



KATHMANDU HOLDINGS LIMITED

23 September 2020

**Preliminary Full Year Report
For the year ending 31 July 2020**

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Results announcement



Results for announcement to the market		
Name of issuer	Kathmandu Holdings Limited	
Reporting Period	12 months to 31 July 2020	
Previous Reporting Period	12 months to 31 July 2019	
Currency	NZD	
	Amount (000s)	Percentage change
Revenue from continuing operations	\$801,524	48.7%
Total Revenue	\$801,524	48.7%
Net profit/(loss) from continuing operations	\$8,879	-84.6%
Total net profit/(loss)	\$8,145	-85.9%
Dividend		
Amount per Quoted Equity Security	No final dividend will be paid	
Imputed amount per Quoted Equity Security	Not Applicable	
Record Date	Not Applicable	
Dividend Payment Date	Not Applicable	
	Current period	Prior comparable period
Net tangible assets per Quoted Equity Security	\$0.14	\$0.25
A brief explanation of any of the figures above necessary to enable the figures to be understood	The results are based on accounts which have been subject to audit. Refer to accompanying audited financial statements and media release for further information.	
Authority for this announcement		
Name of person authorised to make this announcement	Frances Blundell	
Contact person for this announcement	Frances Blundell	
Contact phone number	0064 3 421 5397	
Contact email address	companysecretary@kathmandu.co.nz	
Date of release through MAP	Wednesday, 23 September 2020	

Audited financial statements accompany this announcement.

23 September 2020

(All amounts in NZ\$ unless otherwise stated)

Transformational year with Rip Curl acquisition, well positioned in response to COVID-19

- **Successful acquisition and integration of Rip Curl**
- **Business growth constrained by lockdown-related store closures**
- **Strong balance sheet with low net debt and healthy inventory position**
- **Resilience of all the brands underpins sales recovery post-lockdown, and continued acceleration of online sales**

FY20 key highlights (vs FY19):

- Acceleration in online sales, with group online sales up 63% to \$106.4 million, now comprising 15.7% of direct to consumer (“DTC”) sales¹
 - Rip Curl online sales up 52% to \$25.5 million; 10.6% of DTC sales
 - Kathmandu online sales up 67% to \$80.9 million; 18.5% of DTC sales
- Group sales up 48.7% to \$801.5 million, including 9 months of Rip Curl
 - COVID-19 impact estimated at c. \$135 million of sales (\$80 million retail and \$55 million wholesale)
- Statutory NPAT of \$8.9 million includes \$18.0 million of one-off transaction costs, \$4.6 million of restructuring costs and a \$2.6 million impact from the implementation of the IFRS 16 leasing standard (in total \$22.6 million impact net of tax)
- Group Underlying EBITDA down 15.3% to \$83.4 million (excluding the impact of IFRS 16 and one-off transaction and abnormal costs)
- Group Underlying NPAT down 44.5% to \$31.5 million (excluding the impact of IFRS 16 and one-off transaction and abnormal costs)
- Operating cash flow up 50.9% to \$93.1 million (adjusted for impacts of adopting IFRS 16)
- \$207 million capital raise provided balance sheet strength and optionality for future growth, with closing net debt of \$9.4 million

Kathmandu Holdings Limited (ASX/NZX: KMD) is pleased to announce its results for the twelve months ended 31 July 2020 (FY20).

¹ Sales from Rip Curl and Kathmandu retail stores and direct online sites and marketplaces. Both years include a full year of Rip Curl sales for comparability, including \$3.7 million Rip Curl online sales for the three months pre-acquisition in FY20.

Financial performance for the Group

Group ² NZD \$m	Statutory ³	Underlying ⁴		
	FY20	FY20	FY19	Change %
Sales	801.5	801.5	538.9	48.7%
Gross Profit	467.0	467.0	332.5	40.5%
Operating Expenses	(318.1)	(383.7)	(234.0)	63.9%
EBITDA	148.9	83.4	98.4	(15.3%)
EBIT	45.9	56.2	83.2	(32.5%)

Commenting on the FY20 results, Group CEO Xavier Simonet said: “It has been a transformational year for us with the acquisition of Rip Curl and we are pleased with its integration into the Group over the last nine months. Unfortunately the Group faced significant unexpected challenges with COVID-19 restrictions and lockdowns. We took decisive action early to reduce costs, adjust the operating structure of the business, and raised \$207 million of equity. These initiatives have resulted in a strong balance sheet and healthy inventory level, which position us well for the future.”

“Our omni-channel strategy and infrastructure capacity allowed us to rapidly scale up to meet the surge in online demand from March. In addition, following the easing of lockdown restrictions, we saw retail sales for Rip Curl and Kathmandu perform strongly in our core markets of Australasia, Europe and California, as consumers trended towards outdoor and recreation activities. Both Rip Curl and Kathmandu also enjoyed an exceptional post-lockdown winter sales performance in Australia and New Zealand,” added Mr Simonet.

Rip Curl: acceleration in online sales and strong post-lockdown recovery

	Pre IFRS 16
NZD \$m	Nov 19 to Jul 20
Sales	315.7
Gross Profit	178.5
Operating Expenses	(166.8)
EBITDA (underlying)	11.7
EBIT (underlying)	4.2

COVID-19 had a significant impact on the business, with an estimated sales impact of c. \$70 million. Despite this, Rip Curl generated \$34 million of cash and contributed \$11.7 million to Group underlying EBITDA during the initial nine months of ownership. FY21 will benefit from a full 12 months of ownership.

Total FY20 global sales were down 17.1% vs PCP (equivalent nine months of FY19). Wholesale sales were most affected as lockdowns disrupted the sell-in period for the upcoming Northern hemisphere Autumn/Winter season.

² FY20 NZD/AUD conversion rate 0.939 (FY19: 0.949), FY20 NZD/GBP conversion rate 0.504 (FY19: 0.522), FY20 NZD/USD conversion rate 0.636 (FY19 0.670).

³ FY20 Statutory results include the impact of IFRS 16 leases. For comparability the impact of IFRS 16 is excluded from Underlying results.

⁴ In FY20, \$11.6 million has been incurred in relation to the acquisition and integration of Rip Curl, including establishment of a new Group structure. Further one-off costs of \$4.6 million have been incurred in relation to restructuring support office roles. FY19 Underlying profit excludes abnormal income \$1.1 million from a tax refund relating to the GST treatment of reward vouchers.

DTC same store sales growth was stronger post-lockdown⁵ (+14.4%⁶) than pre-lockdown (+2.6%), assisted by government economic stimulus, and increased opportunity for surfing while consumers worked from home. Post-lockdown same store sales were +17.7%⁶ in Australia and +20.6%⁶ in Europe as interest in surfing increased. Mainland USA same store sales also improved post-lockdown (+12.3%⁶), however, due to travel restrictions, Hawaiian retail stores were down significantly (-73.3%⁶).

Online sales growth underwent a step change. Online sales for FY20 were up 52% overall, and now comprise 10.6% of DTC sales, with a strong runway for future growth.

Kathmandu: online sales accelerate, and strong post-lockdown winter sales performance

NZD \$m	Pre IFRS 16		
	FY20	FY19	Var %
Sales	426.4	472.3	(9.7%)
Gross Profit	265.1	306.1	(13.4%)
Operating Expenses	(198.2)	(216.5)	(8.5%)
EBITDA (underlying)	66.9	89.6	(25.3%)
EBIT (underlying)	51.4	74.7	(31.3%)

Total FY20 sales in Australia were down 11.6% on a constant currency basis, with 117 stores closed during the April-May lockdown period, while New Zealand total sales were down 7.2%, with 48 stores closed during lockdown period. The overall revenue impact of COVID-19 is estimated at c. \$50 million due to store closures and ongoing lockdowns. Same stores sales growth was stronger post-lockdown (+6.9%⁶) than pre-lockdown (+1.2%).

Kathmandu's gross margin was 2.6% below FY19, as a result of foreign currency, increased mix of clearance sales and duration of promotions through the winter season. Operating expenses include restructuring savings of \$1.9 million in FY20, delivering annualised savings of c. \$6.2 million.

Online sales were up 67% on a constant currency basis, and now comprise 18.5% of DTC sales (FY19: 10.1%). This step change in online penetration and an increase in conversion rate was driven by changes in consumer behaviour during COVID-19. Infrastructure and platform capacity allowed the team to scale up to meet this record online demand.

Oboz: strong momentum with key customers despite COVID-19

USD \$m	Pre IFRS 16		
	FY20	FY19	Var %
Sales	37.8	44.6	(15.2%)
Gross Profit	15.0	17.7	(15.4%)
Operating Expenses	(10.1)	(9.7)	4.0%
EBITDA (underlying)	4.8	7.9	(39.1%)
EBIT (underlying)	4.6	7.8	(40.4%)

The revenue impact from COVID-19 is estimated at c. \$15 million (c. US\$10 million). Pre-COVID sales for the 8 months to the end of March 2020 were +4.6% YOY, whilst COVID-19 impacted sales from April to July 2020 were -52.8% YOY.

⁵ 10 full weeks from 18 May to 26 July.

⁶ Adjusted to remove stores that were not able to open this year for a comparable week because of COVID 19 lockdowns.

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Operating expenses increased pre-COVID-19 due to investments in improved distribution capability and in strengthening the brand and product team. Expenses were carefully controlled from March in response to COVID-19.

Oboz penetration and market share has been strong in key customer online trading sites during COVID-19, including REI and Zappos. Oboz aims to launch a DTC online shop this financial year.

Outlook

COVID-19 has continued to impact some key markets during the first seven weeks of FY21, with Melbourne, Auckland, Hawaii, Bali and airport store closures. However, given post-lockdown retail store performance in FY20, demand is expected to return in these markets when stores reopen.

As a result of the COVID-19 disruption, the Group has experienced mixed same store sales performance over the first seven weeks of FY21 (a non-indicative trading period).

Commenting on the outlook for the Group, Xavier Simonet said: “Despite the challenges posed by COVID-19, the business remains strong financially and operationally. The balance sheet was significantly strengthened by the recent equity raise, our brands are well-positioned to capitalise on increased participation in outdoor, beach and surfing activities following the end of the lockdowns, and our investment into omni-channel capabilities allows us to quickly respond to shifts in consumer habits and strong growth in online demand.”

“Beyond the short-term impacts from lockdowns, our long-term strategy remains unchanged. Product innovation, brand differentiation, a key focus on sustainability, and a step change in digital transformation, will enable us to continue answering the needs of our customers and also inspiring them.

“I want to thank our team members and crew worldwide for their outstanding resilience, flexibility and commitment as we addressed the challenges of the global COVID-19 pandemic,” added Mr Simonet.

Investor briefing

An investor call will be hosted by Xavier Simonet (Group CEO) and Chris Kinraid (Group CFO) at 8.30am AEST / 10:30am NZT today, Wednesday 23 September 2020. For those wishing to participate, please dial one of the numbers below and provide the conference ID to the operator:

Australia Toll Free:	1800 558 698
Australia Local:	+61 2 9007 3187
New Zealand Toll Free:	0800 453 055
United States:	+1 855 881 1339

Conference ID: 10009441

This announcement has been authorised for release to ASX by the Board of Directors of Kathmandu Holdings Limited.

- ENDS -



For further information, please contact:

Investors

Eric Kuret, Market Eye

P: +61 417 311 335

E: eric.kuret@marketeye.com.au

Media

Helen McCombie, Citadel-MAGNUS

P: + 61 2 8234 0103

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Kathmandu Holdings Limited
FINANCIAL STATEMENTS
31 July 2020

Introduction and Table of Contents

■ ***In this section ...***

The consolidated financial statements have been presented in a style which attempts to make them less complex and more relevant to shareholders. We have grouped the note disclosures into six sections: 'Basis of Preparation', 'Results for the Year', 'Operating Assets and Liabilities', 'Capital Structure and Financing Costs', 'Group Structure' and 'Other Notes'. Each section sets out the accounting policies applied in producing the relevant notes. The purpose of this format is to provide readers with a clearer understanding of what drives financial performance of the Group. The aim of the text boxes is to provide commentary on each section or note, in plain English.

■ ***Keeping it simple ...***

Notes to the consolidated financial statements provide information required by accounting standards or Listing Rules to explain a particular feature of the financial statements. The notes which follow will also provide explanations and additional disclosures to assist readers' understanding and interpretation of the annual report and the financial statements.

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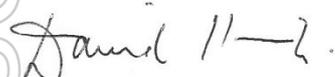
Directors' Approval of Consolidated Financial Statements For the Year Ended 31 July 2020

Authorisation for Issue

The Board of Directors authorised the issue of these Consolidated Financial Statements on 23 September 2020.

Approval by Directors

The Directors are pleased to present the Consolidated Financial Statements of Kathmandu Holdings Limited for the year ended 31 July 2020 on pages 4 to 53.



