31-Jan-2017

Under Armour, Inc. (UA)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Lance Allega
Vice President-Investor Relations

NON-GAAP FINANCIAL MEASURES

- Additionally, we may reference certain non-GAAP financial measures
- We provide a reconciliation of non-GAAP financial measures in our earnings release and in the electronic version of portions of the script from today's call, both of which are available on our website at uabiz.com

Kevin A. Plank
Chairman & Chief Executive Officer

BUSINESS HIGHLIGHTS

Opening Remarks

- As many of you know, Lance has exceptional experience in our space, and we believe that his leadership along with Carrie Gillard will enable us to further strengthen and better communicate our story moving forward
- In addition to our earnings results this morning, we also announced that Chip Molloy has decided to leave Under Armour for personal reasons

- With this marking Chip's last call, I'd like to say thank you and wish him well in his future endeavors
- Chip will continue to serve in an advisory role for a period of time

Executive Appointment

- Dave Bergman, our SVP of Corporate Finance, has been named as our acting CFO effective February 3
- With more than 12 years at Under Armour, Dave has incredibly deep experience across multiple senior roles within the core financial functions of the company
- The board and I have high confidence that he is exactly the right person to provide continuity, and ensure no disruption to our operations

Sports Marketing Assets

- And with that, good morning everyone
- 2016 was a strong year of performance for Under Armour
- We marked our twentieth year in business
- Added sports marketing assets like Cal Berkeley, UCLA and the Southhampton Football Club in the English Premiership
- Announced a new relationship with Major League Baseball
- Debut the Under Armour Sportswear collection, gained incredible brand visibility at the Rio Olympics with U.S. gymnastics and Michael Phelps
- Approached 200mm users in our Connected Fitness community, and hit $1B in both our footwear and women's businesses
    - These are just some of the outstanding accomplishments that we had in 2016 that we're fiercely proud of as a brand
- However, 22% top line growth driven by a 15% increase in apparel, more than 25% growth in our DTC business, and 50% growth in footwear doesn't describe the whole story and shapes the way the year played out for us, specifically our fourth quarter

North America

- While it's certainly not new news
- throughout 2016; bankruptcies, channel dislocation and destocking combined to disrupt the overall North American retail landscape
- We're still a very young company internationally, and 85% of our global revenue comes from North America
    - So a large exposure, but with 63% growth, we have momentum toward greater global balance

FY Targets

- Before diving into what happened in Q4, I think it's important to level set using our last call
- When we spoke with you in October, through the first nine months of the year, we were on track to hit our full year targets
- We had just come off a very strong back-to-school selling season where we saw momentum in the Under Armour business, despite some challenges in the market

Market Share

- Following the liquidation of a major partner, we believe that lost market share would be absorbed by other parts of our business and saw signs to that effect throughout the year
- And as we looked out to Q4, we were bullish in our assumptions, based on a long-standing history of auto replenishments, and at higher full priced cold weather product and DTC traffic built-in

Core Product

- So first, I'd like to explain a few things
- What happened, what we learned, and what we're doing about it? So let's start with what happened
- In Q4, slower traffic caused significant promotional activities earlier, deeper and broader than expected
- This commoditized some of our more basic core product that had previously sold through for us in years past
  - This, in addition to higher demand for more lifestyle silhouettes caused us to be out of balance with our assortment
- So we lost top line volume as we work to adapt through our mix and pricing

Bankruptcy Volume

- Now to be fair, we did comp positively in the quarter in both our retail stores and our e-commerce channel, but ultimately the result was below original plan
- There was also lower channel recapture of bankruptcy volume that we had expected as pricing came down in the points of distribution that we serve
- And finally, we say out of balance with our cold-weather product assortment that was on the floor, which in years past have been able to absorb through full price sales

Segmentation Strategy

- So what have we learned? We learned there's a greater opportunity for better differentiation among our basic core product to better cut through the noise
- We learned that our segmentation strategy could be sharper, that being premium at every price point and having the right product for the right consumer at the right time is the price of admission
- And we learned that when we play in a discounted environment, we can drive volume, and win, but the role both we and our retailers expect us to play is as a premium full price brand
- We were also validated by the fact that as our strong portfolio of footwear, international and DTC growth engines scale, we will be better positioned to deal with imbalances like this going forward

Consumer Demand

- We know that we own this
- So what are we going to do about it? We're working to evolve our selling strategy to better align with what consumers want, with what consumers need
- Tacking our 2017 assortments to ensure that our largest volume drivers are in better balance with fresh, new product on the floor at key points in each season
  - This is our merchandising functions' key priority for the year
- This means amplifying our agenda for newness and innovation at every price point as our partners expect Under Armour to be the premium brand of choice in their stores

- We're also accelerating our lifestyle product offering to capture broader demand, and we're working within our new category management structure to be better merchants and closer to our consumer

Growth Strategy

- All this said, we have a responsibility to perform every quarter
- We have an imbalance due to the function of our extreme growth that we see as a massive opportunity at its core
- We understand very clearly the root causes and reasons behind this imbalance, are humbled by it, and as the fastest-growing brand in our sector over the past 20 years, absolutely have a pathway through it to emerge even stronger going forward
- And it's a pathway based on a record of success, a dedicated and talented management team, incredible brand strength, and a smart and diversified growth strategy

BUSINESS STRATEGY

- And with that, I'd like to take a few minutes to underscore the strength of our business strategy and reflect on our thinking around the current environment and our largest growth opportunities going forward
- I want to be clear: our growth story is intact
- Our brand is truly stronger than it's ever been, and we are actively managing our growth
- We are in command of the things that we can control, and yes, operating in an environment with many things that we can't control, but what you won't from us today are excuses, hope-based expectations or complacency

