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Under Armour, Inc. (UA)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Lance Allega
Senior Vice President, Investor Relations & Corporate Development

GAAP AND NON-GAAP FINANCIAL MEASURES

- We may reference non-GAAP financial measures and information on today's call, including adjusted and currency neutral terms, which are defined under SEC rules, in this morning's press release
- You may also hear us refer to amounts under US GAAP
- Reconciliations of GAAP to non-GAAP measures can also be found in our press release, which identify and quantify all excluded items and provides our view about why we believe this information is helpful to investors

Patrik Frisk
President, Chief Executive Officer & Director

Q2 HIGHLIGHTS

- At the halfway point of 2021, our better-than-expected results continue to validate that our multiyear transformation is working

- With a stronger top and bottom line performance relative to our previous outlook, perhaps, more importantly, we're also driving high quality growth, margin expansion, and greater profitability against our pre-pandemic 2019 results

EPS

- In fact, diluted EPS through the first six months of 2021 are greater than the full year 2019, so all-in, a great H1

Operating Model and Financial Discipline

- Reflecting on the past 18 months, amid a historically challenging environment due to the COVID-19 pandemic, I am incredibly proud of Under Armour's global team and the way we've worked to hold ourselves accountable to our strategic playbook
- By continuing to sharpen our focus, the operating model and financial discipline we have engrained within our culture serve as a constant check and balance to deliver premium products and experiences to our consumers and customers
- And by driving high-quality revenue through a constant lens of operational excellence and applying what we've learned, consistently refining and orienting towards brand-right profitable growth, means we are better positioned today to drive greater returns to our shareholders than we were before the pandemic started

Resiliency

- And, yet, with sustained uncertainty related to COVID, which as of late is trending unfavorably in key sourcing countries in Southeast Asia, the resiliency we have earned over the last year and a half will continue to serve as an asset while we navigate H2 2021

STRATEGIC PILLARS

Strengthening our Brand

- In this respect, we're focused on the things we can control, staying grounded in our four strategic pillars: strengthening the Under Armour brand; improving our operating model; amplifying a DTC-focused approach; and increasing our capacity to return greater profitability across the company
- Starting with strengthening our brand and the proactive decision we've made to reinvest some of this year's upside into additional marketing efforts
- This flexibility is empowering us to amplify our middle to top of funnel activations geared at increasing awareness, attraction, and consideration for the Under Armour brand
- As we work to connect with new athletes and inspire existing ones, we are centered on our brand attributes: resilience, hard work, heart, and edge

PROCESS OF TRAINING, GOALS, STRUGGLING AND RESULTS

- In H2, this will come to light more holistically as we illustrate the journey to compete through the process of training, setting goals, struggling, and ultimately realizing the results
- Through a team sports lens, supported by consistent messaging via The Only Way Is Through, our third quarter activations highlight the importance of mental strength, an often overlooked aspect of training and its relationship to unlocking an athlete's full potential

CONSUMERS INTO PSYCHE AND MENTAL TRAINING

- Certainly, coming out of a long stretch of COVID restrictions and as team sports hopefully open up more broadly this fall, we believe this is a timely effort to draw consumers into the psyche that is uniquely Under Armour as we work to make them better
- So starting this month, via social media, TV, and streaming, be on the lookout for Chase Young, Trent Alexander-Arnold, Ty Harris, and [ph] NICKMERCS (5:33), among others, helping to highlight mental training and the role it plays in achieving one's personal performance goals
  - As we say at Under Armour, if you train your mind, you train your game

GO-TO-MARKET AND MARKETING INVESTMENTS

- So while there is still more work to be done to unlock our full marketing potential, I am pleased with the progress we're making in aligning our go-to-market with focused performers and the evolving needs of our key retail partners around the world
  - Not to mention the incremental marketing investments we're making in 2021 are really geared at setting us up for more strongly in 2022, as awareness and consideration should lead to increased conversion as we strengthen our connectivity

PRODUCT

- In product, our strategy remains firmly rooted in an athlete's journey to sport, leading with insights and data to provide solutions they didn't know they needed and now can't imagine living without
- With quite a few product highlights during the quarter, I'd start by recognizing the incredible milestone that our partners at Virgin Galactic achieved a few weeks ago with their commercial flight into space
  - To play a part in pushing the boundaries of what is possible, we are excited to see what the future holds as new barriers get broken, inspiring all of us to strive for more

APPAREL

- In Apparel, second quarter highlights included strong sell-through of our Iso-Chill running products, featuring a UA innovation that keeps you cooler in hot conditions
- We also saw strong sell-through in men's Unstoppable bottoms and women's leggings, including Meridian and our No-Slip Waistband technology
- Bras continued to build on its momentum as well, with meaningful increases in our Infinity and Crossback products
- And we also saw solid results in tops featuring our RUSH technology
- And finally, Project Rock apparel continued to build on its strong momentum as well, with an excellent response to new drops

FOOTWEAR

- In Footwear, Flow Velociti performed well in all regions, as did HOVR Phantom and Machina 2, including significant growth against last year's already strong performance
  - Our Charged Pursuit 2 and Assert 9 footwear offerings also posted substantial numbers, demonstrating continued success in our segmentation strategy to bring premium innovations across all price points

CURRY AND PROJECT ROCK 3 SHOE

- In Curry, we saw success on and off court with our Curry Flow 8 signature shoe, as well as retro styles that we pre-released in APAC, all good signs of momentum as we work towards the launch of the Curry 9 late this year
- And finally, the Project Rock 3 shoe, which combines UA HOVR and Tribase technologies for a highly comfortable and stable training platform, was also a standout