David Kirk

23 September 2020
Date



Xavier Simonet

23 September 2020
Date

For and on behalf of the Board of Directors

Consolidated Statement of Comprehensive Income For the Year Ended 31 July 2020

	Section	2020 NZ\$'000	2019 NZ\$'000
Sales	2.2	801,524	538,855
Cost of sales		(334,493)	(206,362)
Gross profit		467,031	332,493
Other income	2.2	27,369	1,130
Selling expenses	2.2	(169,272)	(160,581)
Administration and general expenses	2.2	(176,237)	(73,477)
		(318,140)	(232,928)
Earnings before interest, tax, depreciation and amortisation		148,891	99,565
Depreciation and amortisation	3.2-3.4	(103,027)	(15,272)
Earnings before interest and tax		45,864	84,293
Finance income		449	37
Finance expenses		(23,803)	(2,952)
Finance costs - net	4.1.1	(23,354)	(2,915)
Profit before income tax		22,510	81,378
Income tax expense	2.3	(13,631)	(23,745)
Profit after income tax		8,879	57,633
Profit for the period attributable to:			
Shareholders of the company		8,145	57,633
Non-controlling interest		734	-
Other comprehensive income/(expense) that may be recycled through profit or loss:			
Movement in cash flow hedge reserve	4.3.2	(9,259)	620
Movement in foreign currency translation reserve	4.3.2	259	(3,297)
Movement in other reserves	4.3.2	(61)	-
Other comprehensive expense for the year, net of tax		(9,061)	(2,677)
Total comprehensive income/(expense) for the year attributable to shareholders		(182)	54,956
Total comprehensive income/(expense) for the period attributable to:			
Shareholders of the company		(920)	54,956
Non-controlling interest		738	-
Basic earnings per share	2.4	1.7cps	16.0cps
Diluted earnings per share	2.4	1.6cps	15.9cps
Weighted average basic ordinary shares outstanding ('000)	2.4	493,347	359,600
Weighted average diluted ordinary shares outstanding ('000)	2.4	494,582	361,566

Consolidated Statement of Changes in Equity For the Year Ended 31 July 2020

	Share Capital NZ\$'000	Cash Flow Hedge Reserve NZ\$'000	Foreign Currency Translation Reserve NZ\$'000	Share Based Payments Reserve NZ\$'000	Other Reserves NZ\$'000	Retained Earnings NZ\$'000	Non- controlling Interest NZ\$'000	Total Equity NZ\$'000
Balance as at 31 July 2018	249,882	3,498	(8,975)	2,760	-	173,356	-	420,521
Profit after tax	-	-	-	-	-	57,633	-	57,633
Other comprehensive income	-	620	(3,297)	-	-	-	-	(2,677)
Dividends paid	-	-	-	-	-	(33,883)	-	(33,883)
Issue of share capital	1,231	-	-	(1,231)	-	-	-	-
Share based payment expense	-	-	-	721	-	-	-	721
Lapsed share options	-	-	-	(14)	-	14	-	-
Deferred tax on share-based payment transactions	-	-	-	(253)	-	-	-	(253)
Balance as at 31 July 2019	251,113	4,118	(12,272)	1,983	-	197,120	-	442,062
Profit after tax	-	-	-	-	-	8,145	734	8,879
Other comprehensive income	-	(9,259)	255	-	(61)	-	4	(9,061)
Dividends paid	-	-	-	-	-	(27,209)	-	(27,209)
Issue of share capital	375,267	-	-	(1,666)	-	-	-	373,601
Share based payment expense	-	-	-	378	-	-	-	378
Deferred tax on share-based payment transactions	-	-	-	(87)	-	-	-	(87)
Non-controlling interest on acquisition	-	-	-	-	-	-	3,335	3,335
Disposal of non-controlling interest	-	-	-	-	-	-	(66)	(66)
Transition to NZ IFRS 16	-	-	-	-	-	(12,630)	-	(12,630)
Balance as at 31 July 2020	626,380	(5,141)	(12,017)	608	(61)	165,426	4,007	779,202

Consolidated Balance Sheet As at 31 July 2020

	Section	2020 NZ\$'000	2019 NZ\$'000
ASSETS			
Current assets			
Cash and cash equivalents	3.1.2	231,885	6,230
Trade and other receivables	3.1.3	73,668	14,206
Inventories	3.1.1	228,793	122,773
Derivative financial instruments	4.2	53	4,964
Current tax asset		3,790	-
Total current assets		538,189	148,173
Non-current assets			
Trade and other receivables	3.1.3	3,945	-
Property, plant and equipment	3.2	90,722	60,319
Intangible assets	3.3	682,578	386,061
Right-of-use assets	3.4.1	257,998	-
Total non-current assets		1,035,243	446,380
Total assets		1,573,432	594,553
LIABILITIES			
Current liabilities			
Trade and other payables	3.1.5	143,698	74,560
Interest bearing liabilities	4.1	-	-
Derivative financial instruments	4.2	7,414	113
Current tax liabilities		8,060	6,458
Current lease liabilities	3.4.2	77,579	-
Total current liabilities		236,751	81,131
Non-current liabilities			
Derivative financial instruments	4.2	-	9
Non-current trade and other payables	3.1.5	14,413	-
Interest bearing liabilities	4.1	241,270	25,500
Deferred tax	2.3	81,452	45,851
Non-current lease liabilities	3.4.2	220,344	-
Total non-current liabilities		557,479	71,360
Total liabilities		794,230	152,491
Net assets		779,202	442,062
EQUITY			
Contributed equity - ordinary shares	4.3.1	626,380	251,113
Reserves	4.3.2	(16,611)	(6,171)
Retained earnings		165,426	197,120
Non-controlling interest		4,007	-
Total equity		779,202	442,062

Consolidated Statement of Cash Flows For the Year Ended 31 July 2020

Section	2020 NZ\$'000	2019 NZ\$'000
Cash flows from operating activities		
Cash was provided from:		
Receipts from customers	823,951	546,499
Government grants received	21,266	-
Interest received	449	621
Income tax received	1,379	207
	<u>847,045</u>	<u>547,327</u>
Cash was applied to:		
Payments to suppliers and employees	638,393	455,743
Income tax paid	16,897	26,673
Interest paid	21,960	3,237
	<u>677,250</u>	<u>485,653</u>
Net cash inflow from operating activities	169,795	61,674
Cash flows from investing activities		
Cash was provided from:		
Proceeds from sale of property, plant and equipment	61	1
Proceeds from sale of non-controlling interest	141	-
Proceeds from investment in other financial assets	-	22,321
	<u>202</u>	<u>22,322</u>
Cash was applied to:		
Purchase of property, plant and equipment	3.2 15,399	11,345
Purchase of intangibles	3.3 4,463	4,351
Acquisition of subsidiaries	5.1 376,121	22,321
	<u>395,983</u>	<u>38,017</u>
Net cash (outflow) from investing activities	(395,781)	(15,695)
Cash flows from financing activities		
Cash was provided from:		
Proceeds of loan advances	506,746	92,606
Proceeds from share issues	340,646	-
	<u>847,392</u>	<u>92,606</u>
Cash was applied to:		
Dividends paid	27,209	33,883
Repayment of loan advances	293,757	106,606
Repayment of lease liabilities	76,744	-
	<u>397,710</u>	<u>140,489</u>
Net cash inflow / (outflow) from financing activities	449,682	(47,883)
Net increase / (decrease) in cash and cash equivalents held	223,696	(1,904)
Opening cash and cash equivalents	6,230	8,146
Effect of foreign exchange rates	1,959	(12)
Closing cash and cash equivalents	3.1.2 231,885	6,230

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Reconciliation of net profit after taxation with cash inflow from operating activities

Section	2020 NZ\$'000	2019 NZ\$'000
Profit after taxation	8,879	57,633
<i>Movement in working capital:</i>		
(Increase) / decrease in trade and other receivables	24,027	(379)
(Increase) / decrease in inventories	20,305	(13,042)
Increase / (decrease) in trade and other payables	9,732	3,662
Increase / (decrease) in current tax liability	1,526	(3,260)
	55,590	(13,019)
<i>Add non-cash items:</i>		
Depreciation of property, plant and equipment	3.2	19,653
Amortisation of intangibles	3.3	7,539
Depreciation of right-of-use assets	3.4.1	75,835
Impairment of right-of-use assets	3.4.1	2,050
Foreign currency translation of working capital balances		215
Increase / (decrease) in deferred taxation		(3,413)
Employee share based remuneration	6.3	378
Loss on sale of property, plant and equipment & intangibles	3.2, 3.3	3,069
	105,326	17,060
Cash inflow from operating activities	169,795	61,674

Notes to the Consolidated Financial Statements

Section 1: Basis of Preparation

In this section ...

This section sets out the Group's accounting policies that relate to the consolidated financial statements as a whole. Where an accounting policy is specific to one note, the policy is described in the note to which it relates.

1.1 General information

Kathmandu Holdings Limited (the Company) and its subsidiaries (together the Group) is a designer, marketer, retailer and wholesaler of apparel, footwear and equipment for surfing and the outdoors. It operates in New Zealand, Australia, North America, Europe, South East Asia and Brazil.

The Company is a limited liability company incorporated and domiciled in New Zealand. Kathmandu Holdings Limited is a company registered under the Companies Act 1993 and is a FMC reporting entity under Part 7 of the Financial Markets Conduct Act 2013. The address of its registered office is 223 Tuam Street, Central Christchurch, Christchurch.

The Company is listed on the NZX and ASX.

The consolidated financial statements of the Group have been prepared in accordance with the requirements of Part 7 of the Financial Markets Conduct Act 2013 and the NZX Listing Rules.

These audited consolidated financial statements have been approved for issue by the Board of Directors on 23 September 2020.

1.2 Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Practice. They comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards, as appropriate for for-profit entities. The consolidated financial statements also comply with International Financial Reporting Standards (IFRS).

The consolidated financial statements are presented in New Zealand dollars, which is the Group's presentation currency.

1.2.1 Basis of preparation

The principal accounting policies adopted in the preparation of the consolidated financial statements are set out below. These policies have been consistently applied to all periods presented, unless otherwise stated.

Basis of consolidation

The consolidated financial statements reported are for the consolidated "Group" which is the economic entity comprising Kathmandu Holdings Limited and its subsidiaries.

The Group is designated as a for-profit entity for financial reporting purposes.

Subsidiaries are consolidated from the date on which control is obtained to the date on which control is lost.

Non-controlling interests are measured at their proportionate share of the acquiree's identified net assets at the acquisition date. Changes in the Group's interests in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

In preparing the consolidated financial statements, all material intra-group transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. When necessary, amounts reported by subsidiaries have been adjusted to conform to the Group's accounting policies.

Historical cost convention

These consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain assets as identified in the specific accounting policies provided below.

Critical accounting estimates

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

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Estimates and judgements are continually evaluated and are based on historical experience as adjusted for current market conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Further explanation as to estimates and assumptions made by the Group can be found in the following notes to the consolidated financial statements:

Area of Estimation	Section
Business Combinations – purchase price allocation	5.1
Goodwill and Brand – assumptions underlying recoverable value	3.3
Inventory – estimates of obsolescence	3.1.1
Leases – judgment applied to lease term	3.4
Taxation – provision for tax payable	2.3

Foreign currency translation

The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- Income and expenses for each statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and
- All resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity.

Changes in accounting policies

Details about changes in accounting policies applied during the period are included in the following notes to the financial statements:

	Section
Operating segments	2.1
Earnings per share restatement	2.4
New standards and interpretations first applied in the period	6.8

1.3 Going Concern and the impact of COVID-19

On 11 March 2020 the World Health Organisation declared a global pandemic as a result of the outbreak and spread of COVID-19. Global restrictions on movement, travel and gatherings resulted in significant footfall reduction and the closure of our entire store network in late March with gradual reopening commencing in early May in most markets.

As a result, the Group took decisive action to manage its liquidity and profitability specifically:

- Reduced operating expenditure;
- Deferred non-essential capital projects;
- Suspended dividend payments;
- Raised capital; and
- Accessed government subsidies

In addition, the Group obtained support from its bank syndicate in the form of a waiver of the current covenant measurements until 31 July 2021 measurement point.

In April 2020 the Group completed a successful \$207 million equity raising to strengthen its balance sheet and liquidity position in response to the COVID-19 pandemic. The capital raise, strong trading performance and cash generation in key markets has reduced net debt to \$9.4 million (excluding lease liabilities) at balance date. There remains continued uncertainty over future economic conditions and further COVID-19 outbreaks however the Group has \$377 million of liquidity to manage this uncertainty.

Based on the additional capital secured, including an earlier reopening and a significantly stronger trading performance above our COVID-19 forecasts made in April, the Board considers that compliance with financial covenants will continue to be met for at least the next 12 months from approving these consolidated financial statements (refer note 4.1).

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The ongoing uncertainties discussed, and other economic effects of the pandemic have been considered in the Group's key estimates and judgements as disclosed in the following notes:

- Intangible assets - the ability to achieve future forecasts and the consequential impacts on the carrying value of goodwill and other finite life intangibles (refer note 3.3).
- Receivables - the ability of wholesale customers to pay (refer note 3.1.3)
- Leases – certain landlords have provided the Group with rent concessions (refer note 2.2)

Considering the above, the Board has reviewed the operating and cash flow forecasts for the three-year period to 2023. The Board is satisfied based on their review of these financial forecasts that during the period to at least 12 months from the approving of the consolidated financial statements there will be adequate cash flows generated from operating and financing activities to meet the obligations of the Group.

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Section 2: Results for the Year

In this section ...

This section focuses on the results and performance of the Group. On the following pages you will find disclosures explaining the Group's results for the year, segmental information, taxation and earnings per share.

2.1 Segment information

An operating segment is a component of an entity that engages in business activities which earns revenue and incurs expenses and where the chief decision maker reviews the operating results on a regular basis and makes decisions on resource allocation.

Following the acquisition of Rip Curl Group Pty Limited in October 2019 the Group has three operating segments. These operating segments have been determined based on the reports reviewed by the Group Chief Executive Officer and Group Executive Management team.

Outdoor – including the Kathmandu and Oboz brands. This segment designs, markets, retails and wholesales apparel, footwear and equipment for outdoor travel and adventure.

Surf – including the Rip Curl brand. This segment designs, manufactures, wholesales and retails surfing equipment and apparel.

The Corporate segment represents group costs, holding companies and consolidation eliminations and constitutes other business activities that do not fall within outdoor or surf segments.

31 July 2020	Outdoor NZ\$'000	Surf NZ\$'000	Corporate NZ\$'000	Total NZ\$'000
Sales from external customers	485,785	315,739	-	801,524
EBITDA	128,192	35,202	(14,503)	148,891
Depreciation and amortisation	63,291	35,804	3,932	103,027
EBIT	64,901	(602)	(18,435)	45,864
Income tax expense	16,962	2,543	(5,874)	13,631
Total segment assets	750,026	388,222	435,184	1,573,432
<i>Total assets includes:</i>				
Non-current assets	503,162	135,390	396,691	1,035,243
Additions to non-current assets	43,446	14,279	-	57,725
Total segment liabilities	309,539	243,655	241,036	794,230
31 July 2019	Outdoor NZ\$'000	Surf NZ\$'000	Corporate NZ\$'000	Total NZ\$'000
Sales from external customers	538,855	-	-	538,855
EBITDA	102,542	-	(2,977)	99,565
Depreciation and amortisation	15,088	-	184	15,272
EBIT	87,454	-	(3,161)	84,293
Income tax expense	24,188	-	(443)	23,745
Total segment assets	483,038	-	111,515	594,553
<i>Total assets includes:</i>				
Non-current assets	337,441	-	108,939	446,380
Additions to non-current assets	15,696	-	-	15,696
Total segment liabilities	152,006	-	485	152,491

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EBITDA represents earnings before income taxes (a non-GAAP measure), excluding interest income, interest expense, depreciation and amortisation, as reported in the financial statements. EBIT represents EBITDA less depreciation and amortisation. EBITDA and EBIT are key measurement criteria on which operating segments are reviewed by the Group Chief Executive Officer and Group Executive Management team.

Costs recharged between Group companies are calculated on an arms-length basis. The default basis of allocation is % of revenue with other bases being used where appropriate.

Sales from external customers by geographical area

	2020 NZ\$'000	2019 NZ\$'000
Australia	449,930	334,532
New Zealand	133,696	136,950
North America	131,244	63,840
UK & Europe	53,386	3,533
Asia	25,653	-
Rest of World	7,615	-
	<u>801,524</u>	<u>538,855</u>

Non-current assets by geographical area

	2020 NZ\$'000	2019 NZ\$'000
Australia	695,389	230,827
New Zealand	171,075	105,523
North America	143,618	110,024
UK & Europe	16,425	6
Asia	7,057	-
Rest of World	1,679	-
	<u>1,035,243</u>	<u>446,380</u>

2.2 Profit before tax

Revenue recognition

The Group recognises revenue from the sale of footwear, clothing and equipment for surfing and the outdoors and brand licencing arrangements. Revenue comprises the fair value of the consideration received or receivable for the sale of goods and brand licences, excluding Goods and Services Tax and discounts, and after eliminating sales within the Group.

