



2 February 2017

Investment Ideas

Kathmandu Holdings (KMD): Successful Turnaround Completed

Kathmandu has started to show some market resilience following a disappointing FY15 performance, weathering a challenging and competitive retail environment. Though in early stages, we believe that KMD's growth strategy is promising, and has helped deliver a positive FY16 result. As the roll out continues, we expect the company to see near and long term benefits.

At the current share price of \$1.81, KMD offers 17% upside potential relative to the IRESS consensus target price of \$2.12. Coupled with an IRESS consensus dividend yield forecast of around 6%, KMD offers a total potential return of ~ 23%.

Strong Finish to 2016 & Growth Strategy in Place:

- ***Kathmandu concluded the 2016 fiscal year on a high following successful early stages of its long term growth strategy.***
 - o *The group's financial performance rebounded from the FY15 downturn, recording increases to each of its key operating metrics: Sales (+3.96%), EBITDA (+37.6%), NPAT (+64.2%)*
 - o *Same store sales grew by 1.6%: +2.6% in Australia, -0.1% in New Zealand, +3.7% in the UK*
- ***This result was driven by the company's commitment to lowering operating costs and readjusting its sales strategy, by both its promotional and store network strategy.***
 - o *The readjustment of KMD's sales strategy lead to higher gross margins, enhanced by a greater proportion of full price sell and overall higher selling prices. The uplift in overall sales exemplifies growth in the uptake of Kathmandu's products, driven by an increase in new product launches.*
 - o *Overall operating costs decreased primarily through a reduction in office headcount and lower promotional spend. However, an increase in capital expenditure was recorded, largely due to the opening of flagship stores in Melbourne and Adelaide, in addition to the opening of a new distribution centre in Melbourne and support centre in Christchurch. Whilst there was an increase in overall CAPEX due to infrastructure expenditure, the opening of its flagship stores are in profitable regions and can be seen as long term investments which are expected to drive future sales. There was an overall reduction in CAPEX with the exclusion of these one off items, which we expect will contribute to higher margins.*
- ***Kathmandu closed 3 UK stores, leaving 1 store to be closed in FY17 in the region. The company's UK operations failed to eventuate as a profitable segment of the company. Thus, we expect the exit from the UK will allow KMD to focus on its ANZ operations which could potentially benefit KMD in near to medium term. The timing of the exit is also a positive, as prolonged effects of BREXIT on consumer confidence in the UK look set to continue.***
 - o *Following the unsuccessful move to the UK, international options still remain attractive; however KMD will attempt to reduce risk through providing franchise, wholesale and online store options only.*
- ***There remains a focus on driving sales through Kathmandu's online store. Sales from its online channel rose 16.5% in FY16 and now represent 6.9% of total group sales. Overall online retail sales growth in Australia is approximately 30%, which is five times faster than that of traditional brick and mortar stores. We see online store sales growth as an integral part of the business and future profitability as the retail landscape changes.***
- ***Whilst the retail trading environment remains challenging and competitive, Kathmandu looks to have adopted the right strategy in FY16 to turnaround the business.***



KMD share price history (2 February 2017 - Present) (A\$cps)



Source: IRESS, State One Stockbroking

Investment Data	
Share Price (\$)	1.81
Ord Shares (m)	201.5
Market Cap (\$'m)	370.2
EV (\$'m)	415.1
Net Debt (\$'m)	44.9
Average Daily Vol (6 mths)	168,363
52 Week High/Low (\$)	2.07 – 1.23

EPS Data	FY16	FY17F	FY18F	FY19F
EPS (c)	16.56	17.84	19.56	20.53
PER (X)	10.92	10.15	9.25	8.82
DPS (c)	11.00	11.68	12.53	14.41
DPS yield (%)	6.08	6.45	6.92	7.96

Substantial Shareholders (%)	
Briscoe Group Limited	19.90
Yarra Capital Management	13.34
BNP Paribas Pty Limited	6.88
Challenger Limited	6.19
NovaPort Capital Pty Limited	6.12

Source: IRESS, State One Stockbroking



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