Operating Model Improvement

- Switching gears to our next area of focus, which is continuous operating model improvement, our second quarter results demonstrate, once again, that our ability to service increased demand with efficient, effective execution is getting better
- Creating product at the right price and getting it to the right place at the right time is at the core of how we'll win
- To empower this, the adage holds: success is doing the common things uncommonly well
    - Simple perhaps, but precisely at the core of our strategic playbook and what we're obsessing on a day-to-day basis

North America

- Turning to our regions, we believe it's most helpful to compare our results to 2019, since last year's second quarter was an incredibly unique period, and we believe this two-year stack better represents some of the progress we're making in the overall performance of our business

REVENUES AND INVENTORY MANAGEMENT

- Starting with North America, I'd underscore how happy we are with improving our ability to drive higher quality revenue through sharper segmentation, tighter inventory management, and delivering consistent service to our customers. vs. 2019, North American revenue was up 11% in Q2 and about 3% for H1

Direct-to-Consumer Business

- Now, in context, it's important to keep in mind that these comparable periods have some key differences, including: a significant increase in our direct-to-consumer business, offset by considerably lower sales to the off-price channel; lower overall promotional and markdown activities; and supply constraints, engineered to put us in a more advantaged position in the marketplace
- All of this, of course, is geared to continuing to lift the Under Armour brand to a more premium level in our largest market
    - And to that point, as evidenced by our gross margin results, this strategy is working

Channel Perspective

- From a channel perspective, we feel good about the pace we're earning back space with our key North American wholesale partners, driving fuller price revenue and showing up, both digitally and physically, in a more comprehensive way than ever before

Owned and Operated Stores

REVENUES

- Revenue from our owned and operated stores is up meaningfully in the quarter vs. the same period in 2019 and includes improved quality and composition of sales
- For the full year, we expect our North American business to be up at a low 20s percentage rate compared to 2020. vs. 2019, North America will be close to the same revenue, which, taking into consideration the factors I've mentioned, less off-price, lower discounts and promotions, and tighter supply constraints, along with our exit of undifferentiated retail which starts in Q3, leaves me confident that we're setting ourselves up for improving brand-right profitable growth in 2022 and beyond

INTERNATIONAL BUSINESS

- Turning to our international business, we expect revenue to be up at a mid-30s percentage rate vs. 2020 or up at a high-20s percentage rates on a two-year stack

Asia-Pacific Region

REVENUES AND INVESTMENTS

- In our Asia-Pacific region, we remain laser-focused on ensuring our brand remains firmly positioned in athletic performance while staying agile in a quickly evolving marketplace
- With second quarter revenue up 25% vs. 2019 or up 35% for H1 on a two-year stack, our results gives us confidence that the additional investments we're making into marketing, CRM, digital activations, and store expansions, are working to drive greater brand affinity amid a highly competitive backdrop

EMEA

GROWTH, DTC, EMEA WHOLESALE GROWTH AND STRATEGIES

- Next up is EMEA, a region that is also seeing pockets of COVID resurgence, but also delivered strong growth for Under Armour
- Second quarter revenue was up 43% over 2019 and up 44% for the first six months on a two-year stack
- Within DTC, we recently upgraded our eCommerce site platform to improve our capabilities and functionality as we focus on driving more seamless shopping experiences for our consumers
- EMEA wholesale growth was balanced across our full-price and distributor businesses
- Looking at the rest of the year, we remain confident that our strategies to drive greater reach and connection to our consumers are working well

Latin America Region

REVENUES

- And finally, our Latin America region, where second quarter revenue was up 17% over 2019 or up 7% for the first six months on a two-year stack
    - As discussed on our last call, we have begun transitioning our business in certain countries to a strategic distributor model, which we expect to impact revenue more negatively in the back half of this year, so still working through this transition as we rearchitect this business for improved consistency and we believe better profitability

DTC Business

REVENUES, PRODUCT AND BRAND

- Switching to our third pillar, which is our focus on elevating our DTC business, with a 33% increase in revenue for Q2 and a 32% increase for H1 vs. 2019, we're pleased to see the results of our multifaceted strategies come to fruition
- In conjunction with consumer behavioral shifts throughout the pandemic, and an even greater appetite for product and brand experiences that are personalized, unique, and premium, we are advancing how we show up in stores and online to meet their needs
    - All of this, of course, starts with our retail and distribution teammates, who are the backbone of our business, playing an essential role in how we serve focused performers
- Ensuring that they feel valued and appreciated, we increased our minimum pay rate to $15 per hour in our US business, as part of a larger effort that includes professional learning and development opportunities and additional incentive plans
    - In combination, these actions will allow us to drive better connectivity across the consumer journey

Owned Store Perspective

- From an owned store perspective, we experienced improved traffic trends and higher average selling prices in the quarter, driving better productivity and more normalized promotions
- Longer-term, we remain focused on building the capabilities necessary to become a best-in-class retailer by creating incredible experiences in our full-price Brand House stores and better leveraging our Factory House locations to drive greater overall profit

eCommerce Business

- In our eCommerce business, revenue was down 18% in the quarter, a result that we anticipated being the most challenging of the year, considering the shift to online in 2020 following the retail lockdown
- That said, given the work we did to exit the highly promotional elements that this business experienced in 2019, along with the investments we made in our platforms and teams over the last 18 months, and we're very encouraged by a 53% second quarter increase vs. 2019 or a 55% increase for the first six months on a two-year stack
    - Throw in that we expect our eCommerce business to be up at a high single digit rate in 2021, and that puts our growth up nearly 50% on a two-year stack