Retail Sales

For sales of goods to retail customers, revenue is recognised when control of the goods has transferred, being at the point the customer purchases the goods at a retail outlet. Payment of the transaction price is due immediately at the point the customer purchases the goods.

Online Sales

For online sales, revenue is recognised when control of the goods has transferred to the customer, being at the point the goods are delivered to the customer. Delivery occurs when the goods have been shipped to the customer's specific location. When the customer initially purchases the goods online, the transaction price received by the Group is recognised as a contract liability until the goods have been delivered to the customer.

Wholesale Sales

For sales to the wholesale market, revenue is recognised when control of the goods has transferred, being when the goods have been shipped to the wholesaler's specific location (delivery). Following delivery, the wholesaler has full discretion over the manner of distribution and price to sell the goods, has the primary responsibility when onselling the goods and bears the risks of obsolescence and loss in relation to the goods. A receivable is recognised by the Group when the goods are delivered to the wholesaler as this represents the point in time at which the right to consideration becomes unconditional, as only the passage of time is required before payment is due.

Sales Returns

Under the Group's standard contract terms, customers have a right of return within 30 days. At the point of sale, a refund liability and a corresponding adjustment to revenue is recognised for those products expected to be returned. The Group uses its accumulated historical experience to estimate the number of returns on a portfolio level using the expected value

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method. It is considered highly probable that a significant reversal in the cumulative revenue recognised will not occur given the consistent level of returns over previous years.

Royalty Revenue

Royalty revenue from brand license arrangements is recognised based on a right to access the license. Revenue is recognised over the contract period based on a fixed amount or reliable estimate of sales made by a licensee.

	2020	2019
	NZ\$'000	NZ\$'000
Sale of goods	797,410	538,855
Royalty revenue	3,848	-
Commission revenue	266	-
	<u>801,524</u>	<u>538,855</u>

Note 2.1 provides a breakdown of revenue by operating segment and geographical area.

Other Income

	2020	2019
	NZ\$'000	NZ\$'000
Government grants	26,781	-
GST refund	-	1,107
Other	588	23
	<u>27,369</u>	<u>1,130</u>

Government grants that compensate the Group for expenses incurred are recognised as revenue in the statement of comprehensive income on a systematic basis in the same period in which the expenses are recognised. In the current period Government grants relate to wage and other subsidies received in response to the impact of COVID-19.

Government grants of \$5,615,016 relating to the current year are receivable at balance date and have been included in other receivables and prepayments in Note 3.1.3

GST refund relates to a refund received resulting from the treatment of GST on reward vouchers.

Employee entitlements

	2020	2019
	NZ\$'000	NZ\$'000
Wages, salaries and other short term benefits	167,161	86,325
Post-employment benefits	8,629	4,989
Employee share based remuneration	378	721
	<u>176,168</u>	<u>92,035</u>

Lease expense

The Group is a lessee. Refer to section 3.4 for further details around the group's leases and lease accounting policies.

Lease amounts recognised in the consolidated statement of comprehensive income:

	2020	2019
	NZ\$'000	NZ\$'000
Rent expenses	-	69,187
Short-term lease expense	3,872	-
Low-value lease expense	1,277	211
Variable lease expense	532	-
Lease outgoings	16,480	-
Depreciation right-of-use asset	75,835	-
Interest expense related to lease liabilities	8,855	-
Total	<u>106,851</u>	<u>69,398</u>

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Some of the property leases in which the Group is the lessee contain variable lease payment terms that are linked to sales generated from the leased stores. Variable payment terms are used to link rental payments to store cash flows and reduce fixed cost.

Overall the variable payments constitute up to 0.5% of the Group's entire lease payments. The variable payments depend on sales and consequently on the overall economic development over the next few years. Taking into account the development of sales expected over the next 3 years, variable rent expenses are expected to continue to present a similar proportion of store sales in future years.

The Group has adopted the practical expedient in paragraph 46A of NZ IFRS 16 and elected not to account for any rent concessions granted as result of the COVID-19 pandemic as a lease modification. The amount recognised in profit or loss due to changes in lease payments arising from such concessions was \$5 million which has been recognised within the selling, administration and general expenses in the consolidated statement of comprehensive income.

The total cash outflow for leases amounts to NZ\$95,892,000 (2019 NZ\$68,986,000).

2.3 Taxation

■ *Keeping it simple ...*

This section lays out the tax accounting policies, the current and deferred tax charges or credits in the year (which together make up the total tax charge or credit in the consolidated statement of comprehensive income), a reconciliation of profit before tax to the tax charge and the movements in deferred tax assets and liabilities. The Group is subject to income taxes in multiple jurisdictions. As result there is complexity and judgement involved in determining the worldwide provision for income taxes.

Accounting policies

Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the consolidated statement of comprehensive income, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company and Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax liability is not recognised if it arises from the initial recognition of goodwill. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Goods and Services Tax (GST)

The consolidated statement of comprehensive income and the consolidated statement of cash flows have been prepared so that all components are stated exclusive of GST. All items in the consolidated balance sheet are stated net of GST, with the exception of receivables and payables, which include GST invoiced.

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Taxation – Consolidated statement of comprehensive income

The total taxation charge in the consolidated statement of comprehensive income is analysed as follows:

	2020	2019
	NZ\$'000	NZ\$'000
Current income tax charge	17,049	23,206
Deferred income tax charge / (credit)	(3,418)	539
Income tax charge reported in the consolidated statement of comprehensive income	13,631	23,745

In order to understand how, in the consolidated statement of comprehensive income, a tax charge of \$13,630,851 (2019: \$23,744,580) arises on profit before income tax of \$22,509,690 (2019: \$81,377,631), the taxation charge that would arise at the standard rate of New Zealand corporate tax is reconciled to the actual tax charge as follows:

	2020	2019
	NZ\$'000	NZ\$'000
Profit before income tax	22,510	81,378
Income tax calculated at 28%	6,303	22,786
Adjustments to taxation:		
Adjustments due to different rate in different jurisdictions	(91)	741
Non-taxable income	(1,015)	(327)
Expenses not deductible for tax purposes	4,560	1,152
Tax legislation enacted for employee share schemes	-	(506)
Utilisation of tax losses by group companies	(38)	-
Tax expense transferred to foreign currency translation reserve	(13)	2
Adjustments in respect of prior years	274	(130)
Tax losses not recognised	3,651	27
Income tax charge reported in the consolidated statement of comprehensive income	13,631	23,745

Adjustments for prior periods primarily arise where an outcome is obtained on certain tax matters which differs from expectations held when the related provision was made. Where the outcome is more favourable than the provision made, the difference is released, lowering the current year tax charge. Where the outcome is less favourable than the provision, an additional charge to the current year tax will occur.

The tax charge / (credit) relating to components of other comprehensive income is as follows:

	2020	2019
	NZ\$'000	NZ\$'000
Movement in cash flow hedge reserve before tax	(13,162)	13
Tax impact relating to cash flow hedge reserve	3,903	607
Movement in cash flow hedge reserve after tax	(9,259)	620
Foreign currency translation reserve before tax	259	(3,297)
Tax credit / (charge) relating to foreign currency translation reserve	-	-
Movement in foreign currency translation reserve after tax	259	(3,297)
Other reserves before tax	(61)	-
Tax credit / (charge) relating to other reserves	-	-
Movement in other reserves after tax	(61)	-
Total other comprehensive income/(expense) before tax	(12,964)	(3,284)
Total tax credit / (charge) on other comprehensive income	3,903	607
Total other comprehensive income/(expense) after tax	(9,061)	(2,677)

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Current tax	-	-
Deferred tax	3,903	607
Total tax credit / (charge) on other comprehensive income	3,903	607

Taxation – Balance sheet

The following are the major deferred taxation liabilities and assets recognised by the Group and movements thereon during the current and prior year:

	Tax depreciation NZ\$'000	Employee obligations NZ\$'000	Intangibles NZ\$'000	Leases NZ\$'000	Other temporary differences NZ\$'000	Reserves NZ\$'000	Total NZ\$'000
As at 31 July 2018	205	3,123	(54,923)	-	6,965	(1,603)	(46,233)
Recognised in the consolidated statement of comprehensive income	16	(523)	51	-	(83)	-	(539)
Recognised in other comprehensive income	-	-	-	-	-	607	607
Recognised directly in equity	-	(253)	-	-	-	-	(253)
Exchange differences	(2)	(68)	868	-	(231)	-	567
As at 31 July 2019	219	2,279	(54,004)	-	6,651	(996)	(45,851)
Recognised in the consolidated statement of comprehensive income	(2,356)	(695)	1,402	422	4,645	-	3,418
Recognised in other comprehensive income	-	-	-	-	-	3,903	3,903
Recognised directly in equity	-	(87)	-	-	-	-	(87)
Deferred tax on transition to NZ IFRS 16	-	-	-	10,813	-	-	10,813
Deferred tax on business combinations (Note 5.1)	4,053	1,963	(62,598)	-	3,337	-	(53,245)
Exchange differences	(33)	33	(687)	13	271	-	(403)
As at 31 July 2020	1,883	3,493	(115,887)	11,248	14,904	2,907	(81,452)

The deferred tax balance relates to:

- Property, plant and equipment temporary differences arising on differences in accounting and tax depreciation rates
- Employee benefit accruals
- Brands and customer relationships
- Unrealised foreign exchange gain/loss on intercompany loans
- Realised gain/loss on foreign exchange contracts not yet charged in the consolidated statement of comprehensive income
- Lease accounting
- Inventory provisioning
- Temporary differences on the unrealised gain/loss in hedge reserve
- Employee share schemes
- Other temporary differences on miscellaneous items

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Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items;

	2020	2019
	<u>NZ\$'000</u>	<u>NZ\$'000</u>
Deductible temporary differences	2,060	-
Tax losses	18,370	3,609
	<u>20,430</u>	<u>3,609</u>

The deductible temporary differences do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of overseas subsidiaries where it is not yet probable that future taxable profit will be generated in those territories to utilise these benefits.

Imputation credits

	2020	2019
	<u>NZ\$'000</u>	<u>NZ\$'000</u>
Imputation credits available for use in subsequent reporting periods based on a tax rate of 28%	(6,743)	1,615

The above amounts represent the balance of the imputation account as at the end of July 2020, adjusted for:

- Imputation credits that will arise from the payment of the amount of the provision for income tax;
- Imputation debits that will arise from the payment of dividends recognised as a liability at the reporting date; and
- Imputation credits that will arise from the receipt of dividends recognised as receivables at the reporting date.

Tax payments of \$6,808,421 have been financed at year end which once transferred to the Inland Revenue Department will result in a positive imputation balance.

The balance of Australian franking credits able to be used by the Group in subsequent periods as at 31 July 2020 is A\$2,691,472 (2019: A\$6,513,756).

2.4 Earnings per share

■ Keeping it simple ...

Earnings per share ('EPS') is the amount of post-tax profit attributable to each share.

Basic EPS is calculated by dividing the profit after tax attributable to equity holders of the Company of NZ\$8,144,784 (2019: NZ\$57,633,052) by the weighted average number of ordinary shares in issue during the year of 493,346,733 (2019: 359,600,086).

Diluted EPS reflects any commitments the Group has to issue shares in the future that would decrease EPS. In 2020, these are in the form of share options / performance rights. To calculate the impact it is assumed that all share options are exercised / performance rights taken, and therefore, adjusting the weighted average number of shares.

	2020	Restated
	'000	2019
	'000	'000
Weighted average number of basic ordinary shares in issue	493,347	359,600
Adjustment for:		
- Share options / performance rights	1,235	1,966
	<u>494,582</u>	<u>361,566</u>

The Group has restated the prior year basic and diluted EPS to reflect the impact of the implied bonus element on shares issued during the year (Note 4.3.1).

In October 2019 shares were issued as result of an institutional and retail entitlement offer and share placement at an issue price of NZ\$2.55, representing a 14.4% discount to the NZ\$2.98 volume weighted average price (ex-dividend) of Kathmandu's shares traded on the NZX for the last five trading days prior to 1 October 2019, and a 13.6% discount to the theoretical ex-entitlement price of NZ\$2.95.

In April 2020 shares were issued as result of an institutional and retail entitlement offer and share placement at an issue price of NZ\$0.50, representing a 51.0% discount to the NZ\$1.02 NZX closing price on 30 March 2020, and a 30.6% discount to the theoretical ex-entitlement price of NZ\$0.72.

Section 3: Operating Assets and Liabilities

■ In this section ...

This section shows the assets used to generate the Group's trading performance and the liabilities incurred as a result. Liabilities relating to the Group's financing activities are addressed in Section 4. Deferred tax assets and liabilities are shown in note 2.3.

■ Keeping it simple ...

Working capital represents the assets and liabilities the Group generates through its trading activity. The Group therefore defines working capital as inventory, cash, trade and other receivables, other financial assets, trade and other payables and other financial liabilities.

3.1 Working capital

3.1.1 Inventory

Accounting policies

Inventories are stated at the lower of cost and net realisable value. Cost is determined on a weighted average cost method and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Inventory is considered in transit when the risk and rewards of ownership have transferred to the Group.

The Group assesses the likely residual value of inventory. Stock provisions are recognised for inventory which is expected to sell for less than cost and also for the value of inventory likely to have been lost to the business through shrinkage between the date of the last applicable stocktake and balance sheet date. In recognising the provision for inventory, judgement has been applied by considering a range of factors including historical results, stock shrinkage trends and product lifecycle.

Inventory is broken down into trading stock and goods in transit below:

	2020	2019
	NZ\$'000	NZ\$'000
Raw materials and consumables	2,528	-
Work in progress	2,397	-
Trading stock	209,958	105,161
Goods in transit	13,910	17,612
	<u>228,793</u>	<u>122,773</u>

Inventory has been reviewed for obsolescence and a provision of \$4,579,854 (2019: \$294,742) has been made. The acquired inventory obsolescence provision recognised on acquisition of the Rip Curl entities was \$1,997,523.

3.1.2 Cash and cash equivalents

	2020	2019
	NZ\$'000	NZ\$'000
Cash on hand	482	192
Cash at bank	230,429	6,038
Short term investments convertible to cash	974	-
	<u>231,885</u>	<u>6,230</u>

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The carrying amount of the Group's cash and cash equivalents are denominated in the following currencies:

NZD	32,330	738
AUD	163,503	2,832
USD	22,275	2,238
EUR	6,108	116
THB	3,371	-
IDR	1,706	-
BRL	1,126	-
Other currencies	1,466	306
	<u>231,885</u>	<u>6,230</u>

3.1.3 Trade and other receivables

Accounting policies

Trade and other receivables are recognised initially at the value of the invoice sent to the customer (fair value) and subsequently at the amounts considered recoverable (amortised cost). The collectability of trade and other receivables is reviewed on an on-going basis.

