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Under Armour, Inc. (UA)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Under Armour, Incorporated Fourth Quarter 2019 Earnings Webcast and Conference Call. And at this time, all participants' lines are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. Lance Allega, Senior Vice President of Investor Relations & Corporate Development. Thank you. Please go ahead, sir.

Lance Allega

Senior Vice President-Investor Relations & Corporate Development, Under Armour, Inc.

Thank you, and good morning to everyone joining us for Under Armour's fourth quarter and fiscal year 2019 earnings call. On today's call, participants will make forward-looking statements. These statements are based on current expectations and are subject to uncertainties that could cause actual results to differ materially. These uncertainties are detailed in this morning's press release and documents filed regularly with the SEC, all of which can be found on our website at about.underarmour.com.

We may also reference certain non-GAAP financial information, including adjusted and currency-neutral terms, which are defined in this morning's release. We do use a non-GAAP amount as a lead in some of our discussions because we feel that they more accurately represent the true operational nature and performance of underlying results of our business. You may also hear us refer to amounts in accordance with U.S. GAAP. Reconciliations of GAAP to non-GAAP measures can be found in the supplemental financial tables included in the press release, which identify and quantify all excluded items, provide management's view of why this information is useful to investors.

Joining us on today's call will be Under Armour President and CEO, Patrik Frisk; and CFO, Dave Bergman. Following our prepared remarks, we'll open the call for questions.

With that, I'll turn it over to Patrik.

Patrik Frisk

President, Chief Executive Officer & Board Member, Under Armour, Inc.

Good morning, everyone. I want to say something up front. Last night, we learned of a terrible tragedy involving a loss of a member of the Under Armour family at one of our stores in Orlando. Our heart goes out to this teammate and her family and to all the teammates affected by this awful incident. Our concern right now is with the safety and security of everyone involved. We have closed our stores in the Orlando area and are making grief counseling available to our teammates. We will offer updates as soon as possible in coordination with local authorities and the teammate's family.

Now, let's get into the prepared remarks. On my first call as CEO, I'll start by underscoring several things. First and foremost, I'm not satisfied with where we are today. As a company, we made significant operational progress in the form of better systems, structure and processes as well as a considerably stronger balance sheet and the ability to generate cash. As a brand, however, we see a paradox of two challenges in front of us: continued softer demand in North America as we work through our elevated inventory in multiple years of discounting and a highly committed cost structure, which is taking longer to unpack and is limiting us from being able to spend as aggressively as we would like to, to increase brand consideration.

Next, we are firm in our commitment to staying [ph] centered in (03:04) athletic performance and bring authenticity to the brand through innovative products, solutions and experiences that athletes didn't know they needed, and once they have them, can't imagine living without. And finally, to thoroughly execute a strategic, operational and cultural transformation of this magnitude takes time, and quite simply, the realization of milestones and progress within certain areas of our business is taking longer than we anticipated.

Amid this journey and with 2019 behind us, it's important to reflect on the work we've done during the most transformative three-year period in Under Armour's history. Against a highly competitive and dynamic consumer backdrop, we are fundamentally running a better company today, one that strives to deliver the right product to the right place at the right time in a more consistent and purposeful manner than ever before. We have healthier inventories, less debt, and have meaningfully improved cash generation through a more disciplined approach within our sales and operations planning process. And I'm proud of the strong management team we have in place that is committed to executing our long-term goals and objectives.

Operationally and strategically, we are aligned to ensure we have the best opportunity to succeed as a performance-oriented brand. And with ongoing and robust consumer insights work, we have clearly defined our opportunity set. We compete in athletic performance, our target consumer is the focused performer, our brand positioning as the human performance company that gives you the edge to go beyond any limit, and all of this is driven by delivering the world's most innovative products to fulfill our mission, which is to make you better.

Our purpose and strategy are clear to us. However, there are those who believe our focus on athletic performance may currently be too narrow. We disagree. In fact, we're seeing even greater opportunity to drive harder towards our vision and mission. Of course, being in athletic performance requires us to make innovative, highly functional product, but it must also be great-looking and on trend like our design team says, without beauty, there is no performance.

Turning back to the year at hand and our outlook for 2020, I'd first like to take a minute to provide our thoughts on the rapidly evolving situation related to the coronavirus outbreak in China. Along with all companies who do business there, our primary concern is for the health and well-being of the Chinese citizens, our teammates and partners, and those affected around the world. As it relates to potential operational and financial impacts to Under Armour specifically, there are several unknowns that we're continuing to monitor and assess not only for the APAC region, but also on a global basis.

From a supply chain point of view, there could be challenges that develop from the material factory and logistics perspective. In materials, we are assessing possible impacts relating to fabric trim and package sourcing and potential delays and capacity challenges that could prove to be difficult in the second half of the year. With respect to factories, we're continuing to see closures, changing timelines of when they might reopen, and trying to assess what it means for production fulfillment, capacity and the prioritization of which products to make.

In logistics, we think it's reasonable to expect industry-wide delays in terms of delivery around the world, including potentially missed shipment and service windows, and the need for increased air freight and additional measures at ports that could create unforeseen congestion. Looking at the greater marketplace and how consumption, consumer behavior and overall economic shifts could potentially play out, is where it gets even more unclear with respect to duration and the possible levels of elevated inventories and promotional activities later in the year.

In aggregate, we are evaluating each of these items individually and collectively to assess potential impacts and options to try to mitigate risks to the best extent possible. And only five weeks into the situation, one that is clearly not stabilized, we are electing to stay appropriately prudent and not prepared to quantify many of these elements today, as events could meaningfully evolve in the coming weeks.

With respect to what we have factored into today's initial 2020 outlook, with almost 600 monobranded Under Armour doors in China currently closed, we're estimating a first quarter revenue impact to the APAC region of about $50 million to $60 million, which is a little more than a 1 point of growth for Under Armour globally this year. Given the ongoing uncertainty, it is possible that this situation could have a significant material impact both financially and operationally on our full year, including the potential for additional top-line contraction for total UA. But to reiterate, at this point, we're only contemplating a first quarter APAC revenue impact. As we gain better clarity and additional events unfold, we will provide updates as appropriate.

Turning to our full year 2020 outlook, including a little more than a 1 point due to the coronavirus, we are expecting global revenue to be down at a low single-digit rate. This is not where we expected to be at this point in time, so we will need to evaluate what this means with respect to the long-term financial targets from our Investor Day in 2018 and the high level of uncertainty around the situation in China that could further impact these targets.

To provide some more color and context around drivers contributing to this expectation, let's start with our international business where we continue to deliver consistently towards our long-term strategic expectations. Higher service levels and better-managed inventory along with targeted return-based investments and continued improved operational discipline have begun to unlock the potential of our long-term productivity growth algorithm. In total, our international business should be up at a low double-digit rate in 2020 with each region also growing at a double-digit rate for the year.

