

Kathmandu Holdings

1H20 Result – A Mountain to Climb

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RESTRICTED 

Kathmandu (KMD) reported strong headline 1H20 earnings growth due to the first-time inclusion of Rip Curl, while earnings for the Kathmandu brand declined as a result of gross margin contraction. The near-term outlook is highly uncertain against the backdrop of COVID-19, with the majority of store doors temporarily closed. To help partially offset sales declines, KMD is aggressively addressing its cost base with additional support from government subsidies and possible partial rent relief. In addition, KMD has announced an NZ\$207m equity raise in order to de-lever its balance sheet.

NZX Code	KMD	Financials: Jul/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$1.12	NPAT* (NZ\$m)	56.8	n/a	n/a	n/a	EV/EBITDA	3.5	n/a	n/a	n/a
Target price	n/a	EPS* (NZc)	25.1	n/a	n/a	n/a	EV/EBIT	4.1	n/a	n/a	n/a
Risk rating	High	EPS growth* (%)	4.8	n/a	n/a	n/a	PE	4.5	n/a	n/a	n/a
Issued shares	284.4m	DPS (NZc)	16.0	0.0	0.0	0.0	Price / NTA	4.5	n/a	n/a	n/a
Market cap	NZ\$319m	Imputation (%)	100	n/a	n/a	n/a	Cash div yld (%)	14.3	0.0	0.0	0.0
Avg daily turnover	316.3k (NZ\$792k)	*Based on normalised profits					Gross div yld (%)	19.8	n/a	n/a	n/a

1H20 result – A good start for Rip Curl

KMD reported 1H20 underlying EBIT of NZ\$29.0m, up +47% on the prior year and in line with market expectations, with headline growth reflecting the three month inclusion of Rip Curl. 1H20 same store sales growth was positive across all brands, with recent acquisitions Oboz and Rip Curl stand outs in the period. In the three months of KMD ownership, same store sales increased +2.7% on the prior period, helped by a particularly strong North American result. The robust Rip Curl result is an encouraging early sign. Offsetting slightly, Kathmandu brand gross margin contracted as a result of increased clearance sales mix and negative FX movements.

COVID-19; Majority of bricks & mortar stores closed

As a result of COVID-19, the majority of KMD's store doors are temporarily closed across its various markets. In the lead in to closures, social distancing policies had weighed on foot traffic. KMD is aggressively reviewing its cost base, with government wage subsidies and possible landlord support also likely to provide short-term relief to a usually predominantly fixed cost base. Other internal cost initiatives include deferring all non-essential capex (expected to save NZ\$8m in FY20E) and a restructure of the head office functions (expected to deliver NZ\$15m of cost out).

Addressing the balance sheet, raising capital

KMD reported 1H20 net debt of NZ\$273m and net debt to EBITDA of 1.9x (1H19 0.9x), with leverage increasing as a result of its Rip Curl acquisition. In light of elevated gearing, COVID-19 related disruption, and outlook uncertainty, KMD has signalled an NZ\$207m capital raise via an NZ\$30m underwritten placement to certain institutional investors, together with an ~NZ\$177m underwritten 1.2 for 1 pro-rata accelerated entitlement offer. The equity will be used to pay down debt and provide additional cash, with KMD expecting to have sufficient liquidity for the next 12-months.

Forsyth Barr Limited is a Joint Lead Manager and Forsyth Barr Group Limited an underwriter of the Placement and Entitlement Offer and will receive fees in connection with those roles. Our earnings forecasts have not been updated.

1H20 result summary

Figure 1. 1H20 result summary (NZ\$m)