An allowance for lifetime expected credit losses is recognised for trade and other receivables based on the Group's historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date, including time value of money where appropriate. The expected credit loss is estimated as the difference between all contractual cash flows that are due to the Group in accordance with the contract and all the cash flows that the Group expects to receive, discounted at the original effective interest rate.

	2020	2019
	NZ\$'000	NZ\$'000
Current		
Trade receivables	62,143	9,734
Allowance for expected credit losses	(10,329)	(115)
Other receivables and prepayments	21,854	4,587
	<u>73,668</u>	<u>14,206</u>
Non-current		
Other debtors	3,945	-
	<u>3,945</u>	<u>-</u>

The acquired allowance for expected credit losses recognised on acquisition of the Rip Curl entities was \$5,638,857.

Other non-current debtors includes debtors on extended credit terms and security deposits paid in relation to store leases.

The carrying amount of the Group's trade and other receivables are denominated in the following currencies:

NZD	5,101	2,097
AUD	20,853	1,935
USD	22,466	9,326
EUR	13,258	-
GBP	1,650	140
CAD	2,326	708
BRL	2,991	-
THB	4,406	-
IDR	1,997	-
JPY	2,246	-
Other currencies	319	-
	<u>77,613</u>	<u>14,206</u>

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3.1.4 Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

Risk	Exposure arising from	Monitoring	Management
Credit risk	Cash and cash equivalents Trade and other receivables Derivative financial instruments	Credit ratings, aging analysis and review of exposure within regular terms of trade	Credit is given to customers following obtaining credit rating information, confirming references and setting appropriate credit limits

Exposure to credit risk

The below balances are recorded at their carrying amount after any allowance for expected credit loss on these financial instruments. The maximum exposure to credit risk at reporting date was (carrying amount):

	2020 NZ\$'000	2019 NZ\$'000
Cash and cash equivalents	231,403	6,038
Trade receivables	51,814	9,619
Other receivables	12,866	1,741
Derivative financial instruments	(7,361)	4,842
	288,722	22,240

As at balance sheet date the carrying amount is also considered to approximate fair value for each of the financial instruments.

The credit quality of cash and cash equivalents can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates:

	2020 NZ\$'000	2019 NZ\$'000
<i>Cash and cash equivalents:</i>		
Standard & Poors - AA-	207,811	3,783
Standard & Poors - A+	14,008	-
Standard & Poors - A	1,567	-
Standard & Poors - A-	-	1,861
Standard & Poors - BBB+	3,822	394
Standard & Poors - BBB-	1,790	-
Standard & Poors - BB	1,282	-
Standard & Poors - BB-	1,123	-
Total cash and cash equivalents	231,403	6,038

Trade and other receivables consist of a large number of customers spread across diverse geographical areas.

As at balance sheet date, trade and other receivables of NZ\$27,495,000 (2019: NZ\$848,000) were past due. A provision of NZ\$10,329,000 (2019: NZ\$115,000) is held against these overdue amounts. Interest is charged on overdue debtors in some instances.

The ageing analysis of these past due trade receivables is:

	2020 NZ\$'000	2019 NZ\$'000
0 to 30 days	4,825	548
30 to 60 days	3,503	217
60 to 90 days	7,394	73
90 days and over	11,773	10
	27,495	848

Due to COVID-19 credit terms have been extended for some customers which has impacted the aging analysis above.

3.1.5 Trade and other payables**Accounting policies**

Trade payables, sundry creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. Trade and other payables are initially measured at fair value and subsequently measured at amortised cost, using the effective interest method. The carrying value of trade payables is considered to approximate fair value as amounts are unsecured and are usually paid by the 30th of the month following recognition.

Employee entitlements relates to benefits accruing to employees in respect of wages and salaries, annual leave, and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of employee benefits expected to be settled within 12 months are measured at their nominal values using the remuneration rate expected to apply at the time of settlement. Provisions made in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to the reporting date.

	2020	2019
	NZ\$'000	NZ\$'000
Current		
Trade payables	63,939	30,504
Employee entitlements	21,357	8,582
Sundry creditors and accruals	54,912	34,397
Other Provisions	3,490	1,077
	<u>143,698</u>	<u>74,560</u>
Non-Current		
Employee entitlements	3,069	-
Other Provisions	11,344	-
	<u>14,413</u>	<u>-</u>

The carrying amount of the Group's trade and other payables are denominated in the following currencies:

	2020	2019
	NZ\$'000	NZ\$'000
NZD	19,351	11,227
AUD	83,997	40,475
USD	30,046	22,042
EUR	14,944	137
BRL	3,041	-
THB	3,523	-
IDR	2,052	-
Other currencies	1,156	679
	<u>158,110</u>	<u>74,560</u>

Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

The warranties provision represents the present value of the estimated future outflow of economic benefits that will be required under the Group's obligations for warranties under local sale of goods legislation. The provision relates to wetsuits, watches and footwear and is based on estimates made from historical warranty data associated with similar products and services.

A restructuring provision is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly at balance date.

Lease restoration provision represents the present value of the estimated cost to restore leased properties to their original condition upon expiry of the lease.

Other provisions relate to other miscellaneous amounts that meet the definition of a provision but do not fall into any of the other categories.

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	Warranties NZ\$'000	Restructuring NZ\$'000	Lease restoration NZ\$'000	Other NZ\$'000	Total NZ\$'000
Balance at 31 July 2018	-	-	618	535	1,153
Additional provisions recognised	-	-	174	-	174
Provisions used during the year	-	-	-	(129)	(129)
Provisions re-measured during the year	-	-	(97)	-	(97)
Foreign exchange	-	-	(24)	-	(24)
Balance at 31 July 2019	-	-	671	406	1,077
As at 31 July 2019					
Current	-	-	671	406	1,077
Non-current	-	-	-	-	-
	-	-	671	406	1,077
Balance at 31 July 2019	-	-	671	406	1,077
Provision recognised on acquisition (Note 5.1)	1,168	2,541	5,453	-	9,162
Provisions recognised on adoption of NZ IFRS 16	-	-	4,686	-	4,686
Additional provisions recognised	478	1,367	633	364	2,842
Provisions used during the year	(296)	(2,303)	(191)	-	(2,790)
Provisions re-measured during the year	(14)	-	(325)	-	(339)
Foreign exchange	13	70	121	(8)	196
Balance at 31 July 2020	1,349	1,675	11,048	762	14,834
As at 31 July 2020					
Current	1,349	1,675	193	273	3,490
Non-current	-	-	10,855	489	11,344
	1,349	1,675	11,048	762	14,834

3.2 Property, plant and equipment

■ Keeping it simple ...

The following section shows the physical assets used by the Group to operate the business, generating revenues and profits. These assets include store and office fit-out, as well as equipment used in sales and support activities.

Assets are recognised only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

Accounting policies

Property, plant and equipment

All property, plant and equipment are stated at historical cost less depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment.

The assets' residual value and useful lives are reviewed and adjusted if appropriate at each balance sheet date.

Capital work in progress is not depreciated until available for use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Depreciation

Depreciation of property, plant and equipment is calculated using straight line and diminishing value methods so as to expense the cost of the assets over their useful lives. The rates are as follows:

Buildings & leasehold improvements	5 – 50 %
Office, plant and equipment	5 – 50 %
Furniture and fittings	10 – 50 %
Computer equipment	10 – 60 %

Impairment of assets

Property, plant and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use.

Property, plant and equipment can be analysed as follows:

	Land & Buildings NZ\$'000	Leasehold improvement NZ\$'000	Office, plant & equipment NZ\$'000	Furniture & fittings NZ\$'000	Computer equipment NZ\$'000	Total NZ\$'000
Year ended 31 July 2019						
Opening net book value	-	29,949	12,332	19,101	2,132	63,514
Additions	-	5,690	554	4,447	654	11,345
Disposals	-	(394)	(7)	(383)	(18)	(802)
Depreciation charge	-	(6,962)	(930)	(3,394)	(634)	(11,920)
Exchange differences	-	(776)	(419)	(597)	(26)	(1,818)
Closing net book value	-	27,507	11,530	19,174	2,108	60,319
As at 31 July 2019						
Cost	-	67,974	17,936	41,726	9,633	137,269
Accumulated depreciation	-	(40,467)	(6,406)	(22,552)	(7,525)	(76,950)
Closing net book value	-	27,507	11,530	19,174	2,108	60,319

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	Land & Buildings NZ\$'000	Leasehold improvement NZ\$'000	Office, plant & equipment NZ\$'000	Furniture & fittings NZ\$'000	Computer equipment NZ\$'000	Total NZ\$'000
Year ended 31 July 2020						
Opening net book value	-	27,507	11,530	19,174	2,108	60,319
Additions	15	6,478	3,108	5,059	739	15,399
Acquisition of businesses (Note 5.1)	6,475	8,286	3,603	16,440	2,725	37,529
Disposals	(305)	(621)	(474)	(1,632)	(96)	(3,128)
Depreciation charge	(370)	(7,802)	(2,581)	(7,670)	(1,230)	(19,653)
Transfers between categories	-	-	(289)	289	-	-
Exchange differences	(188)	182	199	123	(60)	256
Closing net book value	5,627	34,030	15,096	31,783	4,186	90,722
As at 31 July 2020						
Cost	9,722	97,400	45,612	99,855	20,251	272,840
Accumulated depreciation	(4,095)	(63,370)	(30,516)	(68,072)	(16,065)	(182,118)
Closing net book value	5,627	34,030	15,096	31,783	4,186	90,722

Depreciation

	2020 NZ\$'000	2019 NZ\$'000
Land & buildings	370	-
Leasehold improvement	7,802	6,962
Office, plant and equipment	2,581	930
Furniture and fittings	7,670	3,394
Computer equipment	1,230	634
Total property, plant & equipment depreciation	19,653	11,920

Depreciation expenditure is excluded from administration and general expenses in the consolidated statement of comprehensive income.

Sale of property, plant and equipment

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the consolidated statement of comprehensive income.

	2020 NZ\$'000	2019 NZ\$'000
Loss on sale of property, plant and equipment	3,069	801

Capital commitments

Capital commitments contracted for at balance sheet date include property, plant and equipment of NZ\$974,531 (2019: NZ\$1,877,276).

3.3 Intangible assets

■ *Keeping it simple ...*

The following section shows the non-physical assets used by the Group to operate the business, generating revenues and profits. These assets include brands, customer relationship, software development and goodwill.

This section explains the accounting policies applied and the specific judgements and estimates made by the Directors in arriving at the net book value of these assets.

Accounting policies

Goodwill

Goodwill arises on the acquisition of subsidiaries. Goodwill represents the excess of the cost of the acquisition over the Group's interest in the net fair value of the assets and liabilities of the acquiree. Separately recognised goodwill is tested annually for impairment or more frequently if events or changes in circumstances indicate that it might be impaired. It is carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Brand

Acquired brands are carried at original cost based on independent valuation obtained at the date of acquisition. The brand represents the price paid to acquire the rights to use the Kathmandu, Oboz or Rip Curl brand. The brand is not amortised. Instead the brand is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired and is carried at cost less accumulated impairment losses.

Customer Relationship

Acquired customer relationships are carried at original cost based on independent valuation obtained at the date of acquisition less accumulated amortisation. They are amortised on a straight line basis over a useful life of 5-10 years. The estimated useful life and amortisation period is reviewed at the end of each annual reporting period.

Software costs

Software costs have a finite useful life. Software costs are capitalised and written off over the useful economic life.

Costs associated with developing or maintaining computer software programs are recognised as an expense when incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the costs of software development employees.

Software is amortised using straight line and diminishing value methods at rates of 20-67%.

Other intangibles

Other intangibles relate to lease rights expenditure associated with acquiring existing lease agreements for stores where there is an active market for key money. They are carried at original cost less accumulated impairment losses. Other intangibles have an indefinite useful life and are tested annually for impairment.

Impairment

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets that have an indefinite useful life, including goodwill, are not subject to amortisation and are tested annually for impairment irrespective of whether any circumstances identifying a possible impairment have been identified. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows e.g. cash generating units.

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Intangible assets

	Goodwill NZ\$'000	Brand NZ\$'000	Customer Relationship NZ\$'000	Software NZ\$'000	Other Intangibles NZ\$'000	Total NZ\$'000
Year ended 31 July 2019						
Opening net book value	189,308	187,928	1,747	7,923	-	386,906
Additions	-	-	-	4,351	-	4,351
Disposals	-	-	-	(13)	-	(13)
Amortisation	-	-	(184)	(3,168)	-	(3,352)
Exchange differences	1,013	(2,847)	55	(52)	-	(1,831)
Closing net book value	190,321	185,081	1,618	9,041	-	386,061
As at 31 July 2019						
Cost	191,592	185,081	1,868	33,206	-	411,747
Accumulated amortisation/impairment	(1,271)	-	(250)	(24,165)	-	(25,686)
Closing net book value	190,321	185,081	1,618	9,041	-	386,061
Year ended 31 July 2020						
Opening net book value	190,321	185,081	1,618	9,041	-	386,061
Additions	-	-	-	4,463	-	4,463
Acquisition of businesses (Note 5.1)	84,274	169,687	39,697	917	2,883	297,458
Disposals	-	-	-	-	-	-
Amortisation	-	-	(3,932)	(3,607)	-	(7,539)
Exchange differences	(193)	2,355	(101)	17	57	2,135
Closing net book value	274,402	357,123	37,282	10,831	2,940	682,578
As at 31 July 2020						
Cost	275,673	357,123	41,495	58,943	4,552	737,786
Accumulated amortisation/impairment	(1,271)	-	(4,213)	(48,112)	(1,612)	(55,208)
Closing net book value	274,402	357,123	37,282	10,831	2,940	682,578

Sale of intangibles

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the consolidated statement of comprehensive income.

	2020 NZ\$'000	2019 NZ\$'000
Loss on sale of intangibles	-	13

Impairment tests for goodwill and brand

The aggregate carrying amounts of goodwill and brand allocated to each unit for impairment testing are as follows:

	Goodwill		Brand	
	2020 NZ\$'000	2019 NZ\$'000	2020 NZ\$'000	2019 NZ\$'000
Kathmandu New Zealand	45,484	45,484	51,000	51,000
Kathmandu Australia	76,496	75,564	99,140	96,034
Oboz	68,239	69,273	37,479	38,047
Rip Curl	84,183	-	169,504	-
	274,402	190,321	357,123	185,081

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For the purposes of goodwill and brand impairment testing, the Group operates as four groups of cash generating units, Kathmandu New Zealand, Kathmandu Australia, Rip Curl and Oboz. The recoverable amount of each cash generating unit has been determined based on the fair value less cost of disposal (FVLCO). Five year projected cash flows are used to determine the FVLCO.