Clicking down, in Asia-Pacific, we believe our strategy to expand and penetrate key markets, is working. From a channel perspective, we are seeing outpaced e-commerce growth and plan to invest even more heavily into digital and marketing to continue to increase brand awareness and consumer engagement. We also expect to continue to grow our owned and partner door base, which is now just over 900 locations across the region. By leveraging our integrated go-to-market process, key innovation platforms and more cohesive marketing to drive stronger consumer connections, we remain bullish on this region's long-term growth potential.

Turning to EMEA, we continue to work to optimize the marketplace across accounts, strengthening the business to focus on strategic growth in the countries that we believe have the highest levels of return. Throughout 2019, we made good progress against this objective. With the transition into our new regional headquarters in Amsterdam, we are confident that we have the right infrastructure to continue to deliver greater leverage and operational efficiencies as we grow and scale the business. Based on the operational improvements we've made, we expect our revenue growth to accelerate as our efforts to more cleanly manage the marketplace are yielding stronger bookings among our key wholesale partners. From a portfolio perspective, one of our largest channel opportunities lies in expanding our D-to-C presence where we believe we can better manage the pace and premium presentation of our brand.

In EMEA's e-commerce business, we ran last year with very few promotions and saw little impact to our results, so an encouraging sign of brand strength is returning to this play. Using this as a potential proof point for the rest of the world, we continue to get smarter about volumetric impacts, price sensitivity and overall brand validation to drive consumer engagement. In Latin America, we're staying focused on amplifying footwear and optimizing our distribution model. 2020, in this region, is about underscoring our brand positioning in athletic performance, enhancing our commitment to growing premium distribution with a sharper focus on key accounts and leveraging the integrated go-to-market process we have put in place. We also plan to bring Latin America onto our global ERP platform.

Finally is our North American business where expectation was that we'd see stabilization by the end of last year and pivot back to growth this year. Operationally, we continue to make positive strides managing the marketplace and driving better operational discipline. However, a combination of demand challenges and distribution dynamics is materially impacting our business. These issues are most evident in our full-price, wholesale and e-commerce businesses, leading to an expected mid- to high-single digit decline in 2020 for our North American business.

So, let's dive into each of these channels, review some of the issues we're facing, and what we're doing to fight our way back in our largest market. Starting with our wholesale business. A reduction of sales to the off-price channel from its peak in 2018 is on track where we expected to be in terms of working it down to a more optimal mix within our portfolio. While overall positive for our brand health and eventual supply/demand rebalancing, this reduction should remain a revenue headwind in 2020. In full-price wholesale, we're working to improve every aspect of our partnership, from service levels and on-time delivery to segmentation and marketing support.

Operationally, I'm confident that we've become a better partner for our wholesale accounts, and while we are checking the right boxes and seeing confidence returning to the mix, the rate of recovering our shelf space in this channel is not happening as quickly as we had expected. And, of course, it takes more than being a great operator to win with our accounts. It takes a strong brand and we've been a very quiet brand for the past few years. In 2020, that changes dramatically. Having launched The Only Way Is Through brand platform last month, we believe we are firmly shifting back to offense and putting more of the pieces in place to holistically empower touch points with our consumers and better support our wholesale partners.

As a year-long effort, this is the most comprehensive and coordinated brand campaign in our history, orchestrated globally across wholesale, e-commerce, brick-and-mortar, social media, grassroot and sporting moments. Completely centered around our consumer, we see this platform as a key initiative to improve brand health and drive consideration for purchase and are excited to continue to build off this space as we get deeper into 2020.

So, how does all of this translate into wholesale expectations for 2020? In the first half of this year, wholesale orders came in lower than expected, driven we believe in part by tempered demand against last year's spring/summer season. With respect to the second half, keep in mind that we are just now finalizing our third quarter bookings, which are trending relatively flat. For the fourth quarter, we have only recently started to take orders, so in total are not in a position as of this call to make a well-informed second-half conclusion. So instead, we'll choose to stay prudent with our outlook. Additionally, we continue to plan for a reduction in off-price sales for the full year. We're working hard to support our key retail partners and believe the marketing efforts, assortment improvements and increased digital investments we're making will enable us to better serve both our customers and consumers in our journey to returning to growth.

Moving to our direct-to-consumer business in North America and a little more color on our three concepts, I'll start with our Brand House stores. Although only a small percentage of North American D-to-C, we are very encouraged by some of the stories at work that we've done. Next up is Factory House. Our outlet concept which is at 90% of our physical door count and about two-thirds of D-to-C revenue in North America, it is the workhorse of the fleet. Given the tremendous effort we've done to manage inventories across the marketplace over the last couple of years, we're seeing steadiness across this business with more balanced capacity, increasing the better in-stocks and improving operations.

And while difficult traffic conditions continue to persist, we're expecting our Factory House business to end the year relatively in line if not a little better than 2019 results. So all in, stable. The remainder of direct-to-consumer, our e-commerce business continues to be challenged and is meaningfully behind where we thought we'd be at this point in time. We believe there are two primary things going on. First, we believe prior promotional activity has impacted consumers' willingness to pay full-price for our brand to a higher degree than we originally anticipated. And while the trend of higher AUR among those that do purchase on our site continues, the volume necessary to offset the impact to our business declines that we experienced last year is not yet materializing.

Second, as a vehicle capable of delivering a premium, inspirational brand experience to our consumers, we're working to improve our e-commerce platform to better compete in today's ever-changing, highly competitive market. And to support this, we're standing up a CRM program to drive higher engagement, frequency and repetition. And that's just it. There's a tremendous opportunity to [ph] right (15:19) this business and accordingly we're not sitting idly by. This summer we plan to launch an enhanced e-commerce site in North America on a new platform that is tested successfully at a small scale in EMEA for nearly two years.

We believe this new platform together with investments into personalization and CRM later this year will enhance our ability to elevate our storytelling and experience for our consumers. Additionally, in the second half of 2020, we are currently planning reduced promotional activity across our direct-to-consumer business, and while this may create a revenue headwind, we believe it is the appropriate strategy to enhance our premium positioning with our North American consumers.

To wrap up North America, our transformation is taking longer than we had originally expected and as we work through a reset grounded both in quality of revenue and long-term margin expansion, there are several strategies focusing on our product and brand at every touch point to stabilize and return to growth in our largest market. First, there's sharp focus on ensuring our product innovation and segmentation are well-positioned to drive greater shelf space opportunities with our key accounts and consideration from their consumers.

Second, is building a stronger brand utilizing deep consumer insights and increased marketing investments to better activate our roster of athletes and influencers, significantly amplifying our visibility in the marketplace. Third, is continuing to drive operational improvements to enhance our ability to better serve the end consumer, quite simply becoming their brand of choice. And finally, is underscoring our priority to become a better direct-to-consumer organization that is digitally and physically capable of delighting and inspiring consumers with a premium seamless experience every time they engage our brand.