Profitability

- So to wrap it up, I'll end with our last area of focus, driving profitability to increase shareholder value over the long-term
- Based on our updated full year outlook, which includes revenue being up at a low to mid-single digit rate vs. 2019, and our adjusted EPS being up meaningfully, our strategy to return to profitable brand-right growth is working
- With a high quality in composition of revenue, including significantly reduced off-price sales and less promotions and discounting, we're driving more productive dollars through our P&L, dollars that are contributing nicely to margin improvements and greater EPS, demonstrating results of our transformation and the stronger foundation we have built over the past couple of years

David E. Bergman

Chief Financial Officer

FINANCIAL HIGHLIGHTS

- At the halfway point of 2021, our second quarter results demonstrate that the strategies we've been executing against and the foundation we've worked hard to reset to increase Under Armour's capacity to return sustainable, profitable growth to shareholders are working

Operational Execution

- Our operational execution has never wavered against an incredibly challenging and dynamic global market, punctuated by COVID over the last year and a half
- Our attention to Under Armour's focused performers in delivering best-in-class innovations and premium experiences, have never been sharper
- And all of this has come together to target full year top line, bottom line, and working capital performance at better than pre-pandemic levels

Revenues

- In Q2, revenue was up 91% to $1.4B compared to the prior year. vs. our previous outlook, this overdrive was primarily due to higher demand across our wholesale and Factory House businesses
    - And, of course, in general, our second quarter results were up against last year's significantly restricted retail environment, due to the peak of COVID-impacted store closures
- From a channel perspective, our wholesale revenue was up 157%, driven by broad-based growth as we lapped the most significant impact from the retail door closures in the prior year
    - Additionally, most of our Q2 wholesale overdrive was due to stronger sell-through and higher demand in North America

Direct-to-Consumer Business

- Our direct-to-consumer business increased 52%, led by 234% growth in our owned and operated retail stores, partially offset by an 18% decline in eCommerce which faced a difficult comp as it was the primary business driver of last year's second quarter

Licensing Revenues and Product Type

- Our licensing revenues were up 276%, driven by increases in our North American partner business
- By product type, Apparel revenue was up 105%, driven by strength in our train, golf, and run categories
- Footwear was up 85%, driven by our run and team sports categories
    - And our accessories business was up 99%, driven by hats, bags, and sports masks

North America and EMEA

REVENUES AND GROWTH

- From a regional and segment perspective, second quarter revenue in North America was up 101%
- In wholesale, we continue to drive lower markdowns with tighter inventory, enabling fuller-priced sell-through

- Within DTC, we saw strength in our owned and operated stores, given the easier comparison to the prior year when most of our locations were closed for the quarter
  - This was partially offset by a decline in our eCommerce business, which, conversely, was up against a particularly tough comparison to last year
- In EMEA, revenue was up 133%, driven by growth in wholesale and DTC, with significant strength across our wholesale and distributor partners
- Revenue in Asia-Pacific was up 56%, with balanced growth across all channels
- And in Latin America, revenue was up 317%, driven primarily by lapping the store closures in the prior year
- As we move into the back half of the year, we expect the transition of certain countries to distributor models to negatively impact top line performance, particularly in Q4

Gross Margins

- Second quarter gross margin came in better than expected, improving 20BPS to 49.5%, driven by 570BPS of pricing improvements due to: lower promotional activity within our DTC channel; along with lower promotions and markdowns within our wholesale business, which was significantly impacted by the pandemic in the prior year; and 100BPS of benefit, due to changes in foreign currency

ECOMMERCE AND WHOLESALE

- Offsetting these improvements was a 460 basis point negative impact from channel mix, primarily driven by a lower mix of eCommerce and a larger mix of wholesale, including a higher percentage of off-price sales than last year, when this channel was essentially closed for most of the quarter
- Additionally, we realized 170BPS of negative gross margin impact related to the absence of MyFitnessPal, which will remain a headwind throughout 2021

Supply Chain

- And finally, a 10 basis point negative impact within supply chain, as our continued benefits in product costs were more than offset by higher freight and logistics costs due to developing COVID-related supply chain pressures

Pricing, SG&A Expenses and Restructuring Plan

- Overall, vs. our previous outlook for second quarter gross margin, we experienced lower than planned promotions enabled through higher demand, along with driving more favorable pricing
- SG&A expenses were up 14% to $545mm, primarily due to higher marketing costs and expenses tied to store operations, given most retail locations were closed throughout Q2 2020
- Relative to our 2020 Restructuring Plan, we recorded $3mm of charges in Q2, an amount less than we had anticipated due to the timing of specific executions, such as the realization of lease and contract terminations
  - Throughout the plan thus far, we have realized $483mm of pre-tax restructuring and related charges
- As detailed last September, this plan contemplates total charges ranging from $550mm to $600mm
  - It's important to note that all remaining charges are related to initiatives outlined in 2020, meaning nothing new has been added in 2021
- For the quarter, for Q3, we expect to realize approximately $40mm to $50mm in charges related to this plan

Operating Income, Net Income and EPS

- Moving on, our second quarter operating income was $121mm
  - Excluding restructuring and impairment charges, adjusted operating income was $124mm
- After-tax, we realized a net income of $59mm or $0.13 of diluted EPS during the quarter
- Excluding restructuring charges, loss on extinguishment of $250mm in principal amount of senior convertible notes, and the non-cash amortization of debt discount on our senior convertible notes, our adjusted net income was $110mm, or $0.24 of adjusted diluted EPS.
- In this respect, we are proud to report that in H1 2021, we have already surpassed our full year 2019 diluted EPS, so in a great position to finish out 2021 with strength against pre-pandemic levels

