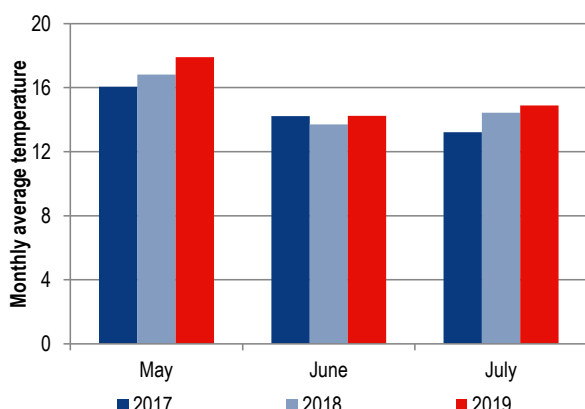
* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Strong trading update

KMD guided to a strong finish to FY19 +8% ahead of market consensus and our forecasts. The positive trading update is particularly encouraging given both New Zealand and Australia (although to a lesser extent) experienced warmer than average temperatures through the key Winter sales period.

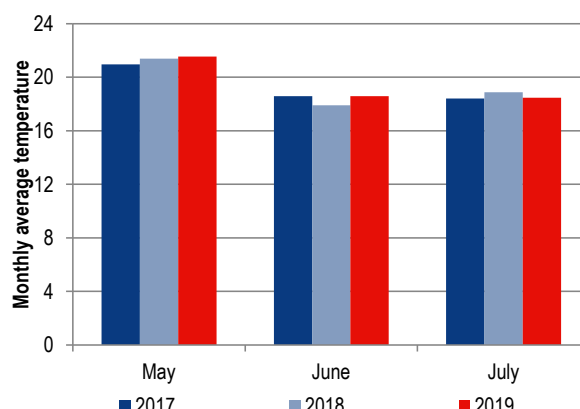
- **FY19 guidance:** FY19 EBIT range of NZ\$82.5m to NZ\$84.0m and NPAT range of NZ\$55.5m to NZ\$57.0m. This implies growth of +12% and +11% respectively on the prior year. EBIT margins remain strong at 15%, marginally ahead of FY18 and the highest since FY14.
- **Sales growth:** KMD reported group sales growth of +9.6% in FY19. The acquisition of Oboz provided the majority of the headline growth with group SSS up +0.6%.
 - **Oboz:** KMD commented it “continues to provide sales and EBIT growth”, although no specifics were provided. The recent acquisition helps to add diversification in terms of brands, product, geography (Australia/New Zealand) and lower its seasonal (Winter) risk. Oboz is expected to be EPS neutral in FY19 and accretive in FY20.
 - **Kathmandu brand:** We estimate revenue growth, after currency, was flat, with a strong result in Australia offsetting weakness in NZ.
- **Gearing:** KMD signalled materially lower net debt in FY19 of NZ\$19.2m, a key positive in the announcement. This was underpinned by strong operating cash flow, driven by EBITDA and a reversal of the seasonal inventory position in the first half. Gearing has reduced materially to 4% from 17% in 1H19 and 7% in FY18.

Figure 1. New Zealand weather



Source: NZX, Forsyth Barr analysis

Figure 2. Australian weather



Source: Australian BoM, Forsyth Barr analysis

Earnings and valuation change

We have lifted our FY19 NPAT forecast to NZ\$56.4m in line with KMD's guidance (NZ\$55.5m to NZ\$57.0m). Revenue guidance of NZ\$545m and an EBIT guidance range of NZ\$82.5m to NZ\$84.0m, implies a small lift in EBIT margins in FY19. However, we do not expect that to be sustainable, with continued cost pressure and a competitive environment likely to see downward pressure. We assume margin contraction over the medium-term. We have made minor revisions to our medium-term forecasts as a result of a lower FY19 revenue base.