So, to closeout, I'd reiterate again that we are not satisfied with where we're at today. While we've made significant improvements as a company, overall, there's more work to do. Given the challenges ahead, Kevin, our board and the entire global management team are aligned and confident that our transformation will continue to support our ability to execute against our long-term strategy and realize Under Armour's full potential.

And with that, I'll hand it over to Dave.

David E. Bergman

Chief Financial Officer, Under Armour, Inc.

Thank you, Patrik. Before moving into greater detail on our initial outlook for 2020, let's take a quick run through our fourth quarter highlights, starting with revenue, which was up 4% to $1.4 billion. Clicking down by channel, sales to our wholesale customers were up 2%, primarily driven by our improving service levels around the world relative to spring floor sets. Direct-to-consumer revenue was up 2% with growth across our international regions offset by continued declines in North America. Licensing increased 36% primarily driven by contractual royalty minimums and one-time settlements with two of our North American partners.

By-product type, apparel revenue was relatively flat compared to the prior year. Footwear revenue was up 10% driven primarily by our team sports and running categories and improved service levels as previously noted. And accessories revenue was up 2%. From a regional perspective, revenue in North America was up 2% in the fourth quarter driven by our licensing and wholesale channels. Within wholesale, service level improvements enabled us to meet demand earlier, providing an incremental benefit to the fourth quarter. This growth was tempered by lower sales to the off-price channel.

In EMEA, revenue was up 2% driven by growth in our DTC business. Relative to wholesale, as a reminder, some shipments originally planned in the fourth quarter of 2019 were shipped in the third quarter in anticipation of Brexit. Revenue in Asia-Pacific was up 10% with growth in wholesale and DTC. Like North America, we experienced improved service levels that benefited the quarter. DTC growth was slightly below our expectations due to softer than expected sales through key e-commerce moments, including [ph] 11/11 and 12/12 (19:20).

Latin America revenue was up 12% driven by growth in wholesale and DTC. As a reminder, this was the first quarter after a full year lapping of our Brazilian business model change effective October of 2018. And finally, our Connected Fitness business was up 16% to $35 million driven by continued strength in subscription revenue.

Turning to gross margin, we saw a 230-basis-point improvement to 47.3% in the fourth quarter. To break this down more, benefits included approximately 110 basis points of pricing including lower discounts with our wholesale partners, 100 basis points of regional mix and channel mix including higher licensing revenues as well as lower year-over-year sales in the off-price channel, and 50 basis points of improvement in supply chain initiatives, including product costs and air freight. These benefits were partially offset by about 20 basis points of product mix due to the strong growth of footwear in the quarter, which carries a lower gross margin rate.

SG&A expense increased 3% to $607 million, which includes approximately $20 million of incremental investments to fund digital and marketing investments to better position us for our 2020 brand platform that launched earlier this year. Fourth quarter operating income was $74 million, and we had a net loss of $15 million or $0.03 of diluted loss per share. This result includes a negative $0.05 impact related to the recording of a valuation allowance against U.S. state deferred tax assets and a negative $0.08 impact from an impairment charge related to our equity investment in our Japanese licensee partner.

To provide a little bit more color on each of these two discrete items, I'll start with the DTA valuation allowance. A three-year cumulative loss position in the majority of our U.S. state jurisdictions coupled with the expectation that our North American business will continue to be challenged in 2020 resulted in recording a valuation allowance against deferred tax assets, which increased our 2019 tax expense by approximately $23 million, a negative $0.05 EPS impact on the full year.

With respect to the impairment of our equity interest investment, consistent with the expectations we laid out on our last call, the negative impact of our licensee's operating results on our full year earnings through our minority interest was about $9 million, or about $0.02 of EPS. However, based on their updated expectations for 2020, we assessed and ultimately recorded a $39 million impairment to our 29.5% equity stake investment during the fourth quarter. This resulted in a negative $0.08 EPS impact for the quarter, or negative $0.09 for the full year. As they work through their plan of action to address their future performance, we are continuing to monitor any new developments. Relative to our 2020 outlook, we anticipate an approximate $0.01 to $0.02 negative impact to EPS as they continue through their transformation.

Turning now to our fourth quarter balance sheet and cash flow statements where we continue to see improvements. A few highlights would include a 41% increase in cash and cash equivalents to $788 million, a 19% decrease in total debt to $593 million, capital expenditures were down 3% to $54 million, and for the full-year, capital expenditures were down 7% to $144 million, or 3% of revenue. Inventory was down 12% to $892 million due to our continued operational and supply chain improvements. And finally, our 2019 cash flow from operations was $509 million.

Moving to our initial outlook for this year, let's walk through the components in more detail. In 2020, we expect revenue to be down at a low single-digit rate compared to 2019, reflecting a mid-to-high single-digit decline in North America and a low double-digit growth in our international business, demonstrating the continued importance of driving greater balance and investment across our regional portfolio.

As Patrik detailed, this outlook includes an anticipated first quarter negative impact in the APAC region stemming from the very unfortunate coronavirus situation, which we currently estimate challenging global revenue growth by little more than a 1 point in 2020. To reiterate, this outlook does not contemplate any additional impact beyond the first quarter, and these impacts could be material depending on how the situation develops.

By channel and segment, we expect wholesale revenue to be down at a low to mid-single digit rate and DTC to be up at a low single digit rate in 2020. Licensing is expected to be down close to 30% due to significantly lower contractual royalty minimums driven primarily by our Japanese business, the termination of certain licensees and contract settlements realized in 2019. And our Connected Fitness business is planning up at a high single-digit rate, driven by continued momentum in our premium subscription business.

Within our product segments, we expect apparel and accessories to be down at a low single-digit rate and footwear to grow at a low single-digit rate for the year. Gross margin is expected to be up approximately 30 basis points to 50 basis points compared to 2019, due primarily to continued product cost benefits from ongoing supply chain initiatives, and regional mix, partially offset by unfavorable channel mix related to lower licensing revenue.

Moving to SG&A, the realization of milestones in progress within certain areas of our business is taking longer than we anticipated. Specifically, looking at our current cost structure when compared to our continued contraction in North America, we are not optimized against this current state. And when juxtaposed against other areas of our long-term strategy, including our need to continue investing more in our digital infrastructure, international expansion and marketing, 2020 places us in a challenging position relative to our near-term SG&A to revenue relationship in order to continue on our path of realizing our long-term objective.