Inventory and Cash

- Inventory at the end of Q2 was down 26% to $881mm as we continue to drive improvements throughout our operating model, along with experiencing some inbound shipping delays due to COVID-related supply chain pressures
- Our cash and cash equivalents were $1.3B at the end of the quarter, and we had no borrowings under our $1.1B revolving credit facility

Debt, Loss and Convertible Bonds

- With respect to debt, during Q2, we entered into exchange agreements with certain convertible bondholders for $250mm in principal amount of our outstanding convertible notes and terminated certain related capped call transactions
- We utilized net $247mm in cash, issued 11mm shares of our Class C stock, and recorded a related loss of approximately $35mm, which is captured in other income and expenses
- Post this transaction, $250mm of our convertible bonds remain outstanding

OUTLOOK

Consumer Trends and Logistics Disruptions

- Next, let's move on to our updated 2021 outlook, where, based on better-than-expected performance in our second quarter, we've flowed through the upside for a meaningful increase for our full year
- That said, although recent consumer trends continue to track positively, we remain cautious with demand and the overall marketplace, due to both the COVID-19 pandemic and developing manufacturing and logistics challenges in key sourcing countries in Southeast Asia
- Accordingly, today's outlook is subject to our business continuing under the same general macros we've seen most recently with no significant shutdowns of manufacturing partners or retail or logistics disruptions, along with continuing improvements within the global retail landscape as we progress through H2 2021

Revenues, Gross Margins and Currency

- That said, let's start at the top with revenue, which we now expect to be up at a low 20s percentage rate for the full year
  - This reflects a low 20s percentage increase in North America and a mid-30s percentage increase in our international business

- For gross margin, on a GAAP basis, we expect the full year rate to be up 50 to 70BPS against our 2020 adjusted gross margin of 48.6%, with benefits from pricing and benefits from changes in foreign currency being partially offset by the sale of MyFitnessPal, which carried a high gross margin rate, along with higher expected freight expenses
- The gross margin improvement relative to our previous outlook is due to improving benefits within pricing, partially offset by increased freight expense related to port congestion and logistics costs, which remains a rapidly evolving situation

SG&A

- Versus 2020, we expect a high single-digit rate increase in SG&A, a rate that is less than half that of our revenue growth
- As laid out previously, it's important to remember that specific to 2021, we are taking advantage of our improved outlook and proactively making incremental investments, particularly in marketing, to build even deeper connections with our consumers
- Additionally, the other significant part of the overall increase in SG&A is higher incentive compensation, which is up against 2020 when we realized significant reductions against target levels
- All-in, of this expected high single-digit rate increase in SG&A in 2021, on an absolute dollar basis, about one-half of this is related to incremental marketing, one-third related to higher incentive compensation, and the balance related to our other underlying SG&A.
- On a two-year stack, the most significant drivers of SG&A dollar growth are the incremental marketing investments and higher incentive compensation we expect in 2021
    - Beyond these items, our underlying SG&A is planned to be up only slightly against 2019's base
- As we look ahead, remaining disciplined around SG&A and striking the right balance between growth, productivity, and profitability is our top priority

Operating Income and Margins

- With that, we now expect operating income to reach $215mm to $225mm this year or $340mm to $350mm on an adjusted basis
- Translated to rate, we expect to deliver an operating margin of approximately 4% or an adjusted operating margin just north of 6% in 2021

EPS

- All this takes us to an expected diluted EPS of $0.14 to $0.16 or excluding restructuring charges, the loss on early extinguishment of convertible senior notes, and non-cash amortization of debt discount on these convertible senior notes, we expect adjusted diluted EPS of $0.50 to $0.52 in 2021

Summary

- In summary, our full year outlook reflects the combination of the overdrive we've realized in H1 2021, along with improvements across our business, positioning us to deliver growth and stronger profitability relative to 2019

Sales, Supply and Demand

- Next, before giving more color on how we're thinking about the balance of the year, I'll highlight some headwinds that impact us more directly in H2 2021, including: lower expected sales of our sports masks;

supply and demand constraints; the absence of MyFitnessPal; lower expected sales to the off-price channel; changes to our Latin American operating model; and the exit of undifferentiated retail, which began in Q3

Revenues

- Looking at quarterly flow, we expect third quarter revenue to be up at a low single-digit rate and Q4 to be relatively flat to finish out the year

Q3

GROSS MARGINS, OPERATING INCOME AND EPS

- Next, we expect third quarter gross margin to be up 130 to 150BPS due to pricing benefits and channel mix as we anticipate lower promotional activity and lower sales to the off-price channel
- These benefits will be partially offset by: the absence of MyFitnessPal; higher expected freight costs; and changes in product mix, driven by lower sales of sports masks
- For Q4, we expect gross margin to be down, due to: negative impacts from the absence of MyFitnessPal; channel mix, driven by lower licensing revenue; and product mix, driven by a higher percentage of Footwear and lower sales of sports masks
- Bringing this to the bottom line, we expect third quarter adjusted operating income to be $95mm to $105mm or $0.13 to $0.15 of adjusted diluted EPS.

CLOSING REMARKS

- So to close out, operational excellence, flexibility, a strong balance sheet, and consistent financial management, when combined, form a model that's allowed us to transcend pandemic challenges proficiently
- Looking at the next six months and the set-up all these accomplishments provide for us going into 2022
  - We believe Under Armour is well positioned to deliver on our next chapter of profitable growth

QUESTION AND ANSWER SECTION

Erinn E. Murphy
Piper Sandler & Co.