INVESTMENTS

- But you will hear about the deep foundation we built for growth, and the confidence that we will capitalize on our competitive advantages
- Moreover, while we will continue to optimize our business and demonstrate prudent investment, there is no change to our growth strategy or investment thesis which remains laser-focused on delivering sustainable, profitable growth and creating value for our shareholders

UNDER ARMOUR DISTRIBUTION HOUSES

- The investments we've made and continue to make in talent, architecture and systems from SAP's enterprise resource planning platform, Connected Fitness and our merchandising capabilities
- Two, our move toward category management in 2016; the addition of DCs, or what we call at Under Armour distribution houses, and supporting the incredible growth of our international business
    - These are the investments, the backbone of $5B company building $10B infrastructure

International Business

- Very rapidly, we delivered industry-leading innovation, significantly accelerated our footwear business, expanded our direct to consumer channel, broadened our global wholesale distribution, grown our lifestyle offering and have gained strong traction in our international business
- And these efforts are paying off
- In fact, we've over-delivered against our own expectations in these strategic growth areas, including a 31% five-year revenue CAGR for our DTC business, 41% for footwear, and 53% for our international business

- Importantly, each of these areas grows by keeping our consumer centrally aligned with our business and evolving our organization and capabilities along with them when, where and how they train, compete or express their own individuality
  - We continue to strengthen our foundation and capacity to meet their demand

Leveraging

- Being a growth company means that we're in a constant state of evolution
- In 2017, we will remain on offense by continuing to invest in our fastest-growing businesses and leveraging our unique strengths and competitive advantages, and we have a lot of advantages:
  - Innovative product, brand strength, a broad base of premium sports marketing assets, unparalleled consumer connections and a strong, strong management team
- Staying on offense, however, does not mean growth at any cost
- It means striking an appropriate and responsible balance for the health of the brand in the near and long term

Revenue and Operating Income

- In the near term, we expect to add about $600mm in revenue this year, but based on all the factors we experienced in Q4 and looking toward 2017, we expect operating income to be down by about $100mm
- So the natural question is, why? Why is operating income going backwards? That is what we believe to be the near-term cost to ensure our path to becoming $10B brand
  - So let me explain why it's important to pay this price now

SG&A Spend

- First, operationally
- Given lower than anticipated revenues, while we are immediately taking measures, we can't reduce our SG&A spend enough in the near term to match our revenue opportunity for meaningful impact in 2017

Footwear, International and DTC

- Second, strategically
- We believe it's critical that we maintain our investments in innovation in our footwear, international and DTC to ensure we reach the opportunity that we see for these businesses
- Again, that doesn't mean we're investing with disregard to the bottom line, but instead we are making a strategic choice to take advantage of this environment to position ourselves to lead within our industry, build a stronger company, and safeguard a pathway toward more consistent future value for our shareholders

Product diversification

- Over the last 20 years, Under Armour has experienced tremendous growth
- As our product diversification and geographic and retail expansion strategies continue to gain critical mass globally, our business has gotten more and more complex
- In my office here in Baltimore, I keep white boards
- I use them as a way of organizing my thoughts, ideas, business plans and strategies
- And recently with all the things written on them, I cleaned them all off, and I wrote just one phrase: make UA simple

- And that's just it
- As we pass through $5B on our way to $10B, we must get better, faster and smarter at what we do, why we do it and how we do it
- And in a way, that is simple and humble

Investments

- So in addition to maintaining appropriate investments in our largest growth drivers, we have begun to work across all areas of the company to look for opportunities to calibrate, streamline and prioritize our business toward a stronger, leaner and more responsive organization

SUMMARY

- In summary, our strategy positions us well to navigate the near-term challenges in our largest market while ensuring the underlying momentum stays squarely on track to drive consistent, profitable growth in our fastest-growing businesses to lift all boats in the harbor
- Our goal is to take UA from a great brand with good operations to a great brand with great operations
- We've got some work ahead of us, and we'll use 2017 to focus on increasing our operational discipline as we look to build out our $10B business

Chip Molloy

Chief Financial Officer

Q4 HIGHLIGHTS

Revenue

- Today, I will review our fourth quarter and full year 2016 results before handing it over to Dave, who will provide an updated outlook on 2017
- Starting with our fourth quarter
- Total revenue was up 12% to $1.3B
- Clicking down into revenue by product type, for reasons Kevin detailed, apparel revenue came in lighter than we had originally anticipated with an increase of 7% to $929mm
  - We did see strong results from our sport categories including golf and basketball
- Footwear revenues increased 36% to $228mm, as both running and basketball delivered strong growth driven by more premium product offerings
- And, revenues for accessories increased 7% to $104mm with solid results in our bags and headwear businesses

Revenue by Channel

- Looking at revenue by channel
- Sales to our wholesale customers were up 5% to $742mm, a result moderated by the challenges in our North American business that we've spoken to today
- Our direct-to-consumer revenues grew 23% to $518mm, representing approximately 40% of total revenues for the quarter
- We finished the quarter with 241 owned stores globally, consisting of 188 Factory House and 53 Brand House locations

LICENSING BUSINESS

- Revenues for our licensing business grew 20% to $30mm, and Connected Fitness revenues grew 8% to $18mm
- On a regional basis, North American revenues, which are 82% of global total, increased 6% to $1.1B
- It's important to note that North American apparel is still our largest and most profitable business by far
- Accordingly, less than expected growth in this area disproportionately pressures our overall growth rate which we saw in Q4

International Business

- Our international business continues to deliver strong top line results as we elevate and expand our brand reach around the world
- With a 55% increase to $215mm, our international business reached 16% of total revenues in Q4
- Excluding currency, revenues were up 60%
- The continued momentum we saw in Q4 across all of our international regions, especially in the Asia-Pacific region, gives us increasing confidence in the investments we have made and the strategy we have executed against to scale our brand around the globe

Margin

- Turning to margins
- Fourth quarter gross margin decreased 320BPS to 44.8% compared to 48% in the prior year's period
- The decrease includes a negative impact of approximately 230BPS, driven by higher discounts and promotions partially offset by continued improvement in product input cost, and about 90BPS of negative impact from the continued strength of our footwear and international businesses, which carry lower margins

SG&A Expenses

- Selling, general and administrative expenses grew 9% to $420mm, an increase predominately driven by investments in our direct-to-consumer business including both physical and digital concepts, and infrastructure necessary to support our strategic growth initiatives
- The overall SG&A increase was lower than planned due to incentive compensation

Operating Income and Tax Rate

- Fourth quarter operating income decreased 6% to $167mm
- Interest expense for Q4 increased to approximately $8mm compared to $4mm in the prior year's period
- Within other expense, we recorded a loss of $1.7mm in the current year vs. a loss of $2.2mm in the prior year
- In addition, the tax rate in Q4 was 33.2% compared to 38.4% in the prior year, due to a higher mix of international sales and profitability, and a tax benefit related to our prior year acquisitions
- And finally, fourth quarter net income decreased 1% to $105mm

BALANCE SHEET ITEMS

Cash and Cash Equivalents

- On the balance sheet, total cash and cash equivalents for the quarter was $250mm compared with $130mm at December 31, 2015
- Inventory for the quarter increased 17% to $917mm and total debt was up 22% to $817mm

CapEx

- Looking at our cash flows, our investments in CapExs was $92mm for Q4 compared to $85mm in the prior year's period

Revenue

- Moving on to the full year
- Revenues in 2016 grew 22% to $4.8B, up 23% on a currency neutral basis
- By region, revenues in North America were up 16% and international revenues grew 63% to reach 15% of our overall business

Wholesale

- By channel, wholesale revenues grew 19% to $3.1B
- Our direct-to-consumer revenues grew 27% to $1.5B and was approximately 31% of total Under Armour revenues for the year
- Licensing revenues grew 19% to $100mm and Connected Fitness revenues grew 51% to $80mm

FY Gross Margin and SG&A

- Full year gross margin declined 160BPS to 46.5%
- The decline was primarily due to actions to better manage our inventory including discounting, especially in the back half of the year
- Mix shifts toward our footwear and international businesses, which carry lower margin, also negatively impacted margin, partially offset by our continued focus on product input cost improvements
- Full year SG&A grew 22% to $1.8B and operating income grew 2.9% to $420mm
- Net income decreased 11% to $259mm

David Bergman
Senior Vice President, Corporate Finance

Q4 HIGHLIGHTS

Revenue

- Starting with revenue, based on the macro factors we've discussed on today's call, and proactive actions to manage inventory levels down in the marketplace, we expect full year revenues to be up approximately 11% to 12% to nearly $5.4B in 2017
- Excluding currency impacts, revenues should be up about 12% to 13%

- Similar to 2016, we expect our footwear, international and direct-to-consumer businesses to be the largest drivers of our top line results outpacing the total rate of growth as we further scale and expand these businesses

Gross Margin

- Next, gross margin
- We expect our 2017 gross margin to be down slightly, as expected benefits and product costs are offset by anticipated changes in foreign currency and continued sales mix shifts as our footwear and international businesses continue to outpace the growth of our higher-margin apparel and North American businesses
- Changes in foreign currency are expected to pressure gross margin throughout 2017, but we believe we will be able to offset some of this margin pressure through our continued focus on product cost improvements along with reduced promotional activity, especially in the back half of the year

Near-Term Investments

- Given the near-term investments that we are maintaining in SG&A, we're expecting operating income of approximately $320mm in 2017
- You've already heard it a few times today, but I will make the point again
- We are $5B business that has been rapidly investing toward an infrastructure capable of supporting $10B company
- Along these lines, we remain confident in our long-term strategy and have a pathway to get us there
- At the core of this journey is a constant, unwavering commitment to protect and do what's right for the brand

Key Investment Strategy

- Accordingly, we believe it is prudent to maintain our key investment strategy focused on growth, share and scale
- However, this inflection point provides an opportunity to manage the operations of our business differently and strive to be a more effective and efficient organization
- Consequently, we are evaluating our capital spend and our operational processes and their associated impact to our overall cost structure with a focus on streamlining and removing complexity, while protecting long term growth investment areas

CapEx

- We've already begun this process and can see some of the initial results of our efforts through targeted areas like CapExs
- For 2017, we're planning CapEx of approximately $400mm, which reflects a significant reduction from the run rate we laid out at our last Investor Day
- Beyond CapEx, we are working through the rest of the business as well to uncover and maximize the critical areas necessary to deliver sustainable, profitable growth and run a more operationally effective company

Tax Rate

- With respect to our full year effective tax rate, we're assuming a 32% to 34% range

- Also to note, due to the magnitude of discrete items within the first two quarters, including the required implementation of accounting rules related to the tax treatment of equity compensation, we expect the rate in H1 to be significantly lower than the full year
- We plan to provide more details on our first quarter effective tax rate in our 10-K as filed in February

Revenue

- Next, I want to provide a little more color on Q1, starting with revenue
- We anticipate Q1 to grow at a mid-single digit rate as fourth quarter conditions in North America carry over and will have not yet lapsed some of the significant bankruptcies we saw in 2016

Gross Margin

- We're expecting first quarter gross margin to be down almost 100BPS y-over-y as many of the same factors from Q4 pressure our margins, including foreign currency impacts and higher promotions and discounts
- Given the expected run rate of SG&A, we are expecting a first quarter operating loss of approximately $12mm to $14mm

Inventory

- Finally, a comment on inventory in 2017
- In our efforts to manage the brand appropriately for the marketplace, we are planning for inventory growth to be higher than revenue growth for the first three quarters of 2017 and coming more in line with revenue growth during Q4