With respect to the work we've done to drive greater operational efficiencies, the restructuring plans that we've implemented in 2017 and 2018 were targeted at reducing our cost structure as well as allowing us to further reinvest back into key areas to drive the brand. Looking at what we have accomplished through 2019 against those objectives, we've been successful in many areas at achieving what those restructuring plans set out to do. However, they have not necessarily yielded as much benefit in the top-line as we expected, given demand challenges.

And, finally, I'd like to comment on brand marketing, where we still see opportunities to increase effectiveness to reignite and deepen our connection with the consumers. As a result, we are amplifying our marketing spend in 2020 to maximize the brand platform we launched earlier this year, further supporting our efforts to drive greater brand strength in North America and around the world.

With all that as a backdrop, we want to make sure we enter 2021 and beyond with greater clarity and focus and in the most cost-effective way possible. To this effect, we are assessing a potential 2020 restructuring plan, which could include approximately $325 million to $425 million of pre-tax restructuring-related charges. Approximately $225 million to $250 million of this total is related to potentially foregoing opening a flagship store in New York City. In this regard, our lease obligation remains. However, we are considering pursuing sublet options for this space. If these restructuring initiatives were implemented, it could drive approximately $30 million to $50 million in pre-tax benefits in 2020. We expect to complete our assessment during the first quarter and, subject to board review and approval, would announce possible restructuring charges upon adoption of any plan.

Now, back to our full year outlook, excluding any potential restructuring initiatives that we are currently exploring and further impacts of the coronavirus, we are expecting operating income to reach approximately $105 million to $125 million. Interest and other expense, net, is planned at approximately $30 million, and diluted EPS is expected to be in the range of $0.10 to $0.13, including $0.01 to $0.02 of negative impact from our equity interest in our Japanese licensee. And finally, we expect our capital expenditures to be approximately $160 million.

Before opening the call for questions, we'd like to give a little more color on the first quarter, where due to several factors, we currently anticipate revenues to be down about 13% to 15%. There are four main drivers of this. First, we're currently expecting the coronavirus outbreak in China to negatively impact us by about 5 points. Second, sales through the off-price channel are planned down significantly against elevated levels in the first quarter of 2019. This, too, is about 5 points of the 13% to 15% decline.

Third, as I mentioned earlier, our continued service level improvements throughout 2019 drove our ability to better service our wholesale accounts, which provided an incremental benefit to Q4 2019. We expect this shipment timing to normalize this year. On a comparable basis, this was about a 3-point shift from Q1 2020 to Q4 2019. And finally, we had softer than expected demand and lower spring/summer bookings in the North America full-price wholesale channel.

Moving to gross margin and illustrating the point on quality of revenue, even with our expected first quarter revenue contraction, we expect gross margin to be up about 120 basis points to 140 basis points compared to the prior year, primarily driven by the significant decrease in year-over-year sales to the off-price channel along with continued supply chain benefits and related product cost and improvements. We anticipate these benefits will be partially offset by higher planned wholesale discounts.

Within SG&A, as I mentioned earlier, we are continuing to work to balance cost efficiencies with key investment into other areas of our long-term strategy including our digital infrastructure, our international expansion and brand marketing. As such, we expect elevated spending in all three of these areas in the first quarter to support our global brand platform.

Bringing all of this to the bottom line, we expect an operating loss for the quarter of approximately $75 million to $80 million which after interest expense and other is approximately $0.14 to $0.15 of diluted loss per share.

Before we open the call to questions, I would like to hand it back over to Patrik for closing remarks.

Patrik Frisk

President, Chief Executive Officer & Board Member, Under Armour, Inc.

Thanks, Dave. I want to underscore a few points. Under Armour is an operationally better company today following our purposeful three-year transformation. We've reengineered our go-to-market, optimized our product innovation engines, and focused ourselves on a well understood and well-defined target consumer. We've improved our balance sheet by reducing our debt and inventory and realized significant improvements in our ability to generate cash.

That said, we absolutely have more work to do, work that will require us to make tough decisions, further evaluate our cost structure and sharpen our prioritization to ensure that we continue to put ourselves in the best position possible to achieve sustainable, profitable growth over the long term.

And now I'll turn it back to the operator for your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Matt McClintock with Raymond James. Your line is now open.

Matthew J. McClintock
Analyst, Raymond James & Associates, Inc.

Q

Hi. Yeah, good morning, everyone. Patrik, you worked pretty hard the last few years getting the organization to a place where we can start to see growth again in North America. Yet, it seems like things are actually getting tougher, albeit maybe in a more profitable manner. As you look back, what would you have done differently? And can you perhaps talk to the product itself that you expect to sell this year – as it seems like the shorter go-to-market calendar should have helped somewhat? Thank you.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Thanks, Matt. Yeah, I think we've had a pretty long call here this morning, and part of that – reason for that, of course, is to try to unpack some of the noise that's going on here right now. Yes, it is true that it's taking longer than we anticipated to get back to growth in North America. And there are several different factors there. Part of it is earning our way back on the shelf at retail is taking a little longer than we thought it would. And some of that actually has to do with the latter part of your question, which is around calendar, and our performance in spring of 2019.

We feel though as we go forward because of the shortened calendar and because of the efforts that we've put into not just the front end of the machine, the commercial part, but also the innovation pipeline, that we have a great product line-up in a coordinated manner in our go-to-market this year like we've never had before. But, again, you've got to earn it back. And it's taking longer than we thought. When it comes to our own control channels, our e-commerce platform is an ailing and old one, and we had planned to move onto a new platform in 2020. And we've worked hard to make sure that that is the most state-of-the-art platform. But not only that, we're also supporting that with loyalty, with CRM, with personalization. So you have both the new site and platform and all of the other things that you need to actually drive that coming online for us in the second half of the year.

We believe that is incredibly important because, ultimately, we would want to tell the right stories around our beautiful product and our marketing in a coordinated manner, better than we are able to do it today. So the way we think about this is about timing. It's more about timing than anything else. And as we said, we did see softer demand in the first half in terms of our wholesale accounts, but we see a stabilization in Q3. But, again, too early to call the ball on what's going to happen in Q4 because we don't have orders at hand.

So I think for us it's about a timing issue. I think when it comes to what would I have done differently, you'd always like to go quicker. You always would like to go quicker. But the reality is also you have to take into consideration the cultural aspect of change management when you go through these things. And it's sometimes hard to call the ball on exact timing of all the transformation because there's so much work that needs to happen across the entire organization. And what we see playing out here now for Under Armour is a little bit of a delayed effect in North America, unfortunately.

Matthew J. McClintock
Analyst, Raymond James & Associates, Inc.

Q

Thanks for the color. Best of luck.

Operator: Thank you. Our next question comes from Edward Yruma with KeyBanc Capital Markets. Your line is now open.

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Good morning. Thanks for taking the questions. I guess first on off-price, this has been kind of a constant narrative for the past couple of quarters, I guess, at what point do you think you'll get comfortable with the mix of full-price to off-price and when will it stop being a drag?

And then secondly, I don't know, maybe this is just the chicken-and-egg, but are you comfortable at this stage with existing product lineup to amplify marketing given some of the challenges that you've outlined in your script? Thank you.

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

Hey, Edward, this is Dave. Yeah, we have talked a lot relative to kind of discounting promotion in the off-price channel and quite frankly, it is a journey for us. And we've taken a lot of good steps in that journey in 2018 and 2019 with kind of walking down the third-party liquidation channel. And some of that's been enabled just by a much-improved supply chain process and not actually creating as much excess, and therefore, not having enough to even move through that channel, which is also a good thing. But we're also starting to take steps this year to take that further into our own DTC channels. We did some of that in 2018 and 2019.

But in 2020, especially the back half of the year in North America, we want to start walking off more of the promotional and discount activity that we're doing in our Factory House stores and also on our e-com space. So we're pretty excited about the combination of being able to launch a new site, being able to build in the personalization, the CRM, and stepping off kind of the promotional and discount cadence there on the e-com platform. But we do have to be careful. Any site transition there's risk around that, and we've got to be prudent around our planning for that.

So we feel good about where we are in that journey. We're kind of about where we expected to be in that step-off process. Is there more that we can do next year and beyond? Probably little bit more, and we'll continue that journey. But we want to make sure we're doing it prudently and that it's backed up by the right brand campaign and brand voice at the same time, to make sure we're really compelling those consumers to stay with the brand and want to stay with us as a premium brand and a full price brand. And so that's another reason why we're so excited about the marketing campaign that we recently launched and kind of doubling down on the investment there as we go through this year.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Yeah, I'll take the second part of that question as it relates to product and the go-to-market, spring 2020 and fall 2020, the entire year of 2020, we're now truly running a coordinated play across product marketing. And we're doing that with what we believe a better product lineup than we've had ever.

And I'm thinking now specifically around RUSH and RECOVER, that metabolic fabric that we have that helps you recover, Iso-Chill, which we're driving now hard into golf, which is an innovation that we've had before but we're now actually expanding it to make sure that we're covering more styles with that, our Infinity Bra for women which is a new bra that we're launching which we believe is absolutely the number one bra for any woman that wants to be active and stay active, our continued driving into Project Rock and some of the new product that's coming out from his line.

And in footwear, continuing to build on something that we have worked hard to do over the last few years as a brand, which is starting to build franchises around our footwear. Our HOVR running, we just launched a new MACHINA on Friday, and we're very happy with how that launch has gone across the world. This was the first time we were able to actually launch a product simultaneously across all of our countries globally. And the big news there is that's real live coaching, right? You can wear a watch, and you can be coached as you run. Has had great reception.

But that's just one of the things that we now have on the HOVR platform. We also have the Phantom/SE, the Sonic, the Infinite, the Mega, the Velociti 2, the Guardian. And that platform itself has been a real accomplishment for the brand in our ability to drive newness in terms of footwear. And you also now start to see that playing out in our sales.

The difference is we're not just doing the product better. We're also doing the messaging better. And we're now able to actually read and react real-time. What I mean by that is we've also built the tools to be able to see the reaction at the consumer level as we start to step on the marketing that Dave talked about. We haven't been able to do that before, but now we're actually monitoring things real-time. And we're able to read and react much more so than ever before.

And ultimately, you are somewhat caught in that calendar war. We have been, and we're now coming out of that. If you think about spring 2019, fall 2019, lots of the product and stuff that was built for those seasons were built when we were still on the old calendar. And as you look forward now into 2020, both the innovation calendar and the commercial calendar are now coordinated for us around a better play.

So we're very optimistic about what we see and our ability to drive harder. And that's one of the reasons why we're working hard to spend more, but also to unlock more opportunity to continue to spend more, which is incredibly important for us to make sure that we're driving brand consideration specifically in the United States.

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. Thanks so much, guys.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Hope that helps.

Operator: Thank you. And our next question comes from Erinn Murphy with Piper Sandler. Your line is now open.

Erinn E. Murphy
Analyst, Piper Sandler & Co.

Q

Great. Thanks. Good morning. I guess my first question is just around the DTC channel. You guys talked about it being up low-single digit in 2020. Could you just talk a little bit more about what's contemplated in terms of store development in this number? And maybe in that talk about how some of your smaller format stores have performed?

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

Sure Erinn, this is Dave. I'll start out. Patrik can add a little bit as well. But we are excited about global retail for us going into 2020. I think from a DTC perspective, we mentioned in our prepared remarks we're a little bit tempered on our e-com outlook, mainly with the site redesign in North America and also just being a little bit prudent there with a lot of the promotional environment we saw in Q4 of 2019.

But relative to retail stores, we're excited about the new Brand House commercial concept we've been launching this year. We're excited about the format for Factory House. And so we're really getting behind that. When you think about globally, we're still planning about 275 doors globally. About 200 of those are going to be more partnered and 75 are going to be more kind of owned and operated.

The partner doors are going to be mainly Brand House stores and the owned and operated are going to be more Factory House stores.

I do want to just caveat that with the fact that plan does not currently anticipate any extended impact from the coronavirus situation in APAC. So we have to keep an eye on that and make sure that we continue to update as we go forward. But we are excited about the continued progress there.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Yeah, we've done a lot of work-around the Brand House and we're truly moving into an era now for Under Armour where we're starting to drive through omni-channel through both personalization, BOPIS, and loyalty as well as CRM. And as part of that, we've been working to coordinate the efforts that we have, of course, in e-commerce but also through this new Brand House concept in terms of both experience and activation.

We did a lot of work on the three stores that we opened in the back half of the year, in 2019, to learn from. Those were hybrid stores. We tried a lot of new things in there, and we put all of that work also into the stores that we're now starting to launch and roll out in 2020. And it's [ph] important to us (43:15). We still are on track to open somewhere between 1,500 and 1,700 stores across the world over the next three to four years. So it's absolutely a critical initiative for us and we're very encouraged by what we see in terms of how those stores are performing right now. Dave, if you want to add any more?

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

I'm good.

Erinn E. Murphy
Analyst, Piper Sandler & Co.

Q

Thank you. Can I just clarify just one thing, Dave, for you on the guidance? For international growing low double, does that include the $50 million to $60 million hit that you're taking in Q1 for coronavirus or is that excluding that?

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

It does include the hit that we're expecting in Q1, the $50 million to $60 million. It does not include anything after Q1.

Erinn E. Murphy
Analyst, Piper Sandler & Co.

Q

Got it. Thank you.

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

You're welcome.

Operator: Thank you. Our next question comes from Alex Walvis with Goldman Sachs. Your line is now open.