Q

My first question, Patrik, is for you on North America. You talked about seeing that region get close to 2019 levels, despite some of the structural strategic changes that you've made. Can you just share a little bit more about what surprised you YTD to the positive on the underlying growth here in this region? And then as we exit 2021, how are you thinking about the long-term growth algorithm for North America?

Patrik Frisk
President, Chief Executive Officer & Director

A

We think, in general, the ability that we've had to execute – if you remember a year ago, we talked on this call about how we were going to continue to drive our innovation and go-to-market pipeline and continue to become more consumer-centric and focus on being able to deliver across all channels better.

I see now the results of that really playing into it. And that, in combination with the demand constraints that we've put in to make sure we're putting the right product, in the right place, at the right time, is playing out with the consistent messaging that we've been able to deliver against.

And I think the consumer patterns, of course, were very hard to predict in 2021 vs. 2020. And I think we have been pleased with how the consumer has returned, to some degree, right, into full-price retail and our outlets and also continued to shop online. Our ability to fulfill demand in terms of doing a better job of delivering a better experience, better product, better messaging, more consistently is really what you're starting to see the effect of.

So really at the essence of it is our strategy is working, and we're able to execute against it.

When we look a little bit forward into next year, I think the way to think about the current environment is there's a lot of uncertainty, right, and Dave highlighted this in terms of what we're seeing with the development of COVID-19 here in the back half. But we've built resiliency and an ability to adapt to be agile. And we're ready for twists and turns in the road, but we're not going to sway off our strategy of direct-to-consumer focus, the focused performer, and being the best we can be in athletic performance.

Erinn E. Murphy
Piper Sandler & Co.

Q

And then, if I can follow up just on the supply chain, it's obviously been very challenging for everyone, really. Can you share kind of what you're seeing real-time? How much longer are the lead times coming out of Southeast Asia? And I think going back to your Investor Day, Vietnam was maybe a 23% exposure back then. What is that now, and is there any work-arounds that you're needing to do to secure a steady flow, or as best of a steady flow, of inventory as possible? Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

I think it's a developing situation. I think that's something we're all dealing with across the industry and industries, I should say. And you're right. Ae did talk about it in our Investor Day. And at that point, it was a little bit lower than it is today.

We're really happy with how we have planned our sourcing strategy. And we talked about that actually at the Investor Day. And we've continued down the path that we talked about, where we're not reliant necessarily in all categories so much on APAC. We have a very balanced sourcing strategy across the world. And today, Vietnam, for example, that you mentioned, is about a third of what we do. But it's split, right. A little bit between Apparel and Footwear. And it's important to note that we also have a good presence in Europe, Middle East, and as well as South America, Latin America in terms of our sourcing strategy.

So we're well balanced. Does that mean we're not going to have potential issues developing? Well, we've in our outlook here, given our current view. Of course, things will continue to develop. But, again, agility here and a well-balanced sourcing platform probably puts us in a, maybe a little bit better position than most, but it's going to be a developing situation.

John Kernan
Cowen & Co. LLC

Q

Can you talk about the returns you're clearly earning on the top of the funnel and performance marketing investments you made in H1 this year, how we should think about them in the back half of the year, particularly within North America and how that fits into the revenue guidance for the back half of the year?

Patrik Frisk
President, Chief Executive Officer & Director

A

I think Dave and I and the team now are starting to feel really comfortable with the capabilities that we've put in place in terms of our ability to read and react as it relates to the messaging and the media that we're seeing through our [ph] roaming (35:46) models. And what that means now for the back half, and one of the reasons that we're choosing to invest, is that we're understanding so much better what happens to every dollar that we put into the marketplace.

And we have seen an opportunity, based on not just H1 this year, but also back half of last year and the investments we've made, that there's an opportunity for us to drive medias efficiency more in the upper funnel. So that means perhaps not so much driving more revenue this year, but really preparing ourselves for the future.

So putting money into the top of the funnel, so to speak, to drive the brand, which will give us a payoff down the line. And we're not just doing that in North America. We're doing it also in Europe in specific countries, as well as in China. And we believe that that's really important for us right now, to continue to enhance the brand. And we believe that with the capabilities that we've built, we're now able to do that in a very measured and strategic way, and looking forward to ramping it up here in the back half.

John Kernan
Cowen & Co. LLC

Q

Maybe one for you. The business generated a 9% adjusted operating margin in H1 this year. It's the highest the company has ever generated, by far. Just curious, the path to a double-digit operating margin doesn't seem that far away, but can you talk to the drivers that you think will get there? We've never seen the business lower from a margin standpoint in the back half of the year as we have relative to the front half, so I'm just curious given how strong your margin performance was in H1, if you could talk to the long-term drivers back to that double-digit operating margin, and any timing around that would be helpful as well. Thank you.

David E. Bergman
Chief Financial Officer
A

Maybe I'll take that in two parts. If you think about playing out the back half of this year, we mentioned a lot of the back half headwinds, around whether it be MyFitnessPal, demand constraints, exiting undifferentiated retail, et cetera, that are going on in the back half from a revenue perspective. We also mentioned some of the pressure on gross margin in the back half relative to some of the additional freight and logistics costs, et cetera.

So some of those things are coming into play in the back half of this year. And then also, as Patrik just highlighted, we're heavying up marketing a fair amount in the back half of the year as well from a spend perspective.

And then last, I would just point out that as DTC is a higher percentage as we get towards Q4, that brings with it more operating and SG&A costs as well.

So there's a lot of things coming into play relative to kind of the tempering operating margin in the back half of the year vs. the front half of the year.