CLOSING REMARKS

- In closing, I want to reiterate the commitment our team has to driving the right level of investment to deliver prudent, long term sustainable growth, while also becoming a more operationally efficient company

QUESTION AND ANSWER SECTION

Omar Saad
Evercore Group LLC

Q

First one, Kevin, if we think back to your last Investor Day, and you guys really pushed the accelerator pedal looking across the board at all the different various opportunities ahead for the company, international, women's, e-commerce, youth, Sportswear, Connected Fitness, footwear, the new headquarters, on and on. At this stage given the bump in the road here, is it time to kind of refine that focus, and think about maybe the top two or three, or three or four, growth opportunities that are most scalable in the next few years and then allocate both financial and human resources accordingly? Or is it kind of stick to that same plan?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Now I want to be clear that, first of all, the investment thesis that we have of investing in the growth drivers, and we talk a lot about the success that we've seen in footwear, international, DTC and so we're of course doubling down on those. But some of the other bets have not come to fruition yet, and the ones that we are still investing and are still curating.

At the same time, watching things that – we made similar comments years ago in talking about things like our footwear and our women's business which both crossed $1B this year. So I think that we've built – when we established a lot of credibility, we're showing you that when we put in and make investments that they definitely bring return. And some of them, frankly, haven't happened as quickly as we wanted to.

When we think about some of the shifts of what we've been investing in, we were a North American company. And go back just, 2014, 9% of our business was outside the United States. In 2015, it was 11%, and 2016, 15%. As we look forward to 2017, we expect that number to be approaching and crossing 20% of our business. And so the move from North America to rest of the world is something we're proud that we've invested in. And we think it's prudent to continue to make those current investments.

The move that we made from performance in the lifestyle is one where this began more than three years ago, and we still see that we're not quite there with everything that we want to do, but we've made massive strides with the launch of Under Armour Sportswear, the leadership we've put in place in building out the team. And then also I think the move that we've made from wholesale to direct consumer, these are just some of the investments that have proven for us to the point that I want to be clear is that we're not sitting here saying that, we're just going to slam our fists on the table and invest in anything that we see. We want to be prudent. We are business people. Our eyes are wide open. We are unemotional about this, but we also want to make sure we continue to invest in and protect the brand.

We have without question one of the strongest brands, obviously, we believe in our industry, and we're going to make sure that that happens. And frankly, some of the things that we've seen, which was a very top line-driven focus as to get to these to allow us to continue to invest in the brand, we've seen a little bit disrupted just because of the nature of where and how we're selling and the environment that's been created around it with promotion. And so that's some of the balance I think that we've been dealing with as a company, is making sure that we are prudent, we're thoughtful, we're protecting the brand, and that we are leaving ourselves the room to grow.

And so, of course, we're going to be prioritizing investments. There will be things that will come off the list, and we feel good about the pieces that we're in right now. But we're going to begin with tightening our own belt in SG&A and some of the obvious ones, but we feel confident about our ability based on our track record to continue to make the right decisions of where that means and where that matters.

Omar Saad
Evercore Group LLC

Q

Okay. Thanks. And then could I ask just another question, maybe if you could expand on a comment you made I think in the prepared remarks around some trends going on in the apparel business, maybe moving away from performance more to fashion or lifestyle? I know that UA Sportswear line is still kind of pretty nascent, but maybe elaborate on what you're seeing from that standpoint. Is there some pretty deep going on at the consumer level? A shift towards more fashion-oriented athletic apparel vs. performance oriented? Obviously, Under Armour is known for its technical performance. And if this is the case, how do you evolve the brand a little bit to be really relevant on both sides of that fence?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Yeah. I don't think there's – I think that performance was something which was, when I look back at it, we're a company that was founded in the equipment section of a sporting goods store. and then we evolved to the apparel section. And then all of a sudden it became something that wasn't just for a football player, or a baseball player, or a lacrosse or soccer player, but something that could be worn skiing or could be worn out. And so we've watched this progression over our 21-year history. And I feel like it's still in the process of happening.

Performance is certainly not dead. Performance is something that is actually a requirement. It's actually just expected, and it's almost given information now. And so where I believe some of the things that we saw in Q4, which is where we've had a base of a core basic business, is it's no longer just a few brands in sporting goods that are participating in this athletic inspiration. And so there's really a lot of competition coming from everywhere, but without question we believe that we're in the perfect position to continue to win.

We need to become more fashionable with the products that we have out there. And one of the things we found is that some of the core basics were some of the challenges that we saw, is that we are counting on core basics as we have in years past to do more work for us. But the consumer today frankly has more options, and frankly most of those options are from good brands that we compete with, that are heavily discounting as well.

So what you'll see is that I don't think it's one shift of abandoning one for the other. Obviously, with things like the investment we're making in [ph] UAS (31:30) in sport lifestyle in general, but we need to become more fashion. The consumer wants it all. They want product that looks great, that wears great, that you can wear at night with a pair of jeans, but that also does perform for them. But the performance has just become a bit of a given information. And so I think you'll see us continue to react to that, and hopefully I think you'll see us continue to lead in that. So our product must be at that point where it's not just a wearing occasion on field or for the quarter for the gym, it must be a wearing occasion that satisfies the consumer whether they're going out or they're going to school.

Camilo Lyon
Canaccord Genuity, Inc.