	1H19	1H20	chg %	Comment
Profit and Loss Account				
Sales	232.0	363.7	57%	
Cost of Sales	(90.1)	(144.8)	61%	COGS negatively impacted by FX
Gross Profit	141.9	218.9	54%	Gross margin contraction to 60.2% (1H19 61.2%)
SG&A Costs	(113.2)	(150.6)	33%	
Reported EBITDA	28.7	68.3	138%	
Underlying EBITDA	28.7	40.5	41%	
Depreciation & Amortisation	7.8	11.5	48%	
RoU asset depreciation	-	33.1	n/a	IFRS 16 accounting change
Underlying EBIT	20.9	29.0	39%	Outdoor underlying EBIT NZ\$15.5, down -29%
Net Interest	(1.5)	(9.5)	n/a	Lease interest NZ\$4.6m
Profit Before Tax	19.5	14.3	-27%	
Tax	(4.7)	(6.1)	30%	
Reported NPAT	14.8	8.1	-45%	
Abnormals	(0.8)	10.1	n/a	Includes Rip Curl transaction costs of NZ\$10.3m
Normalised NPAT	14.0	18.2	31%	
Underlying EPS (cps)	6.2	6.4	4%	
DPS (cps)	4.0	-	n/a	KMD has suspended dividend amid COVID-19 uncertainty
Balance sheet & cashflow				
Operating Cashflow	(16.2)	55.2	n/a	NZ\$20.9m after adjusting for IFRS 16
Fixed Assets	60.9	93.1	53%	Rip Curl acquisition and NZ\$10.6m of capex
Working Capital	80.7	204.6	154%	
Net Debt	79.2	273.2	245%	Net debt/EBITDA 1.9x
Lease liability	-	344.8	n/a	IFRS 16 accounting change
Divisional analysis				
Outdoor				
Sales	229.0	228.7	0%	Oboz sales up +10%, offset by 3 Kathmandu store closures
same store sales growth	0.0%	1.5%	n/a	Australia SSS up +2.0%, NZ up +0.5%
Gross profit	141.9	138.2	-3%	60% gross margin, impacted by higher clearance sales mix
Underlying EBITDA	29.0	23.4	-19%	10% EBITDA margin
Surf				
Sales	n/a	134.9	n/a	Sales up +3.7%
same store sales growth	n/a	2.7%	n/a	North America a highlight market
Gross profit	n/a	80.7	n/a	60% gross margin
Underlying EBITDA	n/a	18.4	n/a	14% EBITDA margin

Source: Company reports, 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 and Rip Curl expected to help accelerate this pathway. Our rating is RESTRICTED.

Business quality

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

Earnings and cashflow 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 and Rip Curl provide platforms in international markets.
- **Oboz and Rip Curl acquisitions:** The strategy is to leverage the companies' wholesale relationships in the US and European markets while also providing product and market diversity.
- **NZDUSD and hedging:** Given the competitive retail backdrop and price conscious consumer, we do not expect retailers to be able to pass on the full impact of unfavourable FX movements.

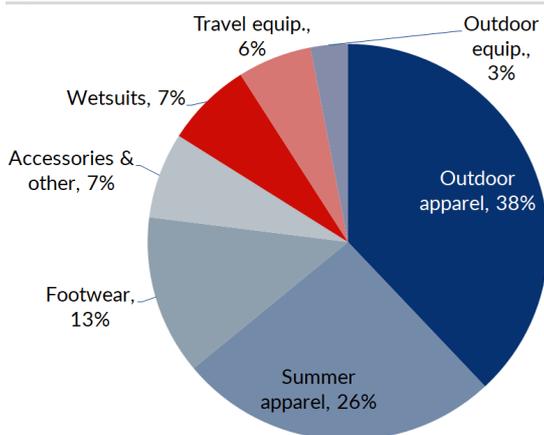
Financial structure

- **Gearing:** KMD materially increased its debt profile following the acquisition of Rip Curl. Facing an uncertain operating backdrop amid COVID-19 related disruption, KMD has signalled a capital raise to pay off debt and provide additional liquidity.

Risk factors

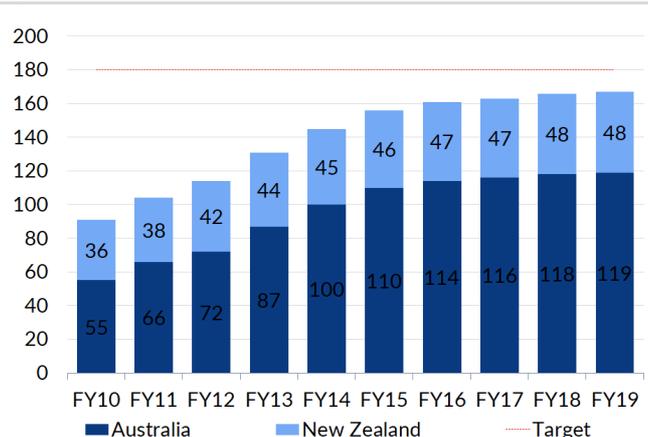
- **Consumer sentiment and cost inflation:** Deterioration in economic conditions. Cost inflation, particularly rising wages and rent.