Alexandra Walvis
Analyst, Goldman Sachs & Co. LLC

Q

Good morning and thanks so much for taking the questions here. My question is on North America guidance and specifically on North America wholesale. I wonder if you could share with us what level of decline you're embedding within the wholesale segment of North America specifically as you contemplate the down mid-to-high single revenues in total? Is there any color that you can share with us on the moving pieces within wholesale beyond the declines that you're expecting in off-price? And here, I'm thinking of whether you're planning to reduce the number of stores that you sell through, and any thoughts that you might have within doors of where share losses are going to. Is it other international brands? Is it private label players? Or any other thoughts around that?

And then my second question is just a quick one on the decision-making process around the New York store, and how you'll come to a conclusion on that.

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

Sure, Alex. This is Dave. Relative to North America and kind of what we're expecting for 2020, there are a couple of different puts and takes that are going on there. Most of the decline is attributable to wholesale and then a little bit from DTC but that's mainly on the e-com side.

When you think about on the wholesale side, as Patrik mentioned in his prepared remarks, we did see some softer demand relative to first half wholesale bookings. Some of that's coming off of some of the performance of our spring/summer 2019 product. But then as we look at the Q3 orders that came in, they're actually more flattish. So we're seeing signs of stabilization there which is good. We don't have Q4 bookings in hand yet, so we want to be careful there, but hopefully that momentum that we're seeing in the stabilization and beyond continues as we get those Q4 bookings in.

And then as we've mentioned on the wholesale side also, we're definitely planning decreased third-party liquidation in 2020 as well. When you look at the DTC side, we are pretty encouraged relative to the Brand House commercial model that I mentioned, and also on the Factory House models. But we are stepping off the promotions a little bit on the e-com side and also on the Factory House side.

Little bit more detail on North American DTC from a doors perspective, we only have about 19 full price stores as we ended last year, so we're going to look to open three more of the new format doors this year but we are being prudent about that expansion. We want to make sure that the profitability of those new models is working the way that we expect before we really amplify that a lot more. But we're excited about the early reads on that.

Relative to the question on the Fifth Avenue store, obviously, this is a big conversation for us and a big decision that we have not officially made yet, but that we're anticipating. Flagship retail is certainly important to us. But in this instance, we would prefer to continue focusing on our smaller, more profitable Brand House commercial concepts that I mentioned, which we're rolling out this year.

In addition, we need to reprioritize and allocate more investments on the digital side of our strategy, including our new e-com platform that I mentioned, CRM and loyalty that Patrik mentioned as well. The Fifth Avenue location is, obviously, a premier retail location, but we're considering whether it may be better suited for someone else at this time. Regardless of whatever decision we make there, our lease obligation remain in place and we begin paying rent on that later this year. But we're continuing to evaluate that.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.
A

And that doesn't – and this is – hi, this is Patrik. I just wanted to add a little bit of color around flagship stores in general. We have other flagship stores around the world, and we'll continue to look at flagship opportunities in the future for sure. But at this point in time, we feel that it's prudent to take this action. And I think for us, we need to make sure that we're also now looking not just in North America, but beyond, in terms of how we support our retail business.

Alexandra Walvis
Analyst, Goldman Sachs & Co. LLC
Q

Fantastic. Thank you.

Operator: Thank you. Our next question comes from Omar Saad with Evercore. Your line is now open.

Omar Saad
Analyst, Evercore ISI
Q

Good morning. Thanks for taking my question. Two quick questions, guys. So number one, I thought I heard you mention at some point in the prepared remarks embracing the performance element of the Under Armour brand really sticking to that kind of knitting in its original DNA. I'd like to hear you elaborate on that, especially given kind of the demand for fashion products in the marketplace and how you see Under Armour's unique performance element fitting into the broader marketplace.

And then my second question is, if you can give us a sense of the rise and fall, and the rise again of marketing spend and ad spend for the brand, how much and how large and far-reaching was the UA voice at its peak versus 2019 so we can think about what ramping back up the brand voice will be through increased marketing going forward? Thanks.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Okay. Well, I'll start, Omar. Thanks for your question. Yes, it's an ongoing conversation, I guess, that we have with investors, and I think also with the media, around our decision to play in athletic performance. And we don't necessarily think about it in terms of bifurcation between performance and style, right. We don't believe that just because we're focused around what our product does for people means that we're not going to be stylish or on trend. We're expecting our products to be bought because people want to get better. But, ultimately, the way that they choose to wear them might be on other wearing occasions.

So our design team, as I said in my prepared remarks, truly believes that there is no performance without beauty. And that's how we think about it. So we believe we can be absolutely relevant in today's trend that's going on right now with the products that we make going forward. The major difference and why we speak about it so pointedly is because we want to make sure that we're focused as it relates to our innovation engine, and ultimately, our go-to-market engine around things that is going to improve people, right – to make them better. And we've got to start from that chart point, and that's really important to us.

If you think about footwear, for example, there's no real footwear platform or success story out there in footwear that isn't based on a performance base at some point or another in terms of history. And so for us in footwear, it's important to build these franchises so that we can then start to expand them more. In our apparel offering, it's similar, right. For us, it's about making sure that we have products that is actually making you better. They need to be innovative. That's what people are expecting from us, but then, ultimately, making them so beautiful that you also want to wear them on different wearing occasions. That's our job.

And I think one thing that's important here is, this is not the management team at Under Armour sitting in a closet somewhere trying to figure this one out. We've done more extensive consumer insights work around understanding the consumer, the marketplace and the consumer's preferences for this brand than I think many other brands have done.

We have done close to 50,000 interviews at this point with consumers around the world, and they continue to tell us the same thing. And that's why we believe in our strategy ultimately. It's not just grounded in internal speak. It's grounded solidly also in the external world in terms of making sure that we're turning this company into more consumer-centric company going forward.

So we believe in our strategy, and we believe we're headed down the right path. And we're going to stick to it for now.

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

And, Omar, this is Dave. Relative to the marketing investment, over the last probably five years or so we kind of fluctuated in that 10% to 11% of revenue range as far as the marketing investment. We kind of hit probably the trough in 2018 as we were really trying to manage costs, and we were all the way down towards 10.5%. As we approach 2020 and the amount of confidence we have in our new brand campaign, we're going to be pushing that closer towards 12% of revenue.

So just over a two-year period that's about 150 basis point increase in marketing as a percentage of revenue. So we're pretty excited about that. And also the mix of that spend has gotten much more powerful, as through the past restructurings we were able to step out of some of the committed sports marketing contracts and pour a lot more of that fuel into the brand kind of top of funnel. So we're excited about kind of the power of that, not just the increase in the dollars.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Yeah, it's a really important point that Dave is making. It's not just the amount of money that you have. It's how you are able to activate that spend ultimately. We had a lot of committed spend in our marketing from 2016, 2017, 2018, and as we stepped out of 2018 and started coming to 2019 and now into 2020, we're starting to be able to activate more of the money top of funnel. And that's incredibly important, and mid-funnel, that's incredibly important in North America because our issue here in North America isn't brand awareness. People know about this brand.