Q

Kevin, you've given a lot of detail today, and I appreciate that. Just curious to get your thoughts on how you gain comfort over the next few year period that North American market for apparel is not undergoing this just kind of deceleration from the furious pace that they have had [ph] growing (32:37) out over the past 5 to 10 years. In that you have the elements in place to go after where that next growth curve is really going to come from. There's obviously been a lot of near-term bumps in the road with the bankruptcies that have dislocated demand. So how do you expect to put the pieces together as you look out and make these investments that you need to make, to make sure that you're going after where that consumer is going ultimately?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Yeah. So I think, without question, I want to start and I want to agree with the fact that what's happened at retailers, that retail is without question being disrupted. But we're not going to sit here and tell you and hang it on any one factor. The fact is as we look back on Q4, we believe that we own a large part of it. This is not something that we are just saying promotions and the consumer environment, all those things are very, very real, but we could have done a better job with our merchandising mix to be more proactive and more thoughtful about where they were going. But retail is being disrupted, and so whether it was what we saw in 2016 and frankly some of the indications we've seen with some of the filings going into 2017, so we need to be proactive with that and be thoughtful about that.

The fact of the matter though is that the consumer, they expect more today. They expect speed and convenience and best price and value, and they expect it the next day. So that choice of newness and customization is something that we need to react to and do a better job of. This idea though is we think that the cycle that we're living in from retail and inventing the next big thing, it's going to come from much closer to the concentric circle vs. something built frankly off of a product that has to be hot, or an athlete or a celebrity, or a product that just happens to be about innovation.

And so as I was giving in the last answer, I think that the combination of those two things is going to be critical as we look forward. And one thing that I'll say as well of inventing the next big thing, I think that there's a lot of people, and this is nothing new, it's always been the case, of people that are trying to attain this world of being a lifestyle brand. But the fact is in order to be a lifestyle brand, you got to be grounded in something. And Under Armour is grounded in performance and so we're not looking to abandon one for the other. And I want to make sure I provide the color that as we look back and we reflect and we think and say, what can we do better, how do we get better, what's the projection looking out?

We've got a lot of great foundation to build on, and whether it is the growth that we've experienced, and frankly the growth that we still see in front of ourselves, it's continuing to define ourselves as a growth company. But, we want to make sure that we can control that based on the environment that we're seeing, based on some of the promotional activity that we're seeing, and make sure above all else we're always protecting the brand because this is $5B – $5 billion-ish company that's focused on driving to $10B plus.

Camilo Lyon
Canaccord Genuity, Inc.

Q

And then just how you – you talked about leaning on footwear and international and DTC, and actually that's where the growth opportunities lie. Does this force you, or does this make you want to speed up the international penetration? You clearly have an opportunity in China that's in the early stages, if that, I think it's less than $200mm business for you. So does this make you want to lean on expanding the brand faster as you are going to reset the North American market and your position in it?

Kevin A. Plank
Chairman & Chief Executive Officer
A

Let me let Dave start with that. Go ahead, Dave.

David Bergman
Senior Vice President, Corporate Finance
A

Yeah, Camilo, international is an area that we've definitely been investing in and doubling down on, and it's really, really been paying off for us. We've seen over 60% growth over the last three years. From a percentage of business, we've gone from 9% of our revs in 2014 up to 15% of our revs in 2016, and we're planning it to potentially exceed 20% of our revenue in 2017. Should actually cross $1B in 2017. So it's been a great area for us. We feel particularly strong on China, very bullish on that market. It's been one of our highest growth and becoming very, very profitable for us. A lot of great, great relationships that we're building in that market with great leadership. Europe as well. We've had some great strides there also, making some good traction with the right marketing investments there.

And then Latin America, which is kind of our newest region, is one that we're still cultivating, but it's growing well. And if you look at our total international profitability, y-over-y we're seeing significant improvement there. So it's a great play for us, and we're going to continue pushing hard in that area.

Kevin A. Plank
Chairman & Chief Executive Officer
A

And the global market, Camilo, it's very hungry for the Under Armour brand. This is one of the places where we must be measured, and I think we want to be thoughtful instead of just opening doors. We've seen this trap. You're seeing it play out a little bit here in North America. So, I think one of the benefits we have as a company with just under 300 company-owned stores and a little less than 600 total stores that we have with our partner doors, et cetera, around the world, that's a very different profile than the other two major players in our space.

And so, I don't know if anyone can invest heavily enough in digital right now and what that footprint's going to look like. But I've got a feeling that the moment and the point where the consumer decides to transact for any brand is going to continue to shift. And we feel very good about frankly the lack of commitment that we have with leases and other things and the ability for us to draw and frankly, paint the picture of what the retail consumer brand of the future is supposed to look like.

Michael Binetti
UBS Securities LLC
Q

Thanks, Kevin, for all the outlook on the longer term. The comments are helpful there. It sounds like you still feel pretty good about the wide space opportunity, and it doesn't seem like you guys are isolated in your thoughts on the North American wholesale market. But if we could just maybe look at the gross margins again in 2017, I would've thought that – maybe I'm wrong here, but I would've thought that that would largely be down next year due to more markdowns. And then your guidance and inventory seems to sound like it will be improving through the year relative to the rate of revenue growth. What do you think is the realistic near term recapture rate for the gross margin after 2017 after some inventory clearing?

David Bergman
Senior Vice President, Corporate Finance
A

Yeah. Michael, this is Dave. Gross margin in 2017, we're definitely going to continue to move forward on product cost improvements, and our internal margin from that will continue to improve. We should see a little bit less pressure from the promotional environment, especially in the back half of the year, but we'll still see a lot of pressure from that in the front half of the year.

In our DTC, expansion is also going to be a little bit of a lift to gross margin, but against that, as we continue to mention, is the footwear growth and the international growth. Those have meaningful differences in our gross margin vs. our apparel and our North America business. So as those continue to outpace, those are going to be big pressures that we continue to face over the next few years. And right now, foreign currency is also little bit of a challenge for us. Not as big as maybe some others with our percentage of international, but it's still definitely something that we're dealing with.

