

# Kathmandu Holdings

## A Tale of Two Brands

**GUY HOOPER**

guy.hooper@forsythbarr.co.nz  
+64 4 495 5255

**ASHTON OLDS**

ashton.olds@forsythbarr.co.nz  
+64 9 368 0127

### OUTPERFORM

Kathmandu (KMD) provided a 1H21 trading update in-line with expectations, with the seasonally important Rip Curl delivering strong growth and offsetting travel linked weakness at Kathmandu. The company issued 1H21 EBITDA (pre-IFRS16) guidance of NZ\$47m–NZ\$49m, which we estimate is broadly consistent with our post-IFRS 16 estimate of NZ\$79m. Outlook commentary was positive, highlighting strong forward wholesale order books for both Rip Curl and Oboz, and we believe KMD is well positioned for a strong 2H21. We make no changes to earnings, and retain our OUTPERFORM rating. Kathmandu will report its 1H21 result on 23 March 2021.

NZX Code	KMD	Financials: Jul/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.28	NPAT* (NZ\$m)	29.0	43.5	72.7	85.2	PE	28.7	19.1	11.4	9.8
Target price	NZ\$1.60	EPS* (NZc)	4.5	6.7	11.2	13.1	EV/EBIT	20.9	14.1	9.1	7.9
Risk rating	High	EPS growth* (%)	-74.9	50.2	67.0	17.1	EV/EBITDA	6.4	5.4	4.4	4.2
Issued shares	649.2m	DPS (NZc)	0.0	4.0	7.0	9.0	Price / NTA	9.0	6.5	4.8	3.9
Market cap	NZ\$831m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	3.1	5.5	7.0
Avg daily turnover	1,938k (NZ\$2,125k)	*Based on normalised profits					Gross div yld (%)	0.0	4.3	7.6	9.8

### Mixed sales result but in-line with expectations

Adjusted for lockdowns, 1H21 group direct to consumer (DTC) same store sales (SSS) fell -10% with Rip Curl up +21% while Kathmandu was down -27%. Rip Curl DTC sales are Southern Hemisphere weighted and likely benefitted from consumer momentum and favourable category exposure. Sales in the Kathmandu brand remain soft, given the exposure to international travel related products such as insulation and rainwear, which heavily weighed on sales. Summer categories performed well, however, the brand is weighted to the winter season (1H/2H profitability split c. 25%/75%). Group wholesale sales were down -12% in the period as orders were impacted by lockdown timing. Online sales made up 13% of DTC sales (vs. 9% in 1H20).

### Outlook comments provide confidence in a strong second half

We view KMD as well positioned to deliver a strong 2H21. We expect to see a continuation of elevated consumer activity in Australasia, supported by the reallocation of travel spend with borders likely to remain closed. Additionally, the wholesale business (Northern Hemisphere weighted) appears well positioned, with orders ahead of pre COVID-19 levels. Vaccine roll out and the seasonal shift should be positive for consumer momentum supporting further sales growth.

### Balance sheet healthy although supply chains remain tight

The balance sheet is in good shape, with KMD signaling 1H21 net debt of c. NZ\$7m as the company has managed its working capital position well. Supply chains and inventory remain tight, although within comfort levels. KMD will provide an announcement regarding dividend resumption at its 1H21 result in March; our FY21E forecast is 4cps (1H21E 2cps).

### Target price lowered -NZ\$0.05 to NZ\$1.60

Our target price falls -NZ\$0.05 to NZ\$1.60, driven solely by changes to our cost of capital assumptions. Our WACC estimate has increased from 8.3% to 8.5% following changes to our risk free rate (from 1.3% to 2.3%) and market risk premium (from 6.0% to 5.5%), consistent with our strategy report, *Still a One Way Bet? – Updated WACC Assumptions*, published 12 February 2021.