And that's why I keep saying that there isn't anything wrong with the brand. The problem is consideration. In other words, why should I consider Under Armour? And to be able to drive consideration, you need to spend against the brand. Of course, you need to have great product, innovative product, beautiful product, but you've got to do it in combination with spending money the right way.

And as we move into 2020, one of the big differences for us is we're now able to activate the dollars. Using the assets we have, spend against the assets but also spend against the brand. And I think that is what's so exciting for us. And to be able to do that in a coordinated way across everything that we do is something that we've never been able to do before. And to do it over a 12-month period consistently, that is new news. I think that is one of the big unlocks for us as a brand, as an organization, and that's also why we firmly believe in our strategy going forward.

Omar Saad
Analyst, Evercore ISI

Q

Thank you. That's very helpful.

Operator: Thank you. And our next question comes from Randy Konik with Jefferies. Your line is now open.

Randal J. Konik
Analyst, Jefferies LLC

Q

Yeah, thanks a lot. I guess, Patrik, two questions. I guess the first one is, when you think about the beauty quotient you're speaking to, you've made some clear progress on the footwear side and talked to improved kind of demand resulting from the stuff looking better. How do you kind of think about that beauty journey across the apparel and broader footwear platforms for the company? Where are we today? Where will we be in six months? And a couple years out from now? Just kind of getting your perspective on where we've come from, where we are today, and where we're going.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Yeah, it's great. Yeah, first of all, I think in footwear we are now really turning the corner in terms of what the composition is of our footwear proposition to the consumer. As we went through 2019, we still were taking some products out that we felt were not necessarily going to be with us going forward. And as we're putting new products in, we're taking old products out. So that rejuvenation, if you like, of the line started to really happen in 2019, and it's starting to play out in a major way in 2020.

In terms of apparel, a lot of the effort that we're doing now going into 2020 is really around a reinvention of where we began our journey around the base layer and how we think about marketing ourselves as kind of part of the equipment as it comes to base layer. We think we have a lot to say there, and we think that the consumer still looks to Under Armour for that first layer.

But what we're also doing a much better job of now is actually continuing to build out our fleece program for both men and women and adding on top of that much better outerwear as we go into 2020. And we're taking a little bit of a different slant on the outerwear. It's not just outerwear for outerwear's sake, so to speak. It's actually functional outerwear that is done together with the performance base that we have. And the idea is really around active outerwear. That is merchandised together back into our categories of Train and Run and so forth, in combination of course with some colder weather gear coming in the back half of the year. All of those different things we believe are incredibly exciting.

We then layer on top additional types of mid-layer. We have, for example, our IntelliKnit sweaters which is a new way for us to showing people of how to run in something different than just a normal mid-layer. This is a very specific product, the IntelliKnit sweater, that does the cool thing of actually being able to maintaining body warmth without overheating, right, while you're running. And we're doing that with these new delta-shaped fibers that they're able to move moisture extraordinarily good or well away from the body, while you're keeping air in. And it's almost like kind of magic. And we're seeing traction for that type of product, too.

So we're also introducing these new ideas and new segments, if you like, into the performance world. And the reality is a lot of that stuff looks so darn good you'd want to wear it day-to-day, right? And I think that is kind of the way to think about what Under Armour is trying to do. And I think that's also really important because we believe that that is a longevity play for us, to make sure that we're grounded in product doing something for you, and then it's going to look so good that actually, you know what? I might just wear it because it looks good.

And I think that is – they don't need to be different. They don't need to be bifurcated. And we continue to get into this conversation about two different things. We don't think they're two different things. We think they're one and the same.

Randal J. Konik
Analyst, Jefferies LLC

Q

Yeah, and then can I just follow up? If we all can agree on the call that the performance has always been there with the products, and the beauty side of the product story is getting better, seeing that first most in footwear, over time in apparel as well. On the consumer work you've done, and then talking to your wholesale channel partners, what's the kind of response or perception you're getting on the pricing side from how the products are priced in the market and that perception of the consumer as it relates to them thinking about, do I purchase an Under Armour product or not given this price point? So I'm just curious on how you're thinking about price architecture.

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Yeah, it's a great question. I think that is what gives us a lot of encouragement, too. And Dave kind of alluded to it here a little bit earlier. That's one of the reasons why we're feeling a little bit more bullish in terms of turning off how we think about promotional activity in the back half of 2020. We've been doing some tests in Europe on this as well, and we've seen great results from some of the turning off the discounting button, if you like, and the willingness from the consumer to pay full price.

And when they are willing to pay full price is when we get the formula of SPF, style, performance, and fit, right. Then the consumer does not have a problem to pay full price for Under Armour. Because the reality is we are well-positioned from a price perspective compared to some of our competitors, right, that are out there right now in terms of some of the categories that we play in, whether it's tights or base layer and so forth.

Of course, we're not as well priced as a private label. When we come to our competition, we feel that we're competitive there. And the great news is, we're competitive there, and we've done great work in the back end of the machine to make sure that our margins are better, right? So as we scale the business, there should be a great benefit there.

Randal J. Konik
Analyst, Jefferies LLC
Q

Helpful. Thank you.

Operator: Thank you. Our next question comes from Matthew Boss with JPMorgan. Your line is now open.

Matthew R. Boss
Analyst, JPMorgan Securities LLC
Q

Great. Thanks. Maybe for Patrik, just to put this all together, what's the timeline you see at this point where the product innovation and the assortment marries the louder marketing message to drive a return to growth in North America?

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.
A

Yeah, well, thank you for that question, Matt. I think for us it will be a gradual improvement from here going out. I think that's how we think about it. What we tried to depict here today is it's a timing issue for us more than anything. And part of this taking a little longer than we thought, some of that is just simply earning it back. And earning it back you don't get to do that in a vacuum, right? Everybody else is also out there trying to make sure they maintain their position.

So we believe now that we've put the play together, so to speak, with the product and the marketing, and our ability to service the business. I mean our service levels are the best they've ever been as a company. All of those things playing in unison is giving us the optimism to say that growth will return to North America, and it is a little bit of a delay but ultimately it will, and we're going to earn our way back. Dave mentioned it, in North America specifically, that we see stabilization in Q3. I think that's good. I think we're choosing to stay prudent here as we look out into Q4, but we believe we have the product. We believe we have the marketing assets. We believe we have the plan in place to return this brand to growth, and the right strategy. It's about consistency, it's about being persistent, it's about spending against the brand at this point in time and executing the playbook.

So we see it as a gradual improvement as we go into the future, second half of 2020, and going forward.

