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Under Armour, Inc. (UA)

Q2 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Under Armour Second Quarter Earnings Webcast and Conference Call. At this time, all participants are a listen-only mode [Operator Instructions] As a reminder, today's conference is being recorded.

I'd now like to introduce your host for today's conference, Mr. Lance Allega, Vice President of Investor Relations. Sir, please go ahead.

Lance Allega
Vice President-Investor Relations, Under Armour, Inc.

Thank you, and good morning to everyone joining us on today's call to discuss Under Armour's second quarter 2017 results. Participants on the call will make forward-looking statements. These statements are based on current expectations and are subject to certain 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 uabiz.com.

During our call, we may reference certain non-GAAP financial information including adjusted and currency-neutral terms, which are defined in this morning's release. We use non-GAAP amounts to lead into some of our discussions because we feel they more accurately represent the true operational performance and 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 including the press release which identify and quantify all excluded items and provide management's view of why this information is useful to investors.

Joining us on today's call will be Under Armour Chairman and CEO, Kevin Plank; President and COO, Patrik Frisk; and Chief Financial Officer, Dave Bergman. Following our prepared remarks, we'll open the call for questions.

With that, I'll turn it over to Kevin Plank.

Kevin A. Plank

Chairman & Chief Executive Officer, Under Armour, Inc.

Thanks, Lance. Good morning, everyone, and thank you for joining us on today's call. Before we begin, I'd like to take a moment to welcome Patrik Frisk to our team. Patrik joined Under Armour as our President and Chief Operating Officer in July. In this role, his responsibility is for our overall go-to-market strategy and will partner with myself and the rest of the executive team to ensure successful execution of our long-term growth plan. His experience working with global iconic brands meaningfully strengthens our capabilities as we enter into our next chapter of growth. Nearly a month in, from sales, strategy and supply chain to product marketing and global operations, he's digging in.

Patrik?

Patrik Frisk

President & Chief Operating Officer, Under Armour, Inc.

Thank you, and good morning, everyone. I would like to take this opportunity to thank Kevin and the board for the partnership and trust that they've given me in taking this role at Under Armour. While understandably I'm not yet in a position to share my initial observations in great detail, what I will underscore is the absolute single-mindedness of this team, the culture and the DNA. The relentless pursuit of innovation, the attention to detail and the outright grit that goes into making all athletes better permeates from every corner of what this company does, and driving it is an infectious, authentic and entrepreneurial energy unlike anything I've experienced before.

So in my first few months as I travel to our offices and distribution centers, meet with our biggest partners and spend time with industry influencers, I'm learning as much as possible about our brand, our consumers, our customers and the opportunities before us, opportunities that capitalize on our strengths: product innovation, connection with our consumers and customers and our largest growth opportunities including our direct-to-consumer, our international, our footwear, women's and lifestyle businesses. And opportunities to improve efficiency and effectiveness: our speed to market, operational processes and digital capabilities.

Putting all of this into better balance will undoubtedly strengthen our ability to execute against our long-term growth strategy and create value for our shareholders.

And with that, I'm greatly looking forward to the journey ahead. Kevin?

Kevin A. Plank

Chairman & Chief Executive Officer, Under Armour, Inc.

Thanks, Patrik. At the halfway point of 2017, Under Armour continues to show resilience in the face of a highly competitive retail landscape in a dynamic global environment. Consumer trendlines are accelerating quickly with consideration, preference and purchase behavior constantly evolving. In this evolution, consumers remain steadfast on their expectation for a brand's ability to deliver innovation, performance, style and value with a strong point of view.

As the world's third-largest athletic company, we are fiercely proud of the incredibly strong brand that we've built, one field by industry-leading innovation and a truly unique intimacy with our athletes and consumers.

Our path has included very rapid growth. In fact, over the last three years we've more than doubled our revenue from $2.3 billion to $4.8 billion and nearly doubled our number of teammates from 8,000 to nearly 15,000 global employees.

To achieve this growth requires significant investment and resources across the organization. It's been a fight since day one. It was a fight to get to $1 million and to $1 billion and $5 billion. There is no let up in our team, and make no mistake: we are squarely in it. We are in this fight.

That said, the playbook that got us to $5 billion is only part of what will deliver our next chapter of growth. Like an athlete always striving to do better, Under Armour trains and competes and is constantly searching for ways to become stronger, faster and smarter. Balance is crucial to success. The mental and strategic plan must be aligned with the physical and tactical execution to ensure consistent, predictable performance.

The landscape is evolving quickly. Therefore, we too must evolve quickly. This evolution requires a pivot, and we're doing just that. We're pivoting from a product company to a consumer-led and category-managed brand, from predominantly men's to distinct collections for men, women and kids; from U.S. mostly apparel-centric to a global apparel, footwear, accessories portfolio; from mainly wholesale to a more balanced direct-to-consumer offering; from a historically top line driven P&L to return-focused more disciplined financial model; and ultimately pivoting from good to great operations. Once balanced, these pivots will work together to build a more efficient, thus more effective Under Armour.

Let's provide a bit more context starting with our move to category management. Nearly two years into our realignment around key sport categories, and we continue to make solid progress. Using 2017 to further empower our team structurally, we are focused on a sharper, consumer-led approach that will drive authenticity within each sport category. In this respect, we've identified five primary categories that represent the largest and fastest-growing opportunities based on innovation, consumer demand and market capacity. They are for us men's training, women's, run, basketball and lifestyle.