## Kathmandu (KMD)

Priced as at 12 Feb 2021 (NZ\$)

1.28

### 12-month target price (NZ\$)\*

1.60

Expected share price return

25.0%

Net dividend yield

4.5%

Estimated 12-month return

29.5%

### Spot valuations (NZ\$)

1. DCF

1.55

2. Sum of the parts

1.60

3. n/a

n/a

### Key WACC assumptions

Risk free rate

2.30%

Equity beta

1.16

WACC

8.5%

Terminal growth

1.5%

### DCF valuation summary (NZ\$m)

Total firm value

1,976

(Net debt)/cash

(9)

Less: Capitalised operating leases

961

Value of equity

1,006

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	538.9	801.5	922.8	993.8	1,033.0
<b>Normalised EBITDA</b>	<b>99.6</b>	<b>148.9</b>	<b>196.2</b>	<b>233.8</b>	<b>248.2</b>
Depreciation and amortisation	(15.3)	(103.0)	(121.8)	(119.1)	(116.8)
<b>Normalised EBIT</b>	<b>84.3</b>	<b>45.9</b>	<b>74.4</b>	<b>114.7</b>	<b>131.4</b>
Net interest	(2.9)	(23.4)	(11.8)	(10.1)	(8.8)
Associate income	0	0	0	0	0
Tax	(23.7)	(13.6)	(19.1)	(31.9)	(37.4)
Minority interests	0	0	0	0	0
<b>Normalised NPAT</b>	<b>57.6</b>	<b>29.0</b>	<b>43.5</b>	<b>72.7</b>	<b>85.2</b>
Abnormals/other	0	20.1	0	0	0
<b>Reported NPAT</b>	<b>57.6</b>	<b>8.9</b>	<b>43.5</b>	<b>72.7</b>	<b>85.2</b>
Normalised EPS (cps)	17.8	4.5	6.7	11.2	13.1
DPS (cps)	16.0	0	4.0	7.0	9.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	8.3	48.7	15.1	7.7	3.9
EBITDA (%)	10.9	49.5	31.8	19.2	6.2
EBIT (%)	13.0	-45.6	62.3	54.1	14.5
Normalised NPAT (%)	14.1	-49.7	50.2	67.0	17.1
Normalised EPS (%)	6.6	-74.9	50.2	67.0	17.1
Ordinary DPS (%)	6.7	-100.0	n/a	75.0	28.6

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
<b>EBITDA</b>	<b>99.6</b>	<b>148.9</b>	<b>196.2</b>	<b>233.8</b>	<b>248.2</b>
Working capital change	(8.2)	37.1	(15.7)	8.4	(6.6)
Interest & tax paid	(29.7)	(37.5)	(30.9)	(42.0)	(46.2)
Other	0	21.3	0	0	0
<b>Operating cash flow</b>	<b>61.7</b>	<b>169.8</b>	<b>149.6</b>	<b>200.2</b>	<b>195.4</b>
Capital expenditure	(15.7)	(19.9)	(30.5)	(32.8)	(34.1)
(Acquisitions)/divestments	(22.3)	(376.1)	0	0	0
Other	22.3	(76.6)	(92.6)	(88.7)	(84.9)
<b>Funding available/(required)</b>	<b>46.0</b>	<b>(302.7)</b>	<b>26.6</b>	<b>78.7</b>	<b>76.4</b>
Dividends paid	(33.9)	(27.2)	(13.0)	(32.5)	(51.9)
Equity raised/(returned)	0	340.6	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>12.1</b>	<b>10.7</b>	<b>13.6</b>	<b>46.2</b>	<b>24.5</b>

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	62.4	158.8	174.4	166.1	172.6
Fixed assets	60.3	90.7	95.7	101.6	107.2
Intangibles	386.1	682.6	677.2	672.0	667.0
Right of use asset	0	258.0	247.1	236.6	226.6
Other assets	5.0	7.8	7.8	7.8	7.8
<b>Total funds employed</b>	<b>513.8</b>	<b>1,197.8</b>	<b>1,202.2</b>	<b>1,184.1</b>	<b>1,181.2</b>
Net debt/(cash)	19.3	9.4	(4.2)	(50.5)	(75.0)
Lease liability	0	297.9	285.3	273.2	261.6
Other liabilities	52.4	111.3	111.3	111.3	111.3
Shareholder's funds	442.1	775.2	805.8	846.0	879.2
Minority interests	0	4.0	4.0	4.0	4.0
<b>Total funding sources</b>	<b>513.8</b>	<b>1,197.8</b>	<b>1,202.2</b>	<b>1,184.1</b>	<b>1,181.2</b>

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	8.6	5.7	4.3	3.6	3.3
EV/EBIT (x)	10.2	18.5	11.3	7.2	6.3
PE (x)	7.2	28.7	19.1	11.4	9.8
Price/NTA (x)	7.4	9.0	6.5	4.8	3.9
Free cash flow yield (%)	5.5	18.0	14.3	20.1	19.4
Net dividend yield (%)	12.5	0.0	3.1	5.5	7.0
Gross dividend yield (%)	17.4	0.0	4.3	7.6	9.8

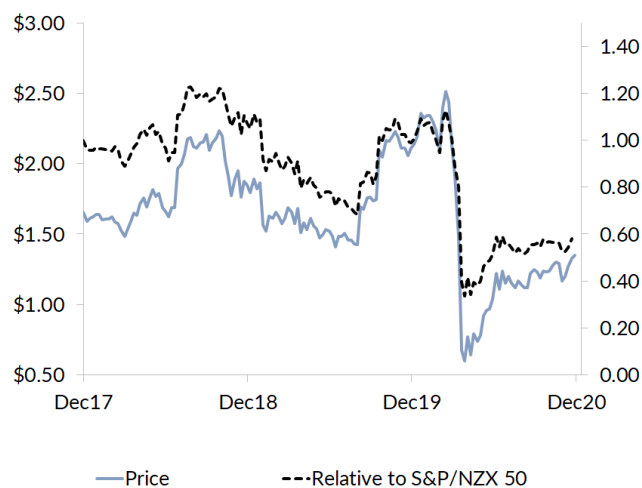
Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	28.9	2.0	6.3	11.4	14.9
Interest cover EBITDA (x)	34.2	6.4	16.6	23.2	28.2
Net debt/ND+E (%)	4.2	1.2	-0.5	-6.3	-9.3
Net debt/EBITDA (x)	0.2	0.1	n/a	n/a	n/a

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	14.2	2.9	4.7	7.3	8.4
Return on equity (%)	13.0	1.1	5.4	8.6	9.7
Return on funds employed (%)	12.9	5.2	6.6	10.1	11.5
EBITDA margin (%)	18.5	18.6	21.3	23.5	24.0
EBIT margin (%)	15.6	5.7	8.1	11.5	12.7
Capex to sales (%)	2.9	2.5	3.3	3.3	3.3
Capex to depreciation (%)	132	21	27	30	31
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	90	0	60	62	69

Operating Performance	2019A	2020A	2021E	2022E	2023E
<b>Divisional sales (NZ\$m)</b>					
Outdoors	538.9	485.8	500.4	537.6	560.9
Rip Curl	0	315.7	422.4	456.2	472.1
<b>Total store sales</b>	<b>538.9</b>	<b>801.5</b>	<b>922.8</b>	<b>993.8</b>	<b>1,033.0</b>
<b>Group gross margin</b>	<b>62%</b>	<b>58%</b>	<b>59%</b>	<b>60%</b>	<b>60%</b>

Divisional EBITDA (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Outdoors	102.5	128.2	133.7	154.1	163.0
Rip Curl	0	35.2	67.6	84.9	90.5
Unallocated	(3.0)	(14.5)	(5.0)	(5.2)	(5.4)
<b>Total EBITDA</b>	<b>99.6</b>	<b>148.9</b>	<b>196.2</b>	<b>233.8</b>	<b>248.2</b>

Divisional EBITDA margin	2019A	2020A	2021E	2022E	2023E
Kathmandu	19%	26%	27%	29%	29%
Rip Curl	n/a	11%	16%	19%	19%
<b>Total store sales</b>	<b>18%</b>	<b>19%</b>	<b>21%</b>	<b>24%</b>	<b>24%</b>