Figure 2. FY19 pro forma revenue breakdown (incl. Rip Curl)

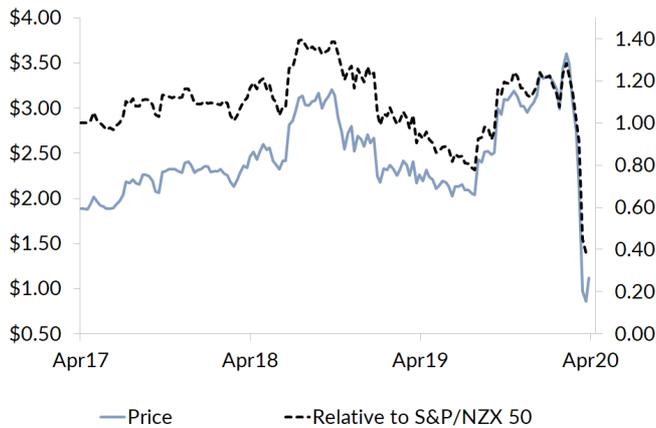


Source: Company reports, Forsyth Barr analysis

Figure 3. Australasian store footprint



Source: Company reports, Forsyth Barr analysis

Figure 4. Price performance


Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Briscoe Group	16.3%
TA Universal	12.0%
Harbour Asset Management & Jarden Securities Limited	9.3%
ACC	6.3%

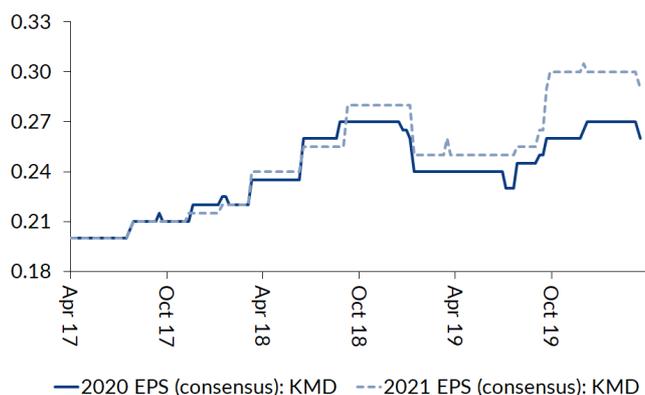
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

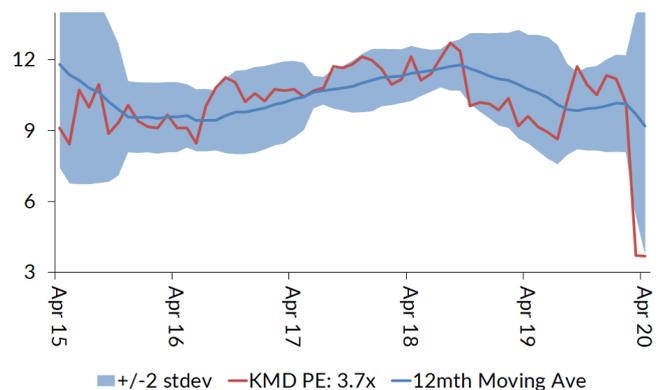
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
				2020E	2021E	2020E	2021E	2020E	2021E	
(metrics re-weighted to reflect KMD's balance date - July)										
Kathmandu Holdings	KMD NZ	NZ\$1.12	NZ\$319	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Briscoe Group *	BGP NZ	NZ\$2.46	NZ\$547	8.8x	8.8x	3.9x	3.8x	4.9x	4.9x	9.1%
Michael Hill Intl *	MHJ NZ	A\$0.25	A\$95	9.9x	27.8x	3.2x	4.3x	7.0x	14.6x	11.5%
Restaurant Brands NZ *	RBD NZ	NZ\$7.12	NZ\$888	19.0x	15.8x	9.6x	7.3x	14.2x	11.1x	0.0%
The Warehouse Group *	WHS NZ	NZ\$2.02	NZ\$701	9.9x	8.2x	4.7x	4.0x	7.3x	6.1x	9.2%
DICK'S SPORTING GOODS INC	DKS US	US\$19.01	US\$1,659	5.5x	5.0x	5.1x	6.4x	11.5x	10.3x	6.7%
PREMIER INVESTMENTS	PMV AT	A\$9.49	A\$1,504	12.3x	11.5x	7.1x	6.8x	13.1x	12.4x	7.0%
VF CORP	VFC US	US\$50.19	US\$19,912	14.8x	13.2x	11.8x	10.8x	14.6x	12.6x	4.1%
COLUMBIA SPORTSWEAR CO	COLM US	US\$62.52	US\$4,201	13.6x	13.2x	7.5x	7.6x	10.7x	10.3x	1.8%
Compco Average:				11.7x	12.9x	6.6x	6.4x	10.4x	10.3x	6.2%
KMD Relative:				n/a	n/a	n/a	n/a	n/a	n/a	n/a

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 7. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)


Source: Forsyth Barr analysis

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