In direct support of this strategy, we are building a relentless product engine while optimizing our merchandising, demand creation and distribution capabilities to ensure our overall go-to-market gets sharper and more agile.

Specifically, we are reengineering the UA System to be clear and more efficient internally, including product design, lead cycle times, samples, procurement processes, cost structure and the overall use of digital. From a designer's rendering to the consumers' closet, we are addressing redundancies and stall points so we can become stronger, faster and smarter.

We're also streamlining our organizational structure to be more efficient on how we work across the matrix of the category, product and regional teams. Working in concert with our shift to category management, our product innovation and consumer connectivity. This trinity; category, product and consumer, backed by Under Armour's unique DNA and culture, fuels our growth and defines our brand.

Delivering great product that's unexpected to our consumers is at the heart of our brand promise. Great product must also be backed by terrific storytelling and it must happen often creatively and inspiringly. To touch on some product highlights, let's start with footwear and the few launches that we expect to help drive our second half.

Our customized footwear program known as Icon launched in June. With just three initial styles, consumer reception and results have exceeded our expectations and show outstanding potential in the second half as we add new lifestyle and basketball options. Next, we celebrate the launch of the C1N, Cam Newton's first signature training shoe that blends performance and lifestyle. With positive reaction from consumers, sneakerheads and sports media, we look forward to building momentum on this great new product.

We also recently launched the Harper 2, our latest Bryce Harper signature model, which significantly pushes innovation once again for one of the sport's biggest rising stars. And between Bryce Harper and Aaron Judge getting the top All-Star votes in their respective leagues, we're building great brand heat momentum ahead of hitting the field as the official outfitter of Major League Baseball in 2019.

In the fall, our footwear portfolio gets even stronger with the launch of the Bandit 3, Threadborne Push for Women and the Curry 4. One in the NBA Finals by Stephen Curry early reaction to the Curry 4 has been quite positive, so we're excited to bring them to market in a couple of months.

On the apparel side, we're focused on staying lighter, longer. Two key innovation platforms; Threadborne and Reactor will see extended offerings this fall. The story around Threadborne continues to evolve with increased comfort and breathability, including a new Lightweight Fleece option. And Reactor, an insulation technology that features temperature and airflow management, as worn by Jordan Spieth just a few Sundays ago, sees a meaningful expansion with additional styles, silhouettes and price points across key categories.

Last year, we learned a lot in the fourth quarter. The pace at which things can change, and what consumers value in certain environments. We've seen that movie, reviewed the tape more than a few times, have learned from it and adapted very quickly.

This year we're in position to be proactive as necessary. Our core sets are more diversified, less key item focused and better balanced between lightweight and heavier-weight products to accommodate changing weather conditions. Additionally, we've amplified our assortment with more lifestyle silhouettes, including our Unstoppable collection, to drive better product flow and newness in the holiday season.

Further strengthening our story is the addition of some new distribution, a diversification that allows us to reach and bring new consumers into the Under Armour brand. We also have stronger capabilities around our pricing strategy, driving much clearer product segmentation and distinction into the mix. Clear segmentation is an absolute priority for us, and something we've made meaningful progress versus last year. We're in a much better position to protect and fight for our brand while serving the changing needs of our consumers going forward.

Turning now to consumer connectivity and a few brand highlights. First off, a huge congratulations to Jordan Spieth for winning the British Open and securing a historic third grand slam leg, as the second youngest golfer ever to achieve that milestone. After an incredibly-difficult 13 holes in the final round, many thought he was out of it. Yet, with the heart of a champion, he stuck to his playbook and found a way; a phenomenal moment for Jordan Spieth and for the Under Armour brand.

On the marketing front, we're also pivoting with respect to approach, construct and point of view. While the intersection of digital, social, and traditional continues to blur lines, success is now measured in terms of months, weeks and even days. Engagement and intimacy requires consistency, saturation and showing up whenever and wherever a consumer engages our brand.

Consumers demand authenticity and our newest women's campaign, unlike any, delivers exactly that. This globally innovative 100% digital campaign with more than 300 pieces of content celebrates the unparalleled accomplishments of female athletes that have shattered the status quo in their respective sports. Through collaboration with spoken word artists unlike any shines the light on the remarkable talents of Under Armour athletes, including Misty Copeland, Alison Désir, Natasha Hastings and others.

As one of the most integrated efforts we've ever constructed, in just a few short weeks, we've seen millions of online views and significant spikes in relevancy and engagement rates.

Next, [ph] with tours (12:47) through Asia in just the last few months featuring two UA athletes, Tom Brady and Stephen Curry, interacting with thousands of fans through training sessions, retail appearances and product launches, we continue to build an authentic connection with our global consumers. These trips underscore our increasing global brand heat and how we are truly just getting started in Asia.

Shifting gears back to our pivot list. We're in the process of strategically and proactively addressing efficiency and effectiveness to build a stronger UA System. Having grown so quickly over the last three years, we developed certain muscle groups really well while underserving others. Starting in January this year, we began a comprehensive formal review of our business to assess how well our resources align strategically, financially and operationally. As detailed in this morning's release, we've developed a restructuring plan that identifies multiple opportunities to drive toward operational excellