

three major sales events per year. This vertical business model has been the foundation of Kathmandu's growth in Australasia for the past 15 years, and we have continued to improve and adapt over this period. Our successful execution of this model, coupled with growing brand recognition, and product loyalty that Kathmandu commands in its key markets, has seen Group sales increase by over \$165m or 75% in the four years since our IPO.

The same period of time has seen the spectacular growth of the internet as a platform for social and consumer interaction. Kathmandu, as a vertically integrated brand business with strong margins in a growing category, is well placed to take advantage of this opportunity, both locally and internationally.

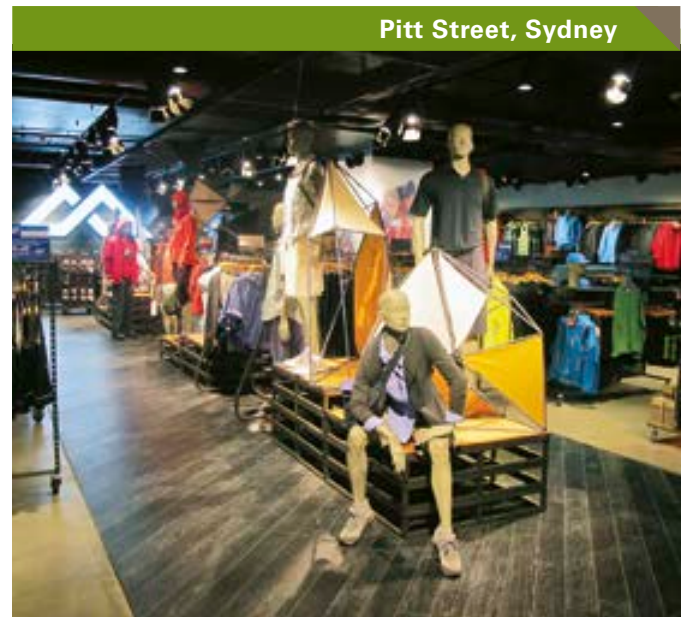
We continue to build on our existing business, primarily through store rollout in Australia, where we still see many opportunities to increase Australian brand awareness and market penetration relative to the level achieved in New Zealand. In tandem with continuing to execute the model we know well, the online opportunity will continue to get an increasing share of our management attention and strategic investment.

#### PRODUCT RANGE AND INVENTORY

Product is a key to our success. Ensuring we are bringing to market innovative, well designed, high quality and competitively priced products that meet the needs of our customers is essential to our future success. Over the last seven years we have invested in our product team and recruited many new skills and capabilities into the business. Capability in areas such as design, quality and fabric R&D have all been added, and their impact on product development will be seen in the seasons ahead.

We intend to increase our return from each sku in our product range, through revenue growth and reduced cost to market ratios, relative to the absolute level of inventory investment and the costs associated with new product development. Assortment range planning is a key medium term enhancement required from our systems upgrade project, which will enable us to maximise our performance in this area.

Inventory levels were well managed throughout the year, and the total value of inventory, \$80.0m at 31 July 2013, was an 9.1% increase on the prior year. One-third of this increase was the year-on-year change in goods in transit for the summer season in FY2014, so after excluding this amount, the value of stock on hand at 31 July was less than \$5m higher than a year earlier, a 4.3% reduction when measured on a per store basis. This was an excellent outcome given the growth in both sales and store numbers, and it was further reflected in reduced volumes of clearance stock, especially in the second half of the year. We do expect a slightly higher rate of inventory growth in FY2014, as we are focused on maintaining adequate range depth in key product groups planned to support key promotional events across the year, as well as further improving our seasonal range availability in regions with major climatic variations.



#### ONLINE AND DIGITAL

Our investment in information systems infrastructure and software continues to be a critical part of our business improvement strategy. During FY2013 we made the strategic decision to follow the development path provided by Microsoft Dynamics AX for Retail in a number of core operational areas of the business. We have already gone live with modules relating to Customer Relationship and Product Information Management, and our Forecasting and Planning software will be live early in FY2014. There is a clear pathway for Kathmandu to substantially upgrade its core systems utilising the AX suite of applications, and replacement of our current Point Of Sale software during the second half of FY2014 is the next stage of our development plan.

In FY2014 our online platform will continue to be enhanced as we progress with building systems infrastructure capable of supporting both our current Australasian business growth, and the future development of new multichannel retail options. Potential opportunities for the Kathmandu brand internationally, outside our core markets, cannot be effectively pursued until we have implemented a tier one software platform which properly integrates our retail stores and websites globally.

#### STORE NETWORK

The makeup of Kathmandu's store network and our strategy for the location and sizing of new stores has continued to evolve through our four years as a listed company, especially in Australia which remains our key growth opportunity for ongoing store rollout. As we previewed in last year's annual report, our store network plan has been further developed to focus on small format site opportunities (stores of 350m<sup>2</sup> or less). In Australia, this store format has become our standard in mall locations, aligning well with the planned growth we are achieving from more lifestyle orientated apparel categories.

We are confident that the Kathmandu store network when fully rolled out across New Zealand and Australia will number at least 170 stores. All current Kathmandu stores in Australasia make a positive contribution to group earnings.