The discounted cash flow valuations were calculated using post tax cash flow projections based on financial budgets prepared by management and approved by the Board for the year ended 31 July 2021. Cash flows beyond July 2021 have been extrapolated based on historical results and a return to pre COVID-19 levels of sales and EBITDA margin over the near to medium term.

The Group engaged an external valuer to perform the valuation of the Rip Curl CGU as at 31 July 2020 using the post tax cash flow projections presented to the Board for the year ending 31 July 2021 and the three year plan that extrapolates cash flows based on historic results and a return to pre-COVID-19 levels of sales and EBITDA margin over the near to medium term.

The key assumption used:

- The FVLCO model assumes an economic downturn in the 2021 financial year and a return to more normalised trading conditions previously experienced in 2022 and beyond. The Group believes the assumptions used in cash flows reflect a combination of the Groups experience and uncertainty associated with COVID-19.
- While temporary store and market closures may impact short term results, these are not expected to impact the long-term performance of each CGU. Several scenarios have been assessed where trading conditions do not normalise until the 2024 financial year, in each scenario the fair value for the CGU exceeds the carrying value.

Other assumptions used:

	Pre tax discount rate		Terminal growth rate	
	2020	2019	2020	2019
Kathmandu New Zealand CGU	11.5%	11.2%	1.0%	1.0%
Kathmandu Australia CGU	11.4%	10.5%	1.0%	1.0%
Rip Curl CGU	13.2%	-	1.5%	-
Oboz CGU	11.8%	12.7%	1.0%	1.0%

The terminal growth rate assumption is based on a conservative estimate considering the current inflation targets and do not exceed the historical long-term average growth rate for each CGU. Pre-tax discount rates are calculated based on a market participant expected capital structure and cost of debt to derive a weighted average cost of capital.

We note that while the sensitivity of key assumptions provided above would not result in an impairment in each case, it is possible that they could occur in a combination. Furthermore, the CGU with the lowest headroom is the Oboz CGU. Prior to COVID-19 the Oboz CGU achieved year on year double digit revenue and EBITDA growth percentages. For impairment testing purposes cash flows for FY21 are lower than those achieved in FY20 with an expected recovery in FY22 to levels similar to FY19. Beyond FY22 it is assumed that historical growth percentages resume. Oboz revenue is forecast to grow at an annual compound growth rate of approximately 15% through to the terminal year in FY25. Prior to the impact of COVID-19 the CGU achieved an annual compound growth rate of 29% from FY17-FY19.

The calculations confirmed that there was no impairment of goodwill and brand during the year (2019: nil). The Board believes that any reasonably possible change in the key assumptions used in the calculations would not cause the carrying amount to exceed its recoverable amount.

The expected continued promotion and marketing of the Kathmandu, Oboz and Rip Curl brands supports the assumption that the brand has an indefinite life.

Capital commitments

Capital commitments contracted for at balance sheet date include intangible assets of NZ\$709,417 (2019: NZ\$703,611).

3.4 Leases

Keeping it simple ...

The following section shows the assets leased by the Group to operate the business, generating revenues and profits. These assets include the lease of retail stores.

This section explains the accounting policies applied and the specific judgements and estimates made by the Directors in arriving at the carrying value of these assets and the corresponding lease liability.

Accounting policies

The Group assesses whether a contract is or contains a lease, at inception of a contract. The Group recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a term of 12 months or less) and leases of low value assets. For these leases, the Group recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Lease Liability

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the Group uses its incremental borrowing rate. The Group's incremental borrowing rate has been determined as the rate of interest that the Group would have to pay to borrow over a similar term and with a similar security the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments (including in-substance fixed payments), less any lease incentives; and
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The Group remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever;

- the lease term has changed in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate;
- the lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using the initial discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used);
- a lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.

Right of Use Asset

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Whenever the Group incurs an obligation for costs to dismantle and remove a leased asset, restore the site on which it is located or restore the underlying asset to the condition required by the terms and conditions of the lease, a provision is recognised and measured under NZ IAS 37. The costs are included in the related right-of-use asset.

Right-of-use assets are depreciated over the shorter period of the lease term and useful life of the underlying asset. The depreciation starts at the commencement date.

The Group applies NZ IAS 36 Impairment of Assets to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss.

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Variable Rents

Variable rents that do not depend on an index or rate are not included in the measurement of the lease liability and the right-of-use asset. The related payments are recognised as an expense in the period in which the event or condition that triggers those payments occurs and are included in the selling expenses line in the consolidated statement of comprehensive income.

Group as a lessee

The Group leases several assets including buildings and motor vehicles. Some of the existing lease arrangements have right of renewal options for varying terms. Renewal options are included within the lease liability if they are within 2 years and the Group is reasonably certain to take up the option. The average lease term including rights of renewal is 8 years.

3.4.1 Right-of-use assets

The movements in right of use assets for the year ended 31 July 2020 were as follows:

	NZ\$'000
Opening carrying amount 1 August 2019	-
Movements on transition	178,774
Additions	37,863
Right-of-use assets recognised on acquisition (Note 5.1)	117,296
Depreciation for the period	(75,835)
Impairment of right-of-use assets	(2,050)
Exchange differences	1,950
Closing carrying amount 31 July 2020	257,998
Cost	335,692
Accumulated depreciation and impairment	(77,694)
Closing carrying amount 31 July 2020	257,998

3.4.2 Lease liabilities

Reconciliation of operating lease commitments to lease liabilities recognised on initial application;

	NZ\$'000
Operating lease commitment as at 31 July 2019	206,476
Above discounted using incremental borrowing rate as of 1 August 2019	193,682
Recognition exemption for short term leases	(318)
Adjustments as result of different treatment of renewal options	28,281
Lease contracts committed to but not yet available for use	(6,256)
Lease liabilities as at 1 August 2019	215,389

The weighted average incremental borrowing rate applied to lease liabilities recognised in the consolidated balance sheet at 1 August 2019 is 3.05%.

The movements in lease liabilities for the year ended 31 July 2020 were as follows:

	NZ\$' 000
Opening lease liabilities 1 August 2019	-
Movements on transition	215,389
Additions	37,811
Lease liabilities recognised on acquisition (Note 5.1)	118,564
Interest expense related to lease liabilities	8,855
Repayment of lease liabilities (including interest)	(85,545)
Exchange differences	2,849
Closing lease liabilities 31 July 2020	297,923

Lease liability maturity analysis

	<u>NZ\$'000</u>
Within one year	77,579
One to five years	172,340
Beyond five years	<u>48,004</u>
Total	<u>297,923</u>
Current	77,579
Non-current	<u>220,344</u>
Total	<u>297,923</u>

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Section 4: Capital Structure and Financing Costs

In this section ...

This section outlines how the Group manages its capital structure and related financing costs, including its balance sheet liquidity and access to capital markets.

Capital structure is how a company finances its overall operations and growth by using different sources of funds. The Directors determine and monitor the appropriate capital structure of the Group, specifically how much is raised from shareholders (equity) and how much is borrowed from financial institutions (debt) in order to finance the Group's activities both now and in the future.

The Directors consider the Group's capital structure and dividend policy at least twice a year ahead of announcing results and do so in the context of its ability to continue as a going concern, to execute strategy and to deliver its business plan.

4.1 Interest bearing liabilities

Accounting policies

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the consolidated statement of comprehensive income over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

The table below separates borrowings into current and non-current liabilities:

	2020 NZ\$'000	2019 NZ\$'000
Current portion	-	-
Non-current portion	241,270	25,500
Total term loans	241,270	25,500

Group Facility Agreement

The Group has a multi-option syndicated facility agreement, with a term loan facility of A\$220 million, a revolving cash advances facility of NZ\$58 million and A\$37 million, a trade finance sub-facility of A\$30 million and NZ\$10 million, and instruments sub-facility of A\$20 million. All facilities are repayable in full on 30 November 2022.

Interest is payable based on the BKBM rate (NZD borrowings), the BBSY rate (AUD borrowings), or the applicable short term rate for interest periods less than 30 days, plus a margin of up to 1.05%. The debt is secured by the assets of the guaranteeing group in accordance with the Security Trust Deed dated 25 October 2019.

The covenants entered into by the Group require specified calculations of Group earnings (excluding one-off transaction costs) before interest, tax, depreciation and amortisation (EBITDA) plus lease rental costs to exceed total fixed charges (net interest expense and lease rental costs) at the end of each half during the financial year. Similarly EBITDA (excluding one-off transaction costs) must be no less than a specified proportion of total net debt at the end of each six month interim period. The calculations of these covenants are specified in the bank facility agreement of 25 October 2019. The Group has obtained a waiver from its banking syndicate of the current covenants until the 31 July 2021 measurement point.

The current interest rates, prior to hedging, on the term loans ranged between 1.00% - 1.25% (2019: 2.31% - 2.47%).

Paycheck Protection Program (PPP) loans

As part of the US government response to COVID-19 the Group's US resident companies applied for a Paycheck Protection Program (PPP) loans of \$4,200,632 (US \$2,814,423). The Group believes that these entities met the criteria to qualify for the loans at the date of the application. The eligibility is subject to a possible audit by the federal government at which time the entities may be deemed not to be eligible. In the event of an unfavourable outcome of the forgiveness application the group would be required to repay the PPP loan as well as 1% interest on that loan from the period it was received until the date it was repaid. The Group believes that the US resident entities meet the criteria to qualify for the loan and future forgiveness.

The PPP loan was initially received as a loan and once various criteria are met the Group can apply for forgiveness of that loan. Once forgiveness of the loan has been approved it will be recognised in the consolidated statement of comprehensive income, until that time it is recognised as a loan.

Reconciliation of movement in term loans

	NZ\$'000
Balance 31 July 2019	25,500
Net cash flow movement	212,989
Foreign exchange movement	2,781
Balance 31 July 2020	241,270

	2020 NZ\$'000	2019 NZ\$'000
The principal of interest bearing liabilities is:		
Payable within 1 year	-	-
Payable 1 to 2 years	4,201	-
Payable 2 to 3 years	237,069	15,000
Payable 3 to 4 years	-	10,500
	241,270	25,500

4.1.1 Finance costs

	2020 NZ\$'000	2019 NZ\$'000
Interest income	(449)	(37)
Interest expense on term debt	4,780	1,877
Interest on lease liabilities	8,855	-
Other finance costs	9,246	886
Net exchange loss/(gain) on foreign currency	922	189
	23,354	2,915

Other finance costs relate to facility fees on banking arrangements and debt underwriting costs.

4.1.2 Cash flow and fair value interest rate risk

Interest rate risk is the risk that fluctuations in interest rates impact the Group's financial performance.

Risk	Exposure arising from	Monitoring	Management
Interest rate risk	Interest bearing liabilities at floating rates	Cash flow forecasting Sensitivity analysis	Interest rate swaps

Refer to section 4.2 for notional principal amounts and valuations of interest rate swaps outstanding at balance sheet date. A sensitivity analysis of interest rate risk on the Group's financial assets and liabilities is provided in the table below.

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At the reporting date the interest rate profile of the Group's banking facilities was (carrying amount):

	2020 NZ\$'000	2019 NZ\$'000
Total secured loans	241,270	25,500
less Principal covered by interest rate swaps	(5,000)	(23,263)
Net Principal subject to floating interest rates	236,270	2,237

Interest rate swaps have the economic effect of converting borrowings from floating to fixed rates. The cash flow hedge loss on interest rate swaps at balance sheet date was NZ\$54,106 (2019: NZ\$111,252).

Summarised sensitivity analysis

The following table summarises the sensitivity of the Group's financial assets and financial liabilities to interest rate risk. A sensitivity of 1% (2019: 1%) has been selected for interest rate risk. The 1% is based on reasonably possible changes over a financial year, using the observed range of historical data for the preceding five year period.

Amounts are shown net of income tax. All variables other than applicable interest rates are held constant. The impact on equity is presented exclusive of the impact on retained earnings.

31 July 2020	Carrying amount NZ\$'000	-1%		+1%	
		Profit NZ\$'000	Equity NZ\$'000	Profit NZ\$'000	Equity NZ\$'000
Derivative financial instruments (asset) / liability	7,361	(50)	38	50	(37)
Financial assets					
Cash	231,885	(1,670)	-	1,670	-
Financial liabilities					
Borrowings	241,270	2,413	-	(2,413)	-
Lease liabilities	297,923	2,979	-	(2,979)	-
		5,392	-	(5,392)	-
Total increase / (decrease)		3,672	38	(3,672)	(37)

31 July 2019	Carrying amount NZ\$'000	-1%		+1%	
		Profit NZ\$'000	Equity NZ\$'000	Profit NZ\$'000	Equity NZ\$'000
Derivative financial instruments (asset) / liability	(4,842)	(235)	154	235	(151)
Financial assets					
Cash	6,230	(45)	-	45	-
Financial liabilities					
Borrowings	25,500	255	-	(255)	-
		255	-	(255)	-
Total increase / (decrease)		(25)	154	25	(151)

4.1.3 Liquidity Risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due.

Risk	Exposure arising from	Monitoring	Management
Liquidity risk	Interest bearing and other liabilities	Forecast and actual cash flows	Active working capital management and flexibility in funding arrangements

The Group has borrowing facilities of NZD \$398,818,966 / AUD \$370,104,000 (2019: NZD \$140,729,053 AUD \$132,060,000) and operates well within this facility. This includes short term bank overdraft requirements, and at balance sheet date no bank accounts were in overdraft.

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Keeping it simple ...

The table below analyses the Group's financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows, so will not always reconcile with the amounts disclosed on the balance sheet.

	Less than 1 year NZ\$'000	Between 1 and 2 years NZ\$'000	Between 2 and 5 years NZ\$'000	Over 5 years NZ\$'000
Group 2020				
Trade and other payables	109,643	-	-	-
Borrowings	3,007	7,197	238,060	-
	112,650	7,197	238,060	-
Group 2019				
Trade and other payables	62,075	-	-	-
Borrowings	600	599	25,751	-
	62,675	599	25,751	-

The Group enters into forward exchange contracts to manage the risks associated with the purchase of foreign currency denominated products.

The table below analyses the Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. They are expected to occur and affect the profit or loss at various dates between balance sheet dates and the following five years.

	Less than 1 year NZ\$'000	Between 1 and 2 years NZ\$'000	Between 2 and 5 years NZ\$'000
At 31 July 2020			
Forward foreign exchange contracts			
- Inflow	179,857	-	-
- Outflow	(187,164)	-	-
Net Inflow / (Outflow)	(7,307)	-	-
Net settled derivatives – interest rate swaps			
Net Inflow / (Outflow)	(51)	-	-
At 31 July 2019			
Forward foreign exchange contracts			
- Inflow	118,968	-	-
- Outflow	(114,015)	-	-
Net Inflow / (Outflow)	4,953	-	-
Net settled derivatives – interest rate swaps			
Net Inflow / (Outflow)	(46)	9	-

4.2 Derivative financial instruments

■ *Keeping it simple ...*

A derivative is a type of financial instrument typically used to manage risk. A derivative's value changes over time in response to underlying variables such as exchange rates or interest rates and is entered into for a fixed period. A hedge is where a derivative is used to manage an underlying exposure.