As we think about playing that forward, we are absolutely driving down that profitable growth journey now, and we're excited about that. And we do believe that we will be able to get to a double-digit operating margin in the future. We're not ready to speak to what year that will be. But, I mean, there are a lot of different opportunities to be able to get there, whether it's: continued improvement on kind of gross to net revenue, with the health of the business that we're driving; whether it be continued gross margin opportunities relative to DTC mix increasing, and continued scale and costing benefits from that; and then, also, obviously, we've done so much work on the SG&A and cost base front that we really look forward to being able to leverage that heavily as we step into 2022 and beyond.

So a lot of different opportunities there that we'll be excited to be able to speak more to in the future.

Jim Duffy
Stifel, Nicolaus & Co., Inc.
Q

A couple questions for me. A lot of shifting sands in the environment, right? I'm trying to understand the impact of stimulus. Can you guys maybe speak to what you saw with retail door productivity cadence across Q2 and into July?

Patrik Frisk
President, Chief Executive Officer & Director
A

I think the way to think about stimulus is that it certainly had an effect on the consumer, keeping the consumer in the market. We think that that's now also, as we think about August, September, and especially Q3 here, turning into what could be a more – I've got to be careful what I say here, but a more normalized back-to-school perhaps, in terms of we think that, for us, as a brand, the back-to-school and also the back to sports, right, back to team sports, is going to be an opportunity for us specifically.

So I do think that the stimulus has played an effect, of course, here on H1. We think that as things maybe normalize here a little bit more in terms of the pattern of the consumer, that's going to help drive business in H2.

David E. Bergman
Chief Financial Officer
A

You covered it pretty well.

Jim Duffy
Stifel, Nicolaus & Co., Inc.

Q

And then, Patrik, it's really encouraging to see the brand successfully engaging with consumers in the US and selling more full-price. How does this leave you thinking about pricing power? Is it too soon to ask consumers for more on like-for-like products, or do you feel the brand is in a position to price for value and offset some of the rising input pressures?

Patrik Frisk
President, Chief Executive Officer & Director

A

I think it's – the way to think about it, I think, is that as we are now in this year and from an Under Armour perspective, what we clearly are seeing as everything comes together for us, is that we're able to sell more full-price product at lower discounts. And our gross to net is continuing to improve. And you see that coming through in the gross margin.

I think in the future, though, as you kind of think about that into 2022 and beyond, there's certainly opportunity for us to have some power, if you like, in terms of the brand continuing to improve, to also raise prices. And we'll do that, as we always try to. And I think we'll have more opportunity now as we become stronger as a brand. And so more to come on that.

Brian Nagel
Oppenheimer & Co., Inc.

Q

So a question I want to ask, it's a bit of a follow-up to some of the other questions, but there's a lot of cross-currents in the consumer environment right now. And a lot of companies are putting up good numbers. You're doing so here on the back of significant repositioning and investments you've made over, now, the last few years or so. So as you look at the business today and given what's happened in the back half, how much do you think this, the acceleration of strength we've seen in H1 2021, is a reflection of what Under Armour has been doing to reposition?

And then on top of that, are you seeing evidence that the new product you've been introducing is really helping drive these top line gains?

Patrik Frisk
President, Chief Executive Officer & Director

A

And I think what we're really proud of at Under Armour is the balance that you see coming through. And our growth is balanced and it's holistic, right. If you think about our ability to grow across all of our regions, grow across our categories, and to do that everywhere with a better gross to net. Our ability to execute, to get the right stuff, to the right place, at the right time, and to be able to build franchises, especially in Footwear, is something we were never able to do before.

And I'd just like to point out here specifically in the run category, I think, in the last few years, we've done a great job instilling a franchise mindset on our HOVR platform, where we now have six or seven franchises and we're now into things like the Sonic 4 and the Machina 2 and the Infinite 3 and so forth. And this year, layering on top of that in a pandemic year, kind of halfway post-pandemic year, whatever you want to call it, actually an elevated expression in terms of a franchise with the Flow that came out in early spring that did incredibly well.

What was interesting for us was the fact that the HOVR platform continued to perform incredibly well, especially the Machina at $150. So you have now a running shoe at $160 and we just introduced the Flow Velociti SE a few weeks ago, and that is also cranking. So I think it isn't as easy as saying that we're just following the trend. I think that we're doing all of the things I just talked about with constrained demand, with making sure that we are being – running a better play in terms of profitability and execution.

So it's really truly, I think, a holistic approach from Under Armour, and what I think we're proving out is that this focus that we put in place around athletic performance, the focused performer, sticking to that strategy, being consistent, executing well, is now playing out.

Brian Nagel
Oppenheimer & Co., Inc.
Q

And then this is a follow-up question. As we head towards back-to-school – again, you talked a little bit about this with your outlook comments, but have you seen any – as we've started to have this sort of resurgence in COVID in certain markets across the country, have you seen any disruption to your business as that's happening?

Patrik Frisk
President, Chief Executive Officer & Director
A

I think currently, we see it more from a Southeast Asia perspective as it relates to store closures a little bit, for example, and the supply chain that we talked about before.

We're not necessarily seeing it yet with the consumer, I think, in North America, but it is a little muddy, right, because you've also got back-to-school happening, so people really have to get out there to get stuff. So I think it's a little early yet here in North America.

Does that mean it's not going to come? I don't know. I think your guess is as good as mine. I think the way we're approaching it, though, is the fact that what I've seen from our teams here at Under Armour is an incredibly resiliency and an ability to adapt and be agile in this pandemic situation. And it's built that resiliency for us. So we're ready to be able to navigate twists and turns here in the road going forward with that agility.