So, in 2017, we're doing a lot of the great things, but we're still going to expect to see gross margin a little bit down and then probably more in the near term seeing that flatten out a little bit. But there's definitely opportunities longer term, and we've got a lot of people focusing on the right areas there, so we're looking for that in the longer term.

Michael Binetti
UBS Securities LLC

Q

And if I could just ask you about revenues in 2017, it sounds like a lot of the – so maybe there's some inventory in the marketplace, and you gave some helpful comments on mid-single digit rev growth in Q1. But if I look out beyond that a little bit, does H2 start to look more like the revenue growth rate that we were looking at 90 days ago? Do we start approaching 20% again in the back half just so that we can think about what's causing you guys to push pause on the revenue growth guidance for the front half of the year? And then the shape of our models as we look out a little bit?

David Bergman
Senior Vice President, Corporate Finance

A

Yeah, Michael. We're not ready at this point to give quarterly revenue guidance, but Q1, we did give our guidance out. We're going to continue to look at the back half of the year. I think there are more opportunities in the back half of the year than the front half of the year, but we're going to avoid giving guidance by quarter at this point.

Robert Drbul
Guggenheim Securities LLC

Q

I just had two questions. When you look at the outlook for the women's business, can you just update us on your thoughts on the opportunities there and the magnitude there? And the second question is, in a tougher top line environment for the company, how committed do you guys remain to the Connected Fitness investments that are ongoing?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Yeah. So let me start with women's is that, again, we're really proud that women's hit that $1B mark for us, which is I think important on many levels. We look at the way in which we hit it though, and we still, even in our women's business approach it from a very much performance-based brand. We think there's a tremendous opportunity and the broader investment the company is making around things like lifestyle, are really going to pay dividends for us there. We remain incredibly bullish on women's, and this is led by leadership. Our shift to category management as well gives us and puts us in a position I think to be more focused on what we're doing.

And just to give you some perspective on how we're building out rounding our women's team, one of the analogies that I used in the last call was that even something as much progress as we made in our women's footwear, we've got six people on our women's footwear team comparatively to the competition that probably has dozens or hundreds in the same type of category. We've been able to double our women's styles. We've got a couple of franchise products that also share between men and women. And we think that we couldn't be more confident, but it's one of these things that continues to take time. And so that's distribution, that's placement. But we've got to deliver. We've got to do a great job in women's with the right merchandising assortment on the floor just as we do for men's.

As far as our commitments, the one thing that we said on one of the other questions was about our ability to force rank, our ability to make tough decisions. As a company, I think that's one of the things that's led to our strength. The first advice we'd ever give to a new entrepreneur is the key to any business is focus. And so I think we've always had that, beginning with the simple mantra of don't forget to sell shirts and shoes.

We know what we do for our livelihoods, and frankly the reason that we got into Connected Fitness to begin with, with an investment like that, was to help us sell more shirts and shoes. And so we still believe in that vision. We still continue to see it coming through. We have a major go-live this year with SAP, with our version of single view of the consumer. And we think that the amount of data that the 200mm users we have, telling us how much they exercise, what they ate and giving us data that will help us learn more about them to ultimately help us sell more shirts and shoes is something important.

At the same time, it doesn't mean that we're not going to be prudent across organization. We'll make sure that we're making and we're tightening the belt. But at this time, I think we feel really good about the leadership we have with Connected Fitness. We'll continue to of course forge on and build something bigger and better there.

Jonathan R. Komp Q
Robert W. Baird & Co., Inc. (Broker)

Kevin, just wanted to ask maybe a bigger-picture question framing up this year. If you think about maybe sitting at this place in this time next year, a year from now, do you think the business will be back on track to somewhere closer towards the long-term growth targets? Or maybe what factors do you think would prevent or keep you from getting back to those types of growth rates?

Kevin A. Plank A
Chairman & Chief Executive Officer

I think that, first and foremost, we talk about getting back. I think we've done a good job of changing the expectation of the way that people think about growth. In our sector still, even at the latest outlook where we said we're not going to look beyond the end of 2017, we're still talking about 12% growth with a business that will be 80%-ish here in North America. So we've got a tremendous amount of growth. We've got managing a tremendous amount of growth. And part of the human side of this too is going from a small business, to a medium business, to becoming a large business. We've been living and we've been dealing with that.

As I look out 12 months, I want to tell you first and foremost that I'm focused on the day-to-day. I'm focus on today and tomorrow. We feel very good about our outlook of where we're going. But, yeah, this isn't saying that Under Armour will never do 20% again. I mean you'll see 20% growth from this company. But we want to be measured, and we want to be thoughtful, and the last thing I ever want to do is try to chase that number.

And so a lot of our revenue outlook that we provided to you today was based on hopefully the explanation of a mature management team with a very young company. And I think that's us being prudent about the places where we do want to make sure that we're keeping our retailers, keeping our floors clean, making sure that we're not defined by basic product that needs to simply compete on price. Our product competes on innovation. Our product competes on newness and freshness.

And so, when we see those market dynamics changing, we don't like that game. And so the fact is, is that unfortunately we are pretty unbalanced when you look at our global mix. But that's quickly changing for us. When you look at our mix of apparel to footwear, that's changing for us. And we do continue to see these opportunities beginning with the top line, but this is not a top line story exclusively, like we understand the value of the bottom line and we're asking investors and telling them that this is our money, we are using your money. Our interests are aligned.

And when we look and say everything from the top line to the operating income, we believe there's acceleration there. We believe that there's a short term where our job is we get paid to see around corners, and I believe we saw these things happening, and whether it's the move to footwear or lifestyle or international, some of them just haven't kicked in as fast as we wanted to, and the shifting dynamics out there in the marketplace has created a different situation than when we talked about even 18 months ago.