Our target price lifts +2cps to NZ\$2.65 due to a combination of earnings and WACC changes. Our WACC estimate has fallen from 11.3% to 10.8% given changes to our risk free rate (from 2.75% to 2.0%) and market risk premium (from 7.75% to 7.5%) — consistent with our strategy report *WACC — New Input Sheet* published 6 August 2019.

Figure 3. Earnings changes

	2019E			2020E			2021E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Sales	551.1	546.6	-0.8%	573.2	564.3	-1.6%	596.0	587.0	-1.5%
EBIT	80.5	83.1	3.2%	83.5	83.3	-0.2%	87.9	86.0	-2.1%
Normalised NPAT	54.3	56.4	4.0%	56.4	57.1	1.1%	60.1	59.6	-0.9%
Underlying EPS	24.0	25.0	4.0%	24.9	25.2	1.1%	26.6	26.3	-0.9%
DPS	15.0	15.0	-	15.0	15.0	-	16.0	16.0	-

Source: Forsyth Barr analysis

Investment summary

Kathmandu Holdings (KMD) has a strong brand, market leading position and its vertically integrated model is a key strength. The key area of optionality is KMD's international expansion strategy, with Oboz expected to help accelerate this pathway. We view risk/reward as broadly balanced, with upside potential if delivery of international earnings moves faster. **NEUTRAL**.

Earnings and cash flow outlook

- **Store rollout:** The long-term target Australasian store footprint is 180, up from its current 167 stores (119 Australia: 48 NZ).
- **International expansion strategy:** This is the key avenue of optionality for growth with its 'capital light' wholesale model. Oboz provides a platform in the US, and KMD is also trialling with a UK and Swedish retailer.
- **Oboz acquisition:** The strategy is to leverage Oboz's wholesale relationships in the US market while also providing a less seasonal product line in the form of footwear.
- **NZDUSD and hedging:** Given the competitive retail backdrop and price conscious consumer, we don't expect retailers to be able to pass on the full impact of unfavourable FX movements.

Business quality

- **Strong base:** KMD has a strong brand, vertically integrated model, valuable loyalty database and a market leading position. Continued investment in IT will also support growth and working capital management.
- **Management:** Execution over the last three years has been strong, with the company delivering a turnaround in its profit trajectory.
- **Briscoe Group's stake:** BGP's full takeover offer in 2015 was unsuccessful; however, it has maintained an 18.9% stake.

Financial structure

- **Gearing:** Gearing has fallen to ~4% due to strong operating cash flows following a short-term increase associated with the Oboz acquisition.

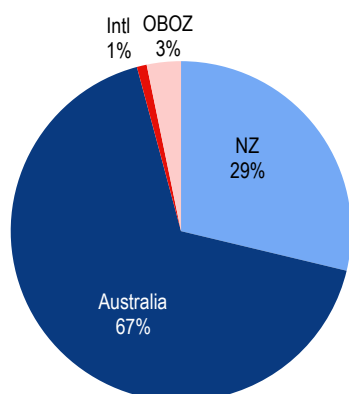
Risks factors

- **Earnings predictability:** A risk given the high seasonality and lumpy nature of earnings which are weighted to its winter sale.
- **Consumer sentiment and cost inflation:** Deterioration in economic conditions or general consumer sentiment. Cost inflation, particularly rising wages and rent

Company description

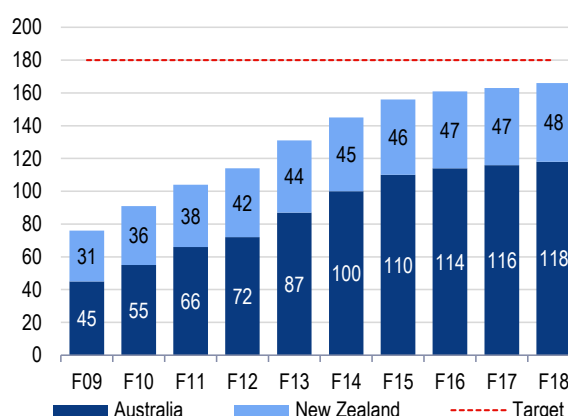
Kathmandu is the largest Australasian travel and adventure clothing and equipment retailer, with 119 stores in Australia and 48 in New Zealand and plans to expand its Australasian footprint to 180 stores. The company is looking to expand in International markets through wholesale and online channels, supported by the recent acquisition of Oboz. KMD offers a wide range of products, including specialist technical products, lifestyle products and general merchandise.