The Group is exposed to changes in interest rates on its borrowings and to changes in foreign exchange rates on its foreign currency (largely USD) purchases. The Group uses derivatives to hedge these underlying exposures.

Derivative financial instruments are initially included in the balance sheet at their fair value, either as assets or liabilities, and are subsequently re-measured at fair value at each reporting date.

An interest rate swap is an instrument to exchange a fixed rate of interest for a floating rate, or vice versa, or one type of floating rate for another.

Accounting policies

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured to their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as hedges of highly probable forecast transactions (cash flow hedges).

At inception of the hedging relationship, the Group documents the economic relationship between hedging instruments and hedged items, including whether changes in the cash flows of the hedging instruments are expected to offset changes in the cash flows of the hedged items. The Group also documents its risk management objectives and strategy for undertaking its hedge transactions.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity in the hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the consolidated statement of comprehensive income.

Amounts accumulated in equity are recycled in the consolidated statement of comprehensive income in the periods when the hedged item will affect profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the measurement of the initial cost or carrying amount of the asset or liability.

When a hedging instrument expires or is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the consolidated statement of comprehensive income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the consolidated statement of comprehensive income.

Foreign currency transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of comprehensive income, except when deferred in other comprehensive income. Translation differences on monetary financial assets and liabilities are reported as part of the fair value gain or loss.

Derivative financial instruments

	2020 NZ\$'000	2019 NZ\$'000
Foreign exchange contracts		
Current asset	53	4,964
Current liability	(7,360)	(11)
Net foreign exchange contracts – cash flow hedge (asset / (liability))	(7,307)	4,953
Interest rate swaps		
Current liability	(54)	(102)
Non-current liability	-	(9)
Net interest rate swaps – cash flow hedge (asset / (liability))	(54)	(111)
Total derivative financial instruments	(7,361)	4,842

The above table shows the Group's financial derivative holdings at year end.

Interest rate swaps - cash flow hedge

Interest rate swaps are to exchange a floating rate of interest for a fixed rate of interest. The objective of the transaction is to hedge the core floating rate borrowings of the business to minimise the impact of interest rate volatility within acceptable levels of risk thereby limiting the volatility on the Group's financial results. The notional amount of interest rate swaps at balance sheet date was NZ\$5,000,000 (2019: NZ\$23,263,048). The fixed interest rate is 1.32% (2019: range from 1.32% and 2.63%). Refer section 4.1.3 for timing of contractual cash flows relating to interest rate swaps.

Foreign exchange contracts - cash flow hedge

The objective of these contracts is to hedge highly probable anticipated foreign currency purchases against currency fluctuations. These contracts are timed to mature when import purchases are scheduled for payment. The notional amount of foreign exchange contracts amount to US\$114,460,000 NZ\$179,802,938 (2019: US\$79,350,000, NZ\$115,606,572).

No material hedge ineffectiveness for interest rate swaps or foreign exchange contracts exists as at balance sheet date (2019: nil).

Refer to section 4.2.1 for a sensitivity analysis of foreign exchange risk associated with derivative financial instruments.

4.2.1 Foreign exchange risk

Foreign exchange risk is the risk that fluctuations in exchange rates will impact the Group's financial performance. The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the NZD, USD and EUR.

Risk	Exposure arising from	Monitoring	Management
Foreign exchange risk	Foreign currency purchases – over 90% of purchases are in USD	Forecast purchases Reviewing exchange rate movements	USD foreign exchange derivatives

The Group is exposed to currency risk on any cash remitted between entities in different jurisdictions. The Group does not hedge for such remittances. Interest on borrowings is denominated in either New Zealand dollars or Australian dollars and is paid for out of surplus operating cashflows generated in New Zealand or Australia.

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Summarised sensitivity analysis

The following table summarises the sensitivity of the Group's financial assets and financial liabilities to foreign exchange risk.

A sensitivity of -10% / +10% (2019: -10% / +10%) for foreign exchange risk has been selected. While it is unlikely that an equal movement of the New Zealand dollar would be observed against all currencies, an overall sensitivity of -10% / +10% (2019: -10% / +10%) is reasonable given the exchange rate volatility observed on a historic basis for the preceding five year period and market expectation for potential future movements.

Amounts are shown net of income tax. All variables other than applicable exchange rates are held constant. The impact on equity is presented exclusive of the impact on retained earnings.

31 July 2020	Carrying amount NZ\$'000	-10%		+10%	
		Profit NZ\$'000	Equity NZ\$'000	Profit NZ\$'000	Equity NZ\$'000
Derivative financial instruments (asset) / liability	7,361	-	(19,160)	-	15,676
Financial assets					
Cash	231,885	15,964	-	(13,062)	-
Trade receivables and other receivables	64,680	(5,063)	-	4,143	-
		10,901	-	(8,919)	-
Financial liabilities					
Trade and other payables	158,111	(11,101)	-	9,082	-
Borrowings	241,270	19,302	-	(15,792)	-
		8,201	-	(6,710)	-
Total increase / (decrease)		19,102	(19,160)	(15,629)	15,676

31 July 2019	Carrying amount NZ\$'000	-10%		+10%	
		Profit NZ\$'000	Equity NZ\$'000	Profit NZ\$'000	Equity NZ\$'000
Derivative financial instruments (asset) / liability	(4,842)	-	(13,339)	-	10,915
Financial assets					
Cash	6,230	439	-	(359)	-
Trade receivables and other receivables	11,360	(806)	-	706	-
		(367)	-	347	-
Financial liabilities					
Trade and other payables	74,560	(5,067)	-	4,145	-
Borrowings	25,500	-	-	-	-
		(5,067)	-	4,145	-
Total increase / (decrease)		(5,434)	(13,339)	4,492	10,915

4.3 Equity

Keeping it simple ...

This section explains material movements recorded in shareholders' equity that are not explained elsewhere in the financial statements. The movements in equity and the balance at 31 July 2020 are presented in the consolidated statement of changes in equity.

Accounting policies

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

Dividends

Dividends are recognised through equity following the approval by the Company's directors.

4.3.1 Contributed equity - ordinary shares

	2020 NZ\$'000	2019 NZ\$'000
Ordinary shares fully paid (\$)	626,380	251,113
Balance at beginning of year	251,113	249,882
Issue of shares under Executive and Senior Management Long Term Incentive Plan	1,666	1,231
Shares issued under share entitlement offers and share placement	340,646	-
Shares issued as consideration on a business combination (Note 5.1)	32,955	-
Balance at end of year	626,380	251,113

Number of issued shares

	2020 '000	2019 '000
Ordinary shares issued at beginning of the year	226,189	225,315
Shares issued under Executive and Senior Management Long Term Incentive Plan	927	874
Shares issued under share entitlement offers and share placement	470,612	-
Shares issued as consideration on a business combination (Note 5.1)	11,273	-
Ordinary shares issued at end of the year	709,001	226,189

As at 31 July 2020 there were 709,001,384 ordinary issued shares in Kathmandu Holdings Limited and these are classified as equity.

926,996 shares (2019: 873,712) were issued under the "Executive and Senior Management Long Term Incentive Plan 24 November 2010" during the year.

During the year 470,613,096 shares were issued in relation to a share placement and share entitlement offers. Total capital raised of \$351,510,652 is net of directly attributable share issue costs of \$10,864,686.

All ordinary shares carry equal rights in respect of voting and the receipt of dividends. Ordinary shares do not have a par value.

Refer to section 6.3 for Employee share-based remuneration plans.

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4.3.2 Reserves and retained earnings

Cash flow hedging reserve

The hedging reserve is used to record gains or losses on a hedging instrument in a cash flow hedge that are recognised directly in other comprehensive income, as described in the accounting policy in section 4.2. The amounts are recognised in profit or loss when the associated hedged transaction affects profit or loss.

Foreign currency translation reserve

The FCTR is used to record foreign currency translation differences arising on the translation of the Group entities results and financial position. The amounts are accumulated in other comprehensive income and recognised in profit or loss when the foreign operation is partially disposed of or sold.

Share based payments reserve

The share based payments reserve is used to recognise the fair value of share options and performance rights granted but not exercised or lapsed. Amounts are transferred to share capital when vested options are exercised by the employee or performance rights are vested.

Reserves

		2020	2019
		NZ\$'000	NZ\$'000
(i) Cash flow hedging reserve			
Opening balance		4,118	3,498
Revaluation - gross		(3,799)	(9,772)
Deferred taxation on revaluation	2.3	3,903	607
Transfer to hedged asset		(9,255)	9,579
Transfer to net profit - gross		(108)	206
Closing balance		<u>(5,141)</u>	<u>4,118</u>
(ii) Foreign currency translation reserve			
Opening balance		(12,272)	(8,975)
Currency translation differences – Gross		255	(3,297)
Currency translation differences – Taxation	2.3	-	-
Closing balance		<u>(12,017)</u>	<u>(12,272)</u>
(iii) Share based payments reserve			
Opening balance		1,983	2,760
Current year amortisation		378	721
Deferred taxation on share options	2.3	(87)	(253)
Transfer to Share Capital on vesting of shares to Employees		(1,666)	(1,231)
Share Options / Performance Rights lapsed		-	(14)
Closing balance		<u>608</u>	<u>1,983</u>
(iv) Other Reserves			
Opening balance		-	-
Current year expense recognised in other comprehensive income		(61)	-
Deferred taxation on other comprehensive income	2.3	-	-
Closing balance		<u>(61)</u>	<u>-</u>
Total Reserves		<u>(16,611)</u>	<u>(6,171)</u>

4.3.3 Dividends

	2020	2019
	NZ\$'000	NZ\$'000
Prior year final dividend paid	27,209	24,836
Current year interim dividend paid	-	9,047
Dividends paid (NZ\$0.12 per share (2019: NZ\$0.15))	<u>27,209</u>	<u>33,883</u>

4.3.4 Capital risk management

The Group's capital includes contributed equity, reserves and retained earnings.

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt or draw down more debt.

Section 5: Group Structure

■ Keeping it simple ...

This section provides information about the entities that make up the Kathmandu Group and how they affect the financial performance and position of the Group.

5.1 Acquisition of Rip Curl Group Pty Ltd

On 31 October 2019 Kathmandu Holdings Limited through its wholly-owned subsidiary Barrel Wave Holdings Pty Limited acquired 100% of the equity interests in Rip Curl Group Pty Limited and its controlled entities based out of Australia. The total purchase price was A\$350,000,000. The non-controlling interest on acquisition relates to the interest acquired by the Group in Rip Curl joint ventures in New Zealand, Thailand and Europe.

Rip Curl is a designer, wholesaler, manufacturer and retailer of surfing equipment and apparel, and has a global presence across Australia, New Zealand, North America, Europe, South East Asia and Brazil. The acquisition creates a global outdoor and action sports company anchored by two iconic Australian brands and provides the opportunity for Kathmandu to considerably diversify its geographic footprint, channels to market and seasonality profile.

At the time the financial statements were authorised for issue, the Group had not yet finalised the purchase price allocation for the acquisition of Rip Curl. Fair values of the assets and liabilities disclosed below are determined provisionally as management is in process of reviewing the details of independent valuations. In segment information (Note 2.1), management temporarily allocates related assets and liabilities of the acquired business in the "Surf" segment. The Group expects to finalise the purchase price allocation in the next few months and will record any allocation adjustments in next financial period.

Provisional Purchase Price Allocation

	NZ\$'000
Purchase price	377,562
Less net indebtedness adjustment	(78,147)
Plus working capital settlement adjustments	23,437
Total net consideration	322,852
<i>Carrying amounts of identifiable assets acquired and liabilities assumed:</i>	
Current assets	
Cash and cash equivalents	29,142
Trade and other receivables (net)	83,361
Inventories (net)	124,675
Derivative financial instruments	990
Current tax asset	6,216
Non-current assets	
Other receivables	4,496
Property, plant and equipment	37,529
Brand	169,687
Customer relationships	39,697
Other intangibles	3,800
Right-of-use assets	117,296
Current liabilities	
Trade and other payables	(78,006)
Current tax liability	(2,224)
Current lease liabilities	(33,167)

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Non-current liabilities	
Non-current trade and other payables	(7,571)
Non-current lease liabilities	(85,397)
Interest bearing liabilities	(115,366)
Deferred tax	(53,245)
Less non-controlling interest acquired	(3,335)
Net assets acquired	239,045
Goodwill on acquisition	84,274
Total net consideration	322,852
Less cash and cash equivalents acquired	(29,142)
Less consideration paid as shares	(32,955)
Plus indebtedness settled on acquisition	115,366
Net cash outflow on acquisition	376,121

Goodwill arising on acquisition

On completion of the purchase price allocation, goodwill may be recognised on the acquisition of Rip Curl because of the established workforce and control premiums paid. This is not recognised separately from goodwill as the expected future economic benefits arising cannot be reliably measured and they do not meet the definition of identifiable intangible assets.

Acquisition costs

Acquisition related costs of \$11,895,000 have been excluded from the consideration transferred and are included in administration and general expenses in the statement of comprehensive income and in operating cash flows in the statement of cash flows in the current year.

Impact of the acquisition on the results of the Group

Group revenue for the year includes \$315,739,000 in respect of Rip Curl. Had the Rip Curl acquisition been effective from 1 August 2019, the unaudited revenue of the Group would have been \$922,635,000 and the unaudited profit for the year would have been \$14,910,000.

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5.2 Subsidiary companies

Subsidiaries are all entities over which the Group has control. Control is achieved when the Group:

- has power over the entity;
- is exposed to, or has rights to, variable returns from its involvement with the entity; and
- can use its power to affect returns.

Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary.