And the new operating model we have. We have very strong leadership that are able to execute at every level. But we do believe, and that's what Dave called out in his remarks, that it's going to be twists and turns in the road here as we look in the back half of this year, for sure. And it's going to be a little bit different depending on where you are. Europe is in and out a little bit. North America's still holding, but probably is going to be a few twists and turns. And then, we have the supply chain in Southeast Asia to deal with. So it's a very fluid moment right now, I think, in terms of what's going to happen next.

Matthew R. Boss
JPMorgan Securities LLC
Q

Maybe as we think about potential for the more normalized world that you laid out that hopefully we see in the back half and beyond, I guess maybe where do you see product execution, product opportunity across Apparel and Footwear today vs. how best to think about the evolution of your game plan on the product side as we think about 2022 and beyond?

Patrik Frisk
President, Chief Executive Officer & Director
A

It's one of my favorite questions, because one of the things that's so exciting about Under Armour right now is our innovation pipeline. And we talked to you guys, as I said here to Erinn earlier today, we decided last year, as we went into the pandemic, that we were going to execute on our innovations and our go-to-market, which is what we've done.

I think this increased laser-focus that we have on consumer-centricity is also helping us understand how to cadence things, how to tune things, and how to really drive not just our innovation, but our go-to-market holistically. So we have now learned, as a brand, how to drive franchises in footwear. We have also learned how to drive specific initiatives like Curry, like the Rock, but we've also learned how to do all of that executing excellently all the way upstream.

So for us, it's really about continuing the play now. Stick to the strategy. Execute the play. Stay consistent. Spend a little bit more in marketing to drive the brand. And when we come out of this pandemic, we're going to be ready for growth.

Matthew R. Boss
JPMorgan Securities LLC

Q

And maybe just as a follow-up, David, on the expense side, what level of revenue growth do you believe is necessary to leverage SG&A multiyear? If we were just thinking or looking for a baseline about how to think about the model going forward, revenues to expenses, how best to think about it?

David E. Bergman
Chief Financial Officer

A

At this point, we've highlighted how, outside of marketing and outside of incentive compensation this year, we expect underlying SG&A to only grow 2% to 3%, and that that same underlying SG&A vs. 2019 is just growing slightly.

So I think those are pointing towards where we've been able to drive that cost base towards. I'm not saying that that's what the growth will be next year, but I'm saying that we are into a much, much better place. And I think Patrik and I, combined with our leadership, really have the right financial discipline and understanding, combined with enterprise mindset, to make sure that we're prioritizing our investments and not letting that cost structure get to any much larger standpoint at longer term.

So we're continuing to look at each spend. We're continuing to prioritize. We're continuing to also invest in the key areas that we believe are critical for our growth. But at the same time, we've got to make sure that we continue to leverage.

So I think we're well positioned as we go into 2022 and beyond. There's a really solid understanding around the leadership of how to drive that growth more profitably going forward, and that's what we're going to be looking to do.

Simeon Siegel
BMO Capital Markets Corp.

Q

If I can go back, just to conceptualize the North America comment, so having North America revs almost hit 2019 is really fantastic. To your point about the difference in the health of those revs, can you just speak a little bit about how the 2021 AUR in units would compare to 2019 embedded within that full-year guide? And then you've touched on it, but maybe how are you thinking about as you move forward, AUR in units going forward, just as we think through channel mix and the different implications of the quality of sale? Thank you.

Patrik Frisk
President, Chief Executive Officer & Director

A

I would say that in general, gross margin tells the story here, to a large extent. And AURs are positive more or less across the board. And we believe that there is – we talked a little bit about pricing power here before. We believe there is opportunity for us as we go forward.

And what's exciting is some of the examples I've given already in terms of footwear, for example. The ability for us to push upward, right, in terms of the $160 Flow, for example, that just came out this year. And we tend to forget that if you back up to 2018, when we launched the HOVR platform, which was really our first foray into a concerted effort at driving into the run category footwear category, if you like, we started at that point at $100 and $120. We then took ourselves up into $130, $150. And then, we now went up into $160.

That kind of thinking and progression as we drive franchises also in Apparel, whether it is our RUSH technology, or in our Iso-Chill technology, is the same sort of thinking, right. We're building franchises. We're building an ability to drive the AURs up over time as the brand gets stronger. And the teams are now doing an excellent job of orchestrating that play, because it is an orchestration, at the end of the day. You got to do it in a very determined and appropriate way, and everything has got to come together. And I think that is what you see, is an ability to execute on that from the brand. So that should give everybody optimism for the future.

David E. Bergman
Chief Financial Officer

A

Maybe one further comment, too, on North America when you compare back to 2019, we're getting close to that same level. But that's also with cutting our third-party off-price liquidation channel pretty close to in half since 2019. So even with that headwind, being able to get back to that level and do it in a much more premium way and a less promotional way, is something that we're really excited about.

Simeon Siegel
BMO Capital Markets Corp.

Q

That's what I was trying to figure out. It would seem that, even on the same level of revs, you're doing it on fewer units. So speaking to the health comment. So that makes a lot of sense.

Simeon Siegel
BMO Capital Markets Corp.

Q

Sorry if I missed it, did you guys – just to the mask business from last year, could you remind us how large it was, just so that we understand the underlying growth rate that's embedded in the guide for the rest of the year?

David E. Bergman
Chief Financial Officer

A

I appreciate the interest in that. It was definitely a decent business for us that we built up a lot in the back half of last year, and it continued to be a reasonable business for us in Q1 and Q2. And we are expecting that to diminish a fair amount in Q3 and especially Q4 of this year. And it is a driver within our Accessories product category. But we haven't been giving the exact dollar or percentage of that amount.