Figure 4. FY18 revenue breakdown



Source: Forsyth Barr analysis, Company reports

Figure 5. Australasian store footprint



Source: Forsyth Barr analysis, Company reports

Figure 6. Substantial Shareholders

Shareholder	Latest Holding
Briscoe Group	18.9%
Harbour Asset Management & Jarden Securities Limited	12.8%
TA Universal	12.0%
Commonwealth Bank of Australia	6.3%
ACC	5.0%

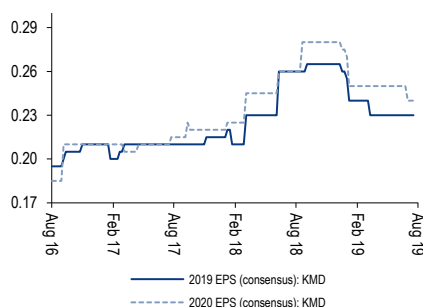
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International Compco's

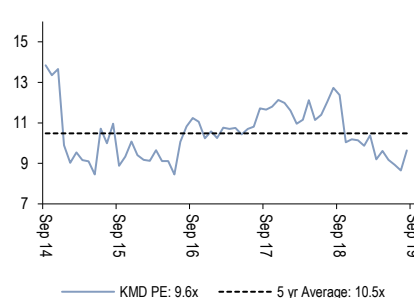
Company	Code	Price	Mkt Cap	PE	EV/EBITDA	EV/EBIT	Cash D/Yld
<i>(metrics re-weighted to reflect KMD's balance date - July)</i>							
			(m)	2019E	2020E	2019E	2020E
Kathmandu Holdings	KMD NZ	NZ\$2.44	NZ\$552	9.8x	9.7x	5.9x	5.8x
Briscoe Group *	BGP NZ	NZ\$3.48	NZ\$772	12.0x	11.8x	7.4x	7.3x
Hallenstein Glasson Holdings	HLG NZ	NZ\$5.33	NZ\$315	n/a	n/a	n/a	n/a
Michael Hill Intl *	MHJ NZ	A\$0.51	A\$198	9.0x	7.7x	4.3x	3.8x
Restaurant Brands NZ *	RBD NZ	NZ\$9.98	NZ\$1,245	27.8x	24.5x	13.3x	12.3x
The Warehouse Group *	WHS NZ	NZ\$2.30	NZ\$798	11.6x	10.1x	6.0x	5.4x
Big 5 Sporting Goods Corp	BGFV US	US\$2.03	US\$44	n/a	n/a	n/a	n/a
Dick's Sporting Goods Inc	DKS US	US\$32.27	US\$2,974	9.8x	9.5x	9.3x	9.4x
Premier Investments	PMV AT	A\$14.49	A\$2,296	17.9x	16.1x	11.5x	10.6x
VF Corp	VFC US	US\$81.47	US\$32,388	25.0x	23.0x	17.8x	17.4x
Columbia Sportswear Co	COLM US	US\$98.75	US\$6,678	22.8x	19.7x	14.1x	12.5x
Compco Average:				17.0x	15.3x	10.5x	9.8x
KMD Relative:				-42%	-37%	-43%	-41%
						-49%	-46%
							+40%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (KMD) companies fiscal year end

Figure 8. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 9. 12 Month Forward PE


Source: Forsyth Barr analysis

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