The following entities comprise the significant trading and holding companies of the Group;

Companies	Parties to Deed of Cross Guarantee	Country of Incorporation	Holding	
			2020	2019
<i>Parent entity:</i>				
Kathmandu Holdings Limited	√	New Zealand	-	-
<i>Subsidiaries:</i>				
Milford Group Holdings Limited	√	New Zealand	100%	100%
Kathmandu Limited		New Zealand	100%	100%
Kathmandu Pty Limited	√	Australia	100%	100%
Kathmandu (U.K.) Limited		United Kingdom	100%	100%
Kathmandu US Holdings LLC		United States of America	100%	100%
Oboz Footwear LLC		United States of America	100%	100%
Barrel Wave Holdings Pty Ltd	√	Australia	100%	-
Rip Curl Group Pty Ltd	√	Australia	100%	-
Rip Curl International Pty Ltd	√	Australia	100%	-
PT Jarosite		Indonesia	100%	-
Rip Curl Pty Ltd	√	Australia	100%	-
Onsmooth Thai Co Ltd		Thailand	100%	-
Rip Curl Investments Pty Ltd		Australia	100%	-
Blue Surf Pty Ltd		Australia	100%	-
RC Surf Pty Ltd		Australia	100%	-
Rip Curl Airport & Tourist Stores Pty Ltd		Australia	100%	-
JRRC Rundle Mall Pty Ltd		Australia	100%	-
Rip Curl (Thailand) Ltd		Thailand	50%	-
RC Airports Pty Ltd		Australia	100%	-
Ozmosis Pty Ltd	√	Australia	100%	-
RC Chermside Pty Ltd		Australia	100%	-
Bondi Rip Pty Ltd		Australia	100%	-
Rip Curl Japan		Japan	100%	-
Curl Retail No 1. Pty Ltd		Australia	100%	-
RC Surf Sydney Pty Ltd		Australia	100%	-
RC Surf South Pty Ltd		Australia	100%	-
RC Surf NZ Limited		New Zealand	50%	-
Rip Curl Finance Pty Ltd	√	Australia	100%	-
Rip Curl Europe S.A.S		France	100%	-
Rip Curl Spain S.A.U		Spain	100%	-
Rip Curl Suisse S.A.R.L		Switzerland	100%	-
Surf Odyssey S.A.R.L (70% share sold in July 2020)		France	0%	-
Rip Surf LDA		Portugal	100%	-
Rip Curl UK Ltd		United Kingdom	100%	-
Rip Curl Germany GMBH		Germany	100%	-
Rip Curl Italy SRL		Italy	100%	-
Rip Curl Nordic AB		Sweden	100%	-
Rip Curl Inc		United States of America	100%	-
Ultra Manufacturing Inc (in liquidation)		Mexico	100%	-
Rip Curl Canada Inc		Canada	100%	-
Rip Curl Brazil LTDA		Brazil	100%	-

All subsidiaries have a balance date of 31 July except for RC Surf NZ Limited which has a 31 March balance date.

5.3 Deed of Cross Guarantee

Pursuant to ASIC Corporations (Wholly-owned Companies) Instrument 2016/785, the Australian-incorporated wholly owned subsidiaries listed in Note 5.2 as parties to the Deed of Cross Guarantee are relieved from the Corporations Act 2001 requirements for preparation, audit and lodgement of financial reports and directors' reports in Australia.

It is a condition of the ASIC Corporations Instrument that the Company and each of the subsidiaries listed enter a Deed of Cross Guarantee. The effect of the Deed is that each party guarantees to each creditor of each other party payment in full of any debt in the event of winding up of the other party under certain provisions of the Corporations Act 2001. If a winding up occurs under other provisions of the Act, the guarantee will only apply if after six months after a resolution or order winding up any creditor has not been paid in full.

A consolidated statement of comprehensive income and balance sheet, comprising the Company and controlled entities which are parties to the Deed of Cross Guarantee, after eliminating all transactions between parties to the Deed of Cross Guarantee, at 31 July 2020, are set out as follows:

Consolidated Statement of Comprehensive Income and Retained Earnings for the year ended 31 July 2020

	2020 NZ\$'000	2019 NZ\$'000
Sales	457,884	339,671
Expenses	(425,853)	(292,303)
Finance costs - net	(16,234)	(279)
Profit before income tax	15,797	47,089
Income tax expense	(7,903)	(14,141)
Profit after income tax	7,894	32,948
Other comprehensive income	2,036	(4,995)
Total comprehensive income for the year	9,930	27,953
Retained Earnings at beginning of the year	(34,571)	(33,650)
Profit for the year after income tax	7,894	32,948
Dividends paid	(27,209)	(33,883)
Lapsed share options	-	14
Adoption of NZ IFRS 16	(6,855)	-
Retained Earnings at the end of the year	(60,741)	(34,571)

Consolidated Balance Sheet as at 31 July 2020

	2020 NZ\$'000	2019 NZ\$'000
ASSETS		
Current assets		
Cash and cash equivalents	204,918	3,206
Trade and other receivables	23,748	2,160
Inventories	106,825	67,407
Derivative financial instruments	4	3,373
Current tax asset	3,490	2,344
Total current assets	338,985	78,490
Non-current assets		
Trade and other receivables	78,460	38,277
Investments	349,911	175,183
Property, plant and equipment	53,010	41,389
Intangible assets	467,138	172,607
Right-of-use assets	156,400	-
Total non-current assets	1,104,919	427,456
Total assets	1,443,904	505,946

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LIABILITIES

Current liabilities

Trade and other payables	78,316	46,790
Derivative financial instruments	5,364	36
Current tax liabilities	7,923	6,378
Current lease liabilities	56,245	-
Total current liabilities	147,848	53,204

Non-current liabilities

Non-current trade and other payables	7,726	-
Interest bearing liabilities	237,069	-
Loans with related parties	295,614	220,237
Deferred tax	65,651	21,044
Non-current lease liabilities	128,777	-
Total non-current liabilities	734,837	241,281
Total liabilities	882,685	294,485

Net assets

	561,219	211,461
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EQUITY

Contributed equity - ordinary shares	626,380	251,113
Reserves	(4,420)	(5,081)
Retained earnings	(60,741)	(34,571)
Total equity	561,219	211,461

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Section 6: Other Notes

6.1 Related parties

All transactions with related parties were in the normal course of business and provided on commercial terms. No amounts owed to related parties have been written off or forgiven during the period.

Key Management Personnel

	2020 NZ\$'000	2019 NZ\$'000
Salaries	3,147	3,414
Other short-term employee benefits	55	457
Post-employment benefits	58	117
Employee performance rights	378	491
	3,638	4,479

6.2 Fair values

The following methods and assumptions were used to estimate the fair values for each class of financial instrument:

Trade debtors, trade creditors and bank balances

The carrying value of these items is equivalent to their fair value.

Term liabilities

The fair value of the Group's term liabilities is estimated based on current market rates available to the Group for debt of similar maturity. The fair value of term liabilities equates to their current carrying value.

Foreign exchange contracts and interest rate swaps

The fair value of these instruments is determined using valuation techniques (as they are not traded in an active market).

These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates.

Specific valuation techniques used to value financial instruments include the fair value of interest rate swaps. These are calculated at the present value of the estimated future cash flows, based on observable yield curves and the fair value of forward foreign exchange contracts, as determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.

These derivatives have all been determined to be within level 2 (for the purposes of NZ IFRS 13) of the fair value hierarchy as all significant inputs required to ascertain the fair value of these derivatives are observable.

Guarantees and overdraft facilities

The fair value of these instruments is estimated on the basis that management do not expect settlement at face value to arise. The carrying value and fair value of these instruments are approximately nil. All guarantees are payable on demand.

6.3 Employee share-based remuneration

Accounting policy

Equity settled long term incentive plan

The Executive and Senior Management Long Term Incentive plan grants Group employee's performance rights subject to performance hurdles being met. The fair value of rights granted is recognised as an employee expense in the consolidated statement of comprehensive income with a corresponding increase in the employee share-based payments reserve. The fair value is measured at grant date and amortised over the vesting periods. The fair value of the rights granted is measured using the Kathmandu Holdings Limited share price as at the grant date less the present value of the dividends forecast to be paid prior to each vesting date. When performance rights vest, the amount in the share-based payments reserve relating to those rights are transferred to share capital. When any vested performance rights lapse upon employee termination, the amount in the share-based payments reserve relating to those rights is transferred to retained earnings.

Executive and Senior Management Long Term Incentive Plan

On 20 November 2013, shareholders approved at the Annual General Meeting the continuation of an Employee Long Term Incentive Plan (LTI) (previously established 24 November 2010) to grant performance rights to Executive Directors, Senior Managers, Other Key Management Personnel and Wider Leadership Management.

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Executive Directors and Senior Managers

Performance rights granted to Executive Directors and Senior Managers are summarised below:

Grant Date	Balance at start of year number	Granted during the year number	Vested during the year number	Lapsed during the year number	Balance at the end of year number
9 Jul 2020	-	597,731	-	-	597,731
20 Dec 2018	261,388	-	-	-	261,388
20 Dec 2017	374,437	-	-	-	374,437
19 Dec 2016	375,810	-	(375,810)	-	-
	1,011,635	597,731	(375,810)	-	1,233,556

The performance rights granted on 9 July 2020 are Long Term Incentive components only.

Long Term Incentive performance rights vest in equal tranches. In each tranche the rights are subject to a combination of a relative Total Shareholder Return (TSR) hurdle and/or an EPS growth hurdle. The relative weighting and number of tranches for each grant date are shown in the table below:

Grant Date	Tranches	EPS Weighting	TSR Weighting
9 Jul 2020	1	0%	100%
20 Dec 2018	1	50%	50%
20 Dec 2017	1	50%	50%

The proportion of rights subject to the relative TSR hurdle is dependent on Kathmandu Holdings Limited's TSR performance relative to a defined comparable group of companies in New Zealand and Australia listed on either the ASX or NZX. The percentage of TSR related rights vest according to the following performance criteria:

Kathmandu Holdings Limited relative TSR ranking	% Vesting
Below the 50 th percentile	0%
50 th percentile	50%
51 st – 74 th percentile	50% + 2% for each percentile above the 50 th
75 th percentile or above	100%

The TSR performance is calculated for the following performance periods:

Tranche	2020	2019
Tranche 1	36 months to 1 December 2022	36 months to 1 December 2021

The fair value of the TSR rights have been valued under a Monte Carlo simulation approach predicting Kathmandu Holdings Limited's TSR relative to the comparable group of companies at the respective vesting dates for each tranche. The fair value of TSR rights, along with the assumptions used to simulate the future share prices using a random-walk process are shown below:

	2020	2019
Fair value of TSR rights	\$119,546	\$205,190
Current price at grant date	\$1.14	\$2.77
Risk free interest rate	0.34%	1.76%
Expected life (years)	3	3
Expected share volatility	69.5%	28.9%

The estimated fair value for each tranche of rights issued is amortised over the vesting period from the grant date.

The proportion of rights subject to the EPS growth hurdle is dependent on the compound average annual growth in Kathmandu Holdings Limited's EPS relative to the year ending 31 July 2020. The applicable performance periods are:

Tranche	2020 Performance Period	2019 Performance Period
Tranche 1	Not applicable	FY21 EPS relative to FY18 EPS

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The percentage of the 2019 EPS growth related rights scales according to the compound average annual EPS growth achieved as follows:

EPS Growth	2019 % Rights Vesting
< 7%	0%
>=7%, < 8%	50%
>=8%, < 9%	60%
>=9%, < 10%	70%
>=10%, < 11%	80%
>=11%, < 12%	90%
>=12%	100%

The fair value of the EPS rights have been assessed as the Kathmandu Holdings Limited share price as at the grant date less the present value of the dividends forecast to be paid prior to each vesting date. The estimated fair value for each tranche of options issued is amortised over the vesting period from the grant date.

Vesting of Long Term Incentive performance rights also require remaining in employment with the Company during the performance period.

Other Key Management Personnel and Wider Leadership Management

Performance rights granted to Other Key Management Personnel and Wider Leadership Management are all Short Term Incentives under the shareholder approved Employee Long Term Incentive Plan, and are summarised below:

Grant Date	Balance at start of year number	Granted during the year number	Vested during the year number	Lapsed during the year number	Balance at the end of year number
20 Dec 2019	-	654,836	-	-	654,836
11 Dec 2017	551,186	-	(551,186)	-	-

Short Term Incentive performance rights vest:

- upon the Company achieving non-market performance hurdles; and
- the employee remaining in employment with the Company until the vesting date.

The performance period and vesting dates are summarised below:

	2020	2019
Grant Date	20 Dec 2019	18 Dec 2018
Performance period (year ending)	31 Jul 2020	31 Jul 2019
Vesting Date – Other Key Management Personnel and Wider Leadership Management	31 Jul 2021	31 Jul 2020

The fair value of the rights were assessed as the Kathmandu Holdings Limited share price as at the grant date less the present value of the dividends forecast to be paid prior to the vesting date.

The non-market performance hurdles set for the year ending 31 July 2020 were not met and accordingly no expense has been recognised in the consolidated statement of comprehensive income.

Expenses arising from equity settled share based payments transactions

	2020 NZ\$'000	2019 NZ\$'000
Executive Director and Senior Managers	378	228
Key Management Personnel and Wider Leadership Management	-	493
	<u>378</u>	<u>721</u>

6.4 Contingent liabilities

There are no contingent liabilities in 2020 (2019: nil).

6.5 Contingent assets

There are no contingent assets in 2020 (2019: nil).

6.6 Events occurring after balance sheet date

There are no events after balance sheet date which materially affect the information within the consolidated financial statements.

6.7 Supplementary information

Directors fees

	2020	2019
	NZ\$'000	NZ\$'000
Directors' fees	779	790

Directors fees for the Parent company were paid to the following:

- David Kirk (Chairman)
- John Harvey
- Philip Bowman
- Brent Scrimshaw
- Andrea Martens (appointed 1 August 2019)
- Sandra McPhee (retired 27 September 2019)

Audit fees

During the year the following fees were paid or payable for services provided by the auditor of the parent entity, its related practices and other network audit firms:

	2020	2019
	NZ\$'000	NZ\$'000
Audit services - PricewaterhouseCoopers		
Group audit – PwC New Zealand	434	186
Acquired balance sheet – PwC New Zealand	85	-
UK Statutory audit – PwC UK	20	20
Half year review – PwC New Zealand	115	36
Total remuneration for PricewaterhouseCoopers audit services	654	242
Audit services – other audit firms	138	-
Non-audit services - PricewaterhouseCoopers		
Taxation Services – PwC France	118	-
Revenue Certificates – PwC New Zealand	11	12
Banking compliance certificates – PwC New Zealand	3	3
Total remuneration for PricewaterhouseCoopers non-audit services	132	15

6.8 New accounting standards and interpretations

New standards and interpretations first applied in the period

New Accounting Standard	Effective Date Applicable to the Group	Summary of Changes	Group Impact
NZ IFRS 16 Leases	1 August 2019	Introduces a single lessee accounting model requiring a lessee to recognise assets and liabilities for all leases with a term of more than 12 months where they are not considered low value. A right-of-use asset is recognised representing the right to use the underlying leased asset and a lease liability representing the obligations to make lease payments. As a consequence, a lessee recognises depreciation of the right-of-use asset and interest on the lease liability.	<p>The Group has applied NZ IFRS 16 using a modified retrospective transition method. Comparative figures have not been restated and the cumulative effect of initially applying IFRS 16 has been recognised as an opening retained earnings adjustment.</p> <p>NZ IFRS 16 changes how the Group accounts for leases previously classified as operating leases under NZ IAS 17, which were off-balance-sheet. Applying NZ IFRS 16, for all leases (except as noted below), the Group has:</p> <ul style="list-style-type: none"> a) recognised lease liabilities and right-of-use assets in the consolidated balance sheet. Lease liabilities have been initially measured at the present value of the remaining lease payments, discounted using the incremental borrowing rate at 1 August 2019. Right-of-use assets have been initially measured at carrying amount as if NZ IFRS 16 had always applied since the lease commencement date, using a discount rate based on the incremental borrowing rate at 1 August 2019; b) recognised depreciation of right-of-use assets and interest on lease liabilities in the consolidated statement of comprehensive income; and c) separated the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the consolidated statement of cash flows. <p>Lease incentives (eg rent free periods) are recognised as part of the measurement of the right-of-use assets and lease liabilities whereas under NZ IAS 17 they resulted in the recognition of a lease liability, amortised as a reduction of rental expense on a straight-line basis.</p> <p>Under NZ IFRS 16, right-of-use assets are tested for impairment in accordance with NZ IAS 36 Impairment of Assets. This replaces the previous requirement to recognise a provision for onerous lease contracts.</p> <p>For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as office equipment), the Group has opted to recognise a lease expense on a straight-line basis as permitted by NZ IFRS 16. This expense is presented within selling expenses and administration and general expenses within the consolidated statement of comprehensive income.</p>

			<p>The Group has used the following practical expedients on initial application of NZ IFRS 16;</p> <ul style="list-style-type: none"> - whether an existing contract is, or contains, a lease has not been reassessed; - applied a single discount rate to a portfolio of leases with reasonably similar characteristics; - relied on its assessment of whether leases are onerous applying NZ IAS 37 Provisions, Contingent Liabilities and Contingent Assets immediately before 1 August 2019 as an alternative to performing an impairment review; - excluded initial direct costs from the measurement of the right-of-use asset at 1 August 2019; - used hindsight in determining the lease term if the contract contains options to extend or terminate the lease.
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Standards, interpretations and amendments to published standards that are not yet effective

There are no standards or amendments published but not yet effective that are expected to have a significant impact on the group.