And so this is where I think we've built a lot of equity. We've built a lot of equity, and things like 26 quarters are the things we're incredibly proud of, but I don't think they define us either. And sometimes you look and you say, we do have a strong management team, we do have a firm vision of the company that we are going to be, it's going to take us, of course, doing the things we've always done, managing our business, running and keeping a tight belt. But we think that there are of course opportunity for us to continue to expand and explode beyond even what we're talking about through 2017.

Jonathan R. Komp
Robert W. Baird & Co., Inc. (Broker)

Q

Okay. Thank you for that. And then maybe just following up more shorter term. I know Dave talked about on the cost side having some areas to pull back in the short run. What about on the sales side? Do you have any kind of shorter-term tactics or levers you can pull? I know Q1 only expected up mid-single digits for revenue, but could you talk about tactically some of the things you're working on in the shorter term?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Well, I think we're reviewing really what happened in Q4 and first quarter together. And so as we think about it, is how do we ensure that we've got a healthy distribution channel? And 60% of our business is U.S. wholesale distribution. And so we've got to be thoughtful there about the way that we approach the marketplace. But from a leverage standpoint, that begins with innovation. We've got two new franchise products we'll be launching this spring as well with our [ph] Banded 3 (48:48) and our Gemini 3 both coming out, running shoes above $100, something we couldn't make that claim even 18 months ago.

We've got innovation from our new Threadborne initiative to Siro. So I think it all begins from a product standpoint, or a product perspective, and we feel really good about what we've got in the pipeline. But we want to be measured. I think right now as we're coming through this and as we thought about what's the best way to communicate, and I want to be clear. We understand the amount of information that we are giving the Street right now. And we've got that again, that 11-year track record that we speak to and say we're not happy about it. And I want you to know, we're not happy about the results that we're telling you right now. And we expect to continue to deliver as we always have.

And so 2017 will be no different. And so we've laid out some marks of what we can do, and where we believe that we can continue to meet and beat expectations. And looking at the year through a very healthy lens. So, I'd answer you in sum that with yes, great innovation. Those will be the accelerants to our growth.

Matthew McClintock
Barclays Capital, Inc.

Q

Kevin, I wanted to focus on DTC for a second because there is a lot of disruption in the U.S. environment specifically, and you talked about one of the lessons learned was speed. Or at least I believe you brought that up, speed. As you think about the need for increased speed and you think about the holes that may be – that are now presented from some of the disruption in the U.S., I mean does that make you want to accelerate the growth of DTC as a channel specifically?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Well, number one. As DTC relates to e-commerce, I don't know if anyone can imagine that they can put enough money toward their digital businesses today. As I answered that earlier question about Connected Fitness, that is an investment in our digital business, in our own direct-to-consumer and e-commerce. And so we feel very bullish, and we feel like [inaudible] (50:56) really unique positioning unlike anyone else in our industry. And frankly I can't think of any companies that have sort of that amount of data flow to understand their consumer better. But as we think about the experiences first and foremost, it's about having a great consumer experience.

It's about when people show up, exciting them and helping them choose to transact, and doing it in a way which either; a, forces them to get up and go to brick and mortar; or b, it help them choose to transact on a phone. And so when I describe our DTC business, I think about e-commerce, full price, and outlet. And probably as recently as a year to two years ago, I'd probably give those in full price, out, and then e-commerce.

And so that world is here, and it's here to stay. And this is not to say that we think that retail is dead either. So we do believe that the move for us of being able to control our destiny. And we talk about upside. Our direct-to-consumer channel last year in Q4 was up 23%, and it was up 27% for the full year. So we're still seeing great momentum there, and DTC represented close to 40% of our total business in Q4 as well.

Controlling our own destiny is something which is, we like to do, but the fact is there are really good partners. But one of the shakeups that we're seeing happen at retail right now is that some are going to win and someone are not going to win. And so we want to make sure that we're getting behind and placing our bets on those great retail partners that are creating incredible dynamic retail experiences. And we have an obligation to them too to make sure that we have great dynamic product that sits on the floor, and will allow them to sell through at great turn and full price and full margin.

So, I don't think any of these things – I think the way that we're viewing it is, of course, we like controlling our destiny, but we began as a wholesaler, and we'll always have a wholesale aspect to our business with the best partners out there that continue to prioritize us and put us and present us in a way which we think tells and helps explain the great products that we have and doesn't just differentiate us by price.

John Kernan
Cowen and Company, LLC

Q

Two questions. Can you just talk about what your assumptions are for apparel and footwear as we go through 2017? And what categories are going to really drive you? What type of growth in those categories is going to drive towards that $10B target?

David Bergman
Senior Vice President, Corporate Finance

A

Hey, John, this is Dave. When you look at apparel and footwear, they're both going to be growing clearly for us. Footwear will definitely continue to outpace apparel to a pretty good degree. When you think about it throughout the year, the footwear growth will be a little bit less in Q1 for us than full year. We're comping a pretty high 64% Q1 2016 growth rate in footwear. And the majority of that growth in North America is going to come from new distribution in DTC. International growth is going to be a little bit more weighted to footwear than the North America growth, but again, footwear is definitely going to be overdriving apparel.

Kevin A. Plank
Chairman & Chief Executive Officer

A

And I'd like to add is that as we think about apparel and footwear, one of the big themes that I want to make sure we get across in this call and your communication is understanding that our commitment to editing. The ability to drive higher revenue is not about making more stuff, it's about having less stuff that's more curated with a stronger point of view.

What brands are required to do is provide two things: personality and point of view. And I think it's one thing you've always been able to count on from us. We see that happening. We see that growing, and it's one of the things that led to the 50% growth that we saw in footwear in 2016. But we know it's not entitled to us either which is one thing that says, we want to make sure we only have the best products and editing that line to the best pieces is what matters.