Sam Poser
Williams Trading LLC

Q

I first would just – I want to just understand something. You talked about demand constraints, or are we really looking at supply constraints that are built into the guidance?

David E. Bergman
Chief Financial Officer

A

And I would say that, to be honest, it's a little bit of both. We've definitely employed demand constraint that we started to go into a little bit last year from a planning perspective. But the real impact is coming into this year relative to buying much, much tighter to demand, especially with certain accounts, non-premium accounts or things like that, that we've been stepping out of. So there certainly is a demand constraint impact going on that we're expecting to be bigger in the back half of the year. And we're doing that for the right reasons.

But in addition, yes, our forecast does contemplate some of those supply chain pressures. We are seeing a little bit of delays in some of our product. And that could lead to some cancelations here and there and other pressure points. So we have included that in what we expect in our outlook for the back half of the year, to a reasonable degree. So it's a little bit of both.

Sam Poser
Williams Trading LLC

Q

I have two more. Just one quick follow-up on that. Your exposure to the southern part of Vietnam, where most of the issues are right now, what kind of exposure do you have there? And when would that impact the supply going forward, taking out of it all the truck issues and all the other things? Just trying to focus on that.

Patrik Frisk
President, Chief Executive Officer & Director

A

I think coming back to the fact that we have about one-third of our supply chain coming out of – or our supply coming out of Vietnam and about half is – it's about half and half Apparel and Footwear. And currently, we have experienced some things happening already, right, from Vietnam in terms of what the impact is, not just on the actual manufacturing, but also to your point, the logistics and some port congestions and container availability and other things.

But I couldn't give you, at this point, an exact number from south vs. north, to be honest with you. It's about a third, in total, that we have coming out of there. But we're monitoring it. And, as you know, it's a very fluid situation right now in terms of what's currently going on and how that thing is spreading.

Sam Poser
Williams Trading LLC

Q

And then lastly, and I think it's to John Kernan's question on the marketing, you're spending a lot of the marketing to build for the longer term, which I appreciate. But are you – it sounds like based on the results that you saw in Q2, that some of this long-term marketing is turning into – you're getting short-term benefits on this long-term marketing. And if that's so, how much of that may be built into the back half guide?

Patrik Frisk
President, Chief Executive Officer & Director

A

Absolutely we are seeing some of it. That's clear. And it's not just in North America. It's also we're seeing some of that happening in EMEA as well. And in terms of that expectation, because of everything that we're playing out in terms of demand constraint and how we're thinking about inventory levels and how we're driving that, we don't really have an opportunity to, let's say, drive a tremendous amount of upside based on the marketing.

David E. Bergman
Chief Financial Officer

A

Again, most of that spend and that increased investment that we've been opportunistic around and planned for in the back half of the year is more top of funnel brand-related marketing. It's not as much related to direct eComm or things like that.

So we do expect more of that benefit to be in 2022 and beyond, but, obviously, some of it helps with brand awareness and consideration in the current year. And we are probably seeing some favorability from that.

But, again, the back half of the year, we do have to be careful with the supply chain pressures we just talked about and some of the delays and impacts that that could have, along with the other headwinds that we outlined.

Q

Looks like your revenue guidance this year suggests North America sales will be down, call it, low to mids, and the back half of the year vs. 2019, it was up in H1. I was just curious if you could help us understand the impact of exiting undifferentiated retail in North America within that guidance? And any more detail on the strategy, how many retail partners do you have, how many do you expect to exit over time, and should we expect you to exit any bigger accounts, or will this be smaller independents? And then, just lastly, how much do you expect to recapture within your own DTC channel? Thanks.

David E. Bergman
Chief Financial Officer

A

I mean, the outlook that we have for North America does contemplate a bigger impact in the back half of the year relative to the demand constraint work but then also exiting the undifferentiated retail.

We've been in that kind of 12,000 to 13,000 door range that we're going to be working down towards about 10,000 doors, and that is in process. A lot of that is the work that we're driving through and the changes that we're implementing this year. So most of that will be behind us. And that exit is not really a huge part of the headwind, but it is a factor.

And when you think about those accounts, again, the accounts that we're exiting, most of them are not large partners. Most of them are going to be partners that we feel are not supporting the brand as well. They're not as aligned with focused performer. They could be some very low volume or low margin doors for us. And so, we're being very strategic in how we approach that. And although the number of doors that we're decreasing is significant, because a lot of them are smaller volume, it doesn't have as dramatic of an impact on revenue for 2022 and beyond.

Q

And then, you mentioned some shelf space gains with key retailers in North America, which is great to see. Could you just elaborate on how exactly that's materializing? Is it in your core Apparel business, Footwear, Men's, Women's? And just more broadly, which area of the business are you feeling most optimistic about further shelf space gains as we look to the back half and beyond?

Patrik Frisk
President, Chief Executive Officer & Director

A

I would say it's broad and it's across categories and it's happening incrementally season-over-season. And a lot of it is with the new product that's coming out, right, that's driving the brand, the innovation. And it's great to see that it's happening also in Footwear right now.

So for us, we're going to continue that. And that is the plan. We're going to earn back the shelf space. And better sell-throughs, higher AURs, better gross margins, all of that stuff helps, right, to drive. And that's why it's also important for us to do this extra marketing spend this year is to continue to also make sure that we're driving the awareness and consideration to help our wholesale accounts, so that we can ultimately earn back even more shelf space.

But we're making good progress. I'm very, very pleased with it. It's, again, very balanced, very holistic, and very much broadly for the brand. So it's good news, and more good news to come here, hopefully.