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Independent auditor's report

To the shareholders of Kathmandu Holdings Limited

We have audited the consolidated financial statements which comprise:

- the consolidated balance sheet as at 31 July 2020;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the accompanying consolidated financial statements of Kathmandu Holdings Limited (the Company), including its subsidiaries (the Group), present fairly, in all material respects, the financial position of the Group as at 31 July 2020, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Group in accordance with Professional and Ethical Standard 1 *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* (PES 1) issued by the New Zealand Auditing and Assurance Standards Board and the *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by the International Ethics Standards Board for Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our firm carries out other services for the Group in the areas of assurance compliance engagement in respect of bank covenant compliance, agreed upon procedures for store turnover certificates and tax advisory. The provision of these other services has not impaired our independence as auditor of the Group.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current year. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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Description of the key audit matter	How our audit addressed the key audit matter
<p><i>Acquisition of Rip Curl Group</i></p> <p>As disclosed in note 5.1 of the consolidated financial statements, the Group acquired 100% of the shares of Rip Curl Group Pty Limited (Rip Curl), on 31 October 2019, for base consideration of A\$350m.</p> <p>The purchase price included identifiable tangible and intangible assets acquired and liabilities assumed.</p> <p>At the time the consolidated financial statements were authorised for issue, management had not yet completed the purchase price allocation.</p> <p>Management have completed a provisional assessment of the fair value of the assets and liabilities that were acquired. This process included engaging a third party valuation expert to assist in the process to identify and determine the fair value of the intangible assets. The full valuation process has not yet been finalised and management’s expert has not yet issued their final report. It is therefore possible that changes in the acquisition accounting may still occur.</p> <p>Intangible assets have been identified in relation to brand and customer relationships provisionally held by Rip Curl at NZ\$169.7m and \$39.7m respectively, in addition to the provisional goodwill of \$84.3m.</p> <p>Our audit focused on this area because the acquisition of Rip Curl was a major transaction and significant judgements and assumptions are involved in identifying and determining fair value of the acquired assets and liabilities, particularly the identified intangible assets.</p>	<p>In responding to the significant judgements involved in identifying and valuing the identifiable intangible assets we:</p> <ul style="list-style-type: none"> • obtained an understanding of the acquisition by reading the sale and purchase agreement, other relevant contractual agreements and documents; • confirmed the fair value of the consideration paid to the sale and purchase agreement; • obtained the provisional valuation undertaken by management’s expert to determine the purchase price allocations and tested the mathematical accuracy of the models; • held discussions with Group management and their valuation expert to obtain an understanding of the business process undertaken to identify and value of the assets acquired and liabilities assumed; • we engaged our own internal valuation specialist to assess the appropriateness of assets identified, evaluate the valuation methodology and consider the key judgements and assumptions as provisionally determined by management and management’s expert; • considered whether the identification and recognition of intangible assets was consistent with the requirements of the accounting standards; and • considered whether the relevant disclosures were appropriate.

Description of the key audit matter	How our audit addressed the key audit matter
<p><i>Impairment testing over indefinite life intangibles, including the impact of COVID-19</i></p> <p>The risk that the Group’s indefinite life assets may be materially impaired is considered a key audit matter, due to the material nature of these assets and the significant judgement exercised by management to:</p> <ul style="list-style-type: none"> • assess the appropriate cash generating units (CGU) to consider for testing; • estimate the future results of the CGUs; • include the impact of COVID-19, revenue and margins; • allocate shared costs to CGUs; and • assess the discount rates and terminal growth rates. <p>As disclosed in note 3.3, the Group assessed the recoverable amount of each CGU as at 31 July 2020 using discounted cash flow valuations on a fair value less cost of disposal (FVLCD) basis.</p> <p>For Kathmandu New Zealand, Australia and Oboz management performed their own calculation and engaged a third party valuation expert to:</p> <ul style="list-style-type: none"> • provide expert advice on the appropriate discount rate for each CGU; • provide macro-economic analysis for each CGU; • provide advice on the appropriate valuation multiples for alternative valuation cross checks; and • perform sensitivity analyses. <p>For Rip Curl, management engaged the third party valuation expert to perform a full year-end valuation.</p> <p>Based on the testing performed for each CGU the Group concluded that there was no impairment of goodwill and brand as at 31 July 2020.</p> <p>The key assumptions used in the impairment testing has been disclosed in note 3.3.</p>	<p>Our audit procedures in assessing the indefinite life intangible assets included the following:</p> <p>For all brands and goodwill we:</p> <ul style="list-style-type: none"> • obtained the calculations performed by management and considered the assumptions used in light of the current and forecast outlook for the business; • reviewed management’s assessment of CGUs and compared this to our knowledge and understanding of the Group’s operations and reporting structure; • engaged our auditor’s expert to independently consider the appropriateness of the discount and long-term growth rates; • assessed the reasonableness of management’s cash flow assumptions by considering external market forecasts, historical performance and other available information; • considered the allocation of shared costs to each CGU; • performed look back tested on historical accuracy of management forecasts; and • performed sensitivity testing for each CGU. <p>For Rip Curl we also:</p> <ul style="list-style-type: none"> • used our auditor’s expert to review and challenge the appropriateness of the assumptions used by management expert’s in the valuation of Rip Curl and assess the appropriateness of the valuation methodology employed by management’s expert. <p>We audited the disclosures in the financial statements to ensure they are compliant with the requirements of the relevant accounting standards.</p>



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Description of the key audit matter	How our audit addressed the key audit matter
<p data-bbox="276 461 810 524"><i>Inventory existence and valuation including the impact of COVID-19</i></p> <p data-bbox="276 539 842 719">At 31 July 2020, the Group held inventories of \$228.8m. Inventory valuation and existence was an audit focus area due to the number of locations that the inventory was held at and the judgement applied in the valuation of inventory on hand.</p> <p data-bbox="276 750 842 871">As described in note 3.1.1 of the consolidated financial statements, inventories are carried at the lower of cost and net realisable value on a weighted average basis.</p> <p data-bbox="276 902 842 1023">The Group has systems and processes, including a barcode inventory management system, to accurately record inventory movements.</p> <p data-bbox="276 1055 842 1144">Management perform full stocktakes at each store twice a year, with annual full stocktakes taking place at Rip Curl distribution centres.</p> <p data-bbox="276 1176 842 1355">Daily cycle counts are performed at the Kathmandu New Zealand and Australian distribution centres. For Rip Curl US and Oboz management keep stock at third party warehouses who provide inventory management services.</p>	<p data-bbox="863 461 1469 524">We performed a number of audit procedures over inventory existence and valuation at year end. We:</p> <ul data-bbox="863 539 1469 1980" style="list-style-type: none"> <li data-bbox="863 539 1469 629">• observed the stocktake process at selected store locations near period end and undertook our own test counts; <li data-bbox="863 660 1469 750">• attended the year end distribution centre count and performed independent test counts for Rip Curl; <li data-bbox="863 781 1469 996">• observed the daily stocktake process at the Christchurch and Melbourne Kathmandu distribution centres near period end and undertook our own test counts. We also tested that the daily counts occurred by selecting a sample of days at each location and inspected the count records throughout the year; <li data-bbox="863 1028 1469 1117">• confirmed the level of inventory held at year end directly with third party warehouses for inventory in the United States; <li data-bbox="863 1149 1469 1328">• assessed the inventory shrinkage provision by reviewing the level of inventory write downs during the period. We tested the shrinkage rate used to calculate the provision for each store since the last stocktake by comparing it to the actual shrinkage rate in prior periods; <li data-bbox="863 1359 1469 1480">• assessed store inventory counts performed post year end to ensure the actual level of shrinkage was consistent with the year end provisioning; <li data-bbox="863 1512 1469 1794">• evaluated the assumptions made by management, and particularly the key assumption that current shrinkage levels are consistent with historical levels, in assessing inventory obsolescence provisions through an analysis of inventory items by category and age and the level of inventory write downs in these categories during the period including the potential impact of COVID-19; and <li data-bbox="863 1825 1469 1980">• tested that inventory on hand at the end of the period was recorded at the lower of cost and net realisable value by testing a sample of inventory items to the most recent retail price which includes the impact of COVID-19.

Description of the key audit matter	How our audit addressed the key audit matter
<p data-bbox="276 454 831 521"><i>Adoption of the accounting standard NZ IFRS 16 Leases</i></p> <p data-bbox="276 539 831 835">The Group adopted NZ IFRS 16 <i>Leases</i> on 1 August 2019. The standard requires the recognition of a right of use asset and lease liability on the balance sheet for all leases. Previously operating leases were not recognised on the balance sheet. The adoption of the standard has resulted in the recognition of a right of use asset of \$178.8m and a lease liability of \$206.5m.</p> <p data-bbox="276 853 831 981">As outlined in note 3.4 and 6.8, a number of judgements and estimates have been made by management in establishing these opening values. These comprise of the:</p> <ul data-bbox="276 999 831 1261" style="list-style-type: none"> • incremental borrowing rates at the time of adoption; • lease terms, including any rights of renewals expected to be exercised; • application of practical expedients in respect of short term lease exemptions; and • recognition of abatements received from landlords. <p data-bbox="276 1279 831 1406">This was considered an area of focus for our audit due to the number of leases and the significant judgements and estimates inherent in the calculation.</p>	<p data-bbox="863 454 1465 555">We have performed the following audit procedures in relation to the adoption of the new accounting standard for leases. We:</p> <ul data-bbox="863 573 1465 1653" style="list-style-type: none"> • held discussions with management to understand the implementation process including the basis for key assumptions used in the calculation of opening balances and management's process; • performed testing, on a sample basis, of the accuracy of information included in the calculations by comparing them to the terms in the underlying lease contracts; • tested completeness of the identified lease contracts by checking that leased stores and other major leased assets were included in the calculation through reconciliation to the audited lease commitments schedule at 1 August 2019; • on a sample basis, recalculated the right of use asset and lease liability for individual leases; • reviewed assumptions used to determine the lease term including rights of renewal and assessed whether they were supported by past practice and current business plans; • reviewed the appropriateness of practical expedients applied for exclusion of low value and short term lease exemptions; • on a sample basis, assessed the appropriate treatment of rent abatements received from landlords; and • reviewed the appropriateness of disclosures in the financial statements. <p data-bbox="863 1671 1465 1769">In relation to the incremental borrowing rates, we engaged our auditor's valuation expert to assess the appropriateness of the discount rates used.</p>

Our audit approach

Overview



An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement.

Overall Group materiality: \$3.7m, which represents approximately 5% of weighted average of last three years' annualised profit before tax, excluding the acquisition cost in relation to Rip Curl.

Given the volatility in profit before tax due to the impacts of COVID-19 we chose a weighted average of the last three years' annualised profit before tax adjusted for the acquisition cost, as the appropriate benchmark for the year ended 31 July 2020.

In order to appropriately reflect the current brand profile of the Kathmandu Group, we have annualised the past financial performance by incorporating Rip Curl Group's audited profit before tax in our calculation. This ensured the historical profits reflects the financial performance of all brands within the Group.

Further, we have excluded the acquisition cost in relation to the acquisition of Rip Curl which, due to its size, causes unusual fluctuation in profit before tax due to its infrequent occurrence.

As reported above, we have four key audit matters, being:

- Acquisition of Rip Curl Group
- Impairment testing over indefinite life intangibles, including the impact of COVID-19
- Inventory existence and valuation, including the impact of COVID-19
- Adoption of the accounting standard NZ IFRS 16 *Leases*

Materiality

The scope of our audit was influenced by our application of materiality.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Group materiality for the consolidated financial statements as a whole as set out above. These, together with qualitative considerations, helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

Audit scope

We designed our audit by assessing the risks of material misstatement in the consolidated financial statements and our application of materiality. As in all of our audits, we also addressed the risk of management override of internal controls including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group audit was conducted by a New Zealand based team, with support from component auditors in France and Thailand.



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Information other than the consolidated financial statements and auditor's report

The Directors are responsible for the annual report. Prior to the date of our auditor's report, we received a first draft of the corporate governance section of the annual report, but we have not received any of the other components of the annual report, which is expected to be made available to us at a later date. Our opinion on the consolidated financial statements does not cover the other information included in the annual report and we do not and will not express any form of assurance conclusion on the other information.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard, except that not all other information was available to us at the date of our signing.

Responsibilities of the Directors for the consolidated financial statements

The Directors are responsible, on behalf of the Company, for the preparation and fair presentation of the consolidated financial statements in accordance with NZ IFRS and IFRS, and for such internal control as the Directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (NZ) and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

A further description of our responsibilities for the audit of the consolidated financial statements is located at the External Reporting Board's website at:

<https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/>

This description forms part of our auditor's report.

Who we report to

This report is made solely to the Company's shareholders, as a body. Our audit work has been undertaken so that we might state those matters which we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's shareholders, as a body, for our audit work, for this report or for the opinions we have formed.

The engagement partner on the audit resulting in this independent auditor's report is Leopino Foliaki.

For and on behalf of:

Chartered Accountants
23 September 2020

Christchurch