**Figure 1. Price performance**


Source: Forsyth Barr analysis

**Figure 2. Substantial shareholders**

Shareholder	Latest Holding
TA Universal	9.2%
Harbour Asset Management & Jarden Securities Limited	8.5%
Briscoe Group	6.8%
ACC	5.2%
New Zealand Superannuation Fund	5.0%

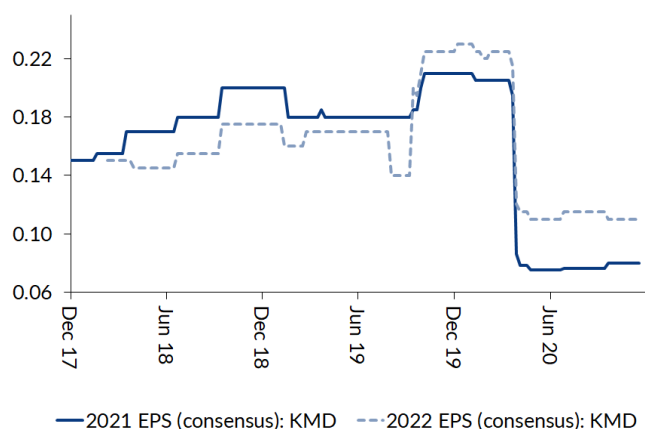
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 3. International valuation comparisons**

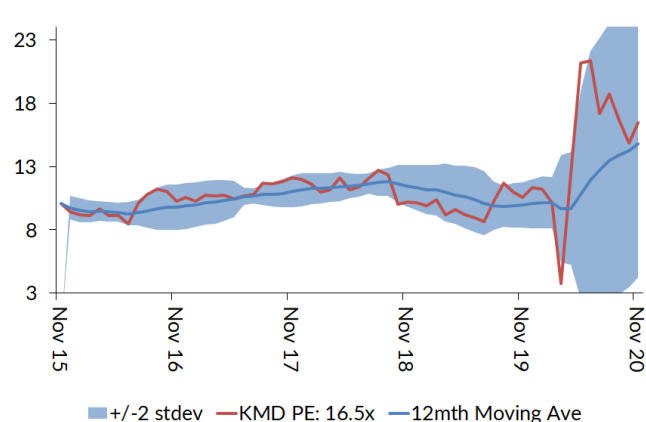
Company	Code	Price	Mkt Cap	PE	EV/EBITDA	EV/EBIT	Cash Yld
(metrics re-weighted to reflect KMD's balance date - July)							
Kathmandu Holdings	KMD NZ	NZ\$1.28	NZ\$831	19.1x	11.4x	4.3x	5.5%
SUPER RETAIL GROUP	SUL AT	A\$11.57	A\$2,613	10.1x	14.0x	5.4x	4.7%
VF CORP	VFC US	US\$80.27	US\$31,838	>50x	25.3x	29.4x	2.5%
COLUMBIA SPORTSWEAR CO	COLM US	US\$90.99	US\$6,755	20.5x	16.3x	15.7x	1.8%
DICK'S SPORTING GOODS INC	DKS US	US\$70.06	US\$6,913	13.1x	13.2x	9.1x	1.9%
PREMIER INVESTMENTS	PMV AT	A\$22.34	A\$3,549	16.4x	20.0x	8.2x	3.8%
MICHAEL HILL INTL *	MHJ NZ	A\$0.70	A\$287	8.3x	9.0x	2.7x	7.0%
BRISCOE GROUP *	BGP NZ	NZ\$5.60	NZ\$1,268	17.0x	16.9x	8.5x	4.5%
THE WAREHOUSE GROUP *	WHS NZ	NZ\$3.24	NZ\$1,131	8.5x	12.4x	2.7x	5.6%
Compco Average:				13.4x	15.9x	10.2x	4.0%
KMD Relative:				42%	-28%	-58%	37%

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 4. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 5. One year forward PE (x)**


Source: Forsyth Barr analysis

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