And so there's lessons to be learned as we look back on the successes and we look back on some of the misses that we had, but net-net, we're a better, stronger company. And when we look at things like footwear of not only being able to drive scale and saying, are we making a shoe that a consumer wants to buy? But being able to drive leverage with our manufacturing partners and things of – this year for the first time we'll make more than 50mm pairs of shoes. And that's something that helps us in that longer supply chain and ultimately help us with things like gross margin.

And so we're not talking about footwear being a materially smaller gross margin than what we're doing in apparel. And so, all these things I think are part of the natural process and progression of a company. I wish I could've read a book on it, but I think we're living it real time right now and we're giving you the best information we can. And you should know that you've got a management team and a commitment that we're going to run like hell for our shareholders.

John Kernan
Cowen and Company, LLC

Q

Just one final question for me. CapEx this year around 7% of sales, a lot of investments in growth and working capital. There's quite a bit of cash burn. The debt is growing on the balance sheet. Given the investments that likely need to go into digital and DTC, where do you think CapEx should trend over the next few years?

David Bergman
Senior Vice President, Corporate Finance

A

Yeah, John. This is Dave again. CapEx is an area that we're really, really digging in deep on. We're challenging every CapEx dollar spent to make sure it really aligns with our longer term strategy. So as we look through that, there's some areas that we're going to be a little bit smarter about. North America Brand House builds in 2017 – we're not going to do as many as we've done in 2016. We're going to be a little careful in that retail environment.

Also, being more prudent about the different areas that we have a footprint in. Looking at our office space, looking at our real estate, looking at our distribution centers, and really trying to make sure that we can stretch out those spaces as long as possible and being really, really prudent about when we need to expand and take on more space.

So we're looking across the board from that perspective. This year, we are targeting $400mm CapEx number. We don't see that massively increasing in the next year or two. We're going to continue to try and manage and prioritize those spend areas with a big focus on protecting the areas of long-term growth.

Robert F. Ohmes
Bank of America Merrill Lynch

Q

Kevin, I was just curious, kind of a follow-up question on international. When you guys look at the international business, whether it's Europe or China, some of the stuff you talked about for North America, I think you mentioned core basics not coming through as you guys were expecting, the need for more fashion, et cetera, and also the promotional environment going on over here. Can you give us some color on how much those things are playing out in both Europe and China right now?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Yeah. I think we're having – we're seeing a very different picture. I want to make sure that I underscore for the group that listens, is that this is a great American brand. And it's in the process of becoming a great global company. And the demand that we're seeing from outside the United States was 63% growth for the year, consistent in building off the 59% – 69% growth that we saw in 2015. It is something that is very real and very happening. And managing and curating and taking care of that brand is something important.

And, yeah, there is a great sense. And I don't know if I'd say it's greater than what we're seeing in America, but in categories that you've heard where we fought, and looked like in China our Curry product has done incredibly well and blown through our plans and our expectation. And that's because of probably two former tours that we did with the reigning MVP, the two-time reigning MVP, but we'll continue to do that.

I think at the same time, Robbie, is we want to stay measured. Is that we've got a great leader in our Head of Revenue, Charlie Maurath, who joins us from 20-plus years in the industry, and knows the global markets better than anyone else. And so establishing that global footprint as we now sell in more than 60 countries, it's taken us a long time to do that and to become – get to scale.

And at the same time, as good as we're seeing the market and the reaction to UA in China, as good as we're seeing the reaction of now 13 years or 12 years having built in places like Europe, we're still seeing things like in Latin America that it's a bit challenged because of a market like Brazil. And that's one of the things when we look at the measurement, we look at OI, and we ask about prioritizing our investments, we believe in a market like Brazil. We just think it's going to take time, and this will be part of the cycles that as we become a broader, global company, that we'll be happy that we have the balance of region with Europe, and with Asia, and with Latin America, and with the United States. And so this is something that we believe.

I think North America, I think as I said earlier, I think that we're definitely going through a shift. I think it's one of the things that's playing out in many of our core distribution. But we're excited to bring on partners like what we're having with Kohl's. But frankly as you look at the total landscape, and you look at why isn't the revenue going up more, is that where Kohl's is and where Sports Authority was were basically a one-to-one wash from a revenue standpoint.

And so we're very pragmatic. I think we're very practical. I want you to know we're very sober. Our eyes are wide open, and we're making the best decisions that we can to drive this company forward focused on being $10B brand. And so all these things hurt. I want you to know that we take it personally. And I want you to know that you've got a committed team here that is ready to run based off the track record of history and success that we put up in the past. We expect people to feel that more and more. And so we know how to win, and we expect to do a lot of it and a lot more of it.

Kevin A. Plank
Chairman & Chief Executive Officer

Q4 HIGHLIGHTS

Accomplishments

- I'm extremely proud of what our team has accomplished in 2016
- And as a brand, we've grown up very, very quickly
- With quick growth comes lessons
- And to be sure there were some valuable lessons in Q4, we learned lessons
- Ones that we'll use to reduce future vulnerability, ones that we'll use to ignite and inspire even greater magnitude of hunger and humility throughout the organization, and ones that serve as a catalyst to transform the complex to the simple, to move faster, stronger and smarter across the board

SUMMARY

- Someone asked me recently, and they said – they asked if this has been a humbling experience for me? And as we were looking and contemplating, preparing for the call, and one of our senior execs, and my reaction to them was, like all of us, I'd like to think that being humble or being made humble is never required
- But who knows, we probably all get over our skis a little bit
- At the same time, the way that I view this year is something that I think we can definitely look back on and say we've been made much wiser
- And so I don't believe there are surprises in life. I believe that everything is something that we can hopefully forecast or see
- But sometimes it's not so clear to us
- And so, again, I want to remind you that our eyes are wide open, and we are ready to run in 2017 and beyond
  - That's exactly what we're working on in 2017
- And we're going to work on adding the next $5B to our company.