Matthew R. Boss
Analyst, JPMorgan Securities LLC
Q

Great. And then maybe just on the gross margin, so inventory exits the year down double digits and you've outlined an effort to be less promotional in the back half of the year. Maybe what drivers of this past year's gross margin expansion moderate? If you could just help unpack your gross margin guidance for this year?

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

A

Yeah, Matthew. This is Dave. When we step back and look at 2020, there's a lot of great progress we've made on gross margin in the last few years, and a lot of that's come from the supply chain side with all the consolidation of vendors and SKU rationalization, costing transparency and everything else. And so we've been seeing a lot of those benefits starting to come in in 2018 and then full year 2019, so we are starting to comp some of those benefits.

But we see them continuing, but when you're comping a lot of that 2019, it's not as much of an incremental benefit year-over-year. You couple that with the fact that we are continuing to step off the off-price channel, so that helps a little bit as well.

But then there's a couple things that temper us a little bit this year on gross margin, and that's when you think about the APAC region, we've tempered our royalty revenue a little bit with some of the challenges in Japan and we've also talked about the impact of the coronavirus that we're expecting in Q1. So that takes the APAC growth down a little bit for us which is our highest gross profit region. So we don't have as much of a tailwind this year that we normally would have with the APAC growth there, that we would be expecting that to continue more so in 2021 and beyond.

So a couple different things going on there. And when you think about channel mix, which would normally be a little bit of a tailwind more for us as we go into 2020, it's actually going to look a little bit neutral this year because we do have the benefits of the reduction in the third-party off-price channel, but we also have the decrease in our licensing revenue that we talked about. Some of that is related to Japan, some of that's related to onetime settlements in 2019, and some of that is also stepping away from a couple partners that we don't think are as in line with the focus performer.

So that license revenue is obviously an extremely high gross margin business as well, so that kind of offsets the off-price channel benefit.

So there's some puts and takes going on as to why our progression in 2020 might not be as much as what you've seen in 2019 and prior. But we feel good about the direction and the continued supply chain improvements.

Matthew R. Boss
Analyst, JPMorgan Securities LLC

Q

Great. Best of luck.

Operator: Thank you. Our next question comes from Jim Duffy with Stifel. Your line is now open.

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

Q

Thank you. Guys, just thinking big picture, you've made great progress operationally, quality of sales have improved, you remain confident in the consumer positioning. Can you talk more about how you're thinking about distribution strategies in North America? Give us an update on the segmentation efforts. Specifically, I'm curious versus the plan outlined in December 2018, are there notable changes in go-to-market thought process or channel strategy? Or is North America decline simply share loss and just less volume through channels that remain strategic?

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Yeah, thanks very much, Jim. You know it's interesting, we don't talk about it, but there are certainly dynamics in terms of distribution that's going on in North America too, right? Just thing about some of the news that came out this week around Macy's and other things, right. We're in some of those channels where contraction is also happening right now which is another way to think about it as well, right, in terms of what's going on. But essentially at the core of it, our strategy remains the same as it relates to how we think about segmentation. And we've been able to – as we work through 2019 and into 2020, also validate a lot of that, right? In other words, especially as we think about footwear, where we have been driving a lot of the Run initiative in HOVR, for example, into the endemic channel, Run specialty channel, a channel that we were not in before as a positioning vehicle, for example for the brand. So we see our distribution footprint currently and going forward being fairly stable in North America, I would think. But there's going to certainly, in pockets, be some contraction. We're estimating that there's going to be some stores disappearing as we go into the future, and that's calculated into our model as well.

But we think that in spite of that, we're going to be able to grow the business because we're going to have – earning our way back into the winners. So part of our strategy going forward is definitely win with the winners. Right? So – and we believe there are going to be winners in this market too and we're going to make sure that we're on that shelf. So I think from a distribution perspective, it's no change in terms of how we think about our world going forward. It might be a little bit of a pocket here or there where we'll find some opportunities to find a new partner or so and there might be some areas where we see contraction with some of our current partners. But in terms of segmentation into our distribution, there's no change. We're going to continue to make sure that we do a better job and we've continuously made sure that as we've rolled through 2018 and 2019, we've gotten better and better at segmentation, not just in terms of price segmentation, but also category segmentation and that's a global view.

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

Q

And, Patrik, you mentioned the 3Q bookings flattish, to what do you attribute the improvement in third quarter versus what you're seeing in bookings in the first half?

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Yeah, I think it's year-over-year. Our business with the wholesale channel in North America and I would say also in Europe where we have the most wholesale, those two regions, improved. And therefore, we're seeing flattish earn back, if you like. And I think part of that is also definitely in terms of our product, and our marketing efforts, right, where we're able to put together a holistic play for our partners and the product is getting better. So I think that's part of it, and both of those things are playing into it.

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

Q

Thank you.

Operator: Thank you. And our last question comes from Michael Binetti with Credit Suisse. Your line is now open.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, guys. Thanks for getting me in here. Thanks for all the detail today. I guess, Patrik as you look past 2020, I have to ask about the comments that you're stepping up the costs on some of the – spending on some of the long term drivers like digital and marketing this year, and also the CapEx looks like it's rising a little bit. So I guess a few questions, is 10% to 12% marketing still the right longer-term zone? I know you talked about butting up against the high end of that today and I think you offered some comments, Patrik, that I'd say were appropriately cautious reflecting the longer-term algorithm given today's update. As we think about that plan that you gave in 2018, how realistic do you think it is to still have the business margins surpass 10% by 2023 at this point knowing what we know now?

Patrik Frisk
President, Chief Executive Officer & Board Member, Under Armour, Inc.

A

Two things there, and thanks very much, Michael. I think two things, first of all in terms of the marketing spend, we believe that as we have implemented ROMI or return on marketing investment practices diligently over the last 14 to 18 months, we are that much more well-informed now as we think about how to spend the money. And we believe that you will see an acceleration because we actually, right now, believe that we can continue to spend, the way that we're spending right now in 2021 as well. And what I mean by that is prioritizing North America, and then APAC secondly, and spending with the same kind of percentage spend going into next year as well to continue to drive what we now believe is a much smarter engine, and more and better well-defined engine, if you like, in terms of understanding how to spend. So we are all-in as it relates to spending against the brand as we turn the corner into 2021. That's the first question. I think Dave, do you want to give a little bit more color around the longer-term outlook?

David E. Bergman
Chief Financial Officer, Under Armour, Inc.

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Yeah, I mean, I think this year, obviously, we're taking a little bit of pause on operating margin rate expansion. But through all the different things that we've been laying out and driving, we still see the long-term objective of being able to get into that low double-digit operating margin rate. The exact year, we're still going to be working through as we continue to update our long-term plans and assess that. But they're still absolutely the plan that we want to drive towards that.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC

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Okay. Thanks a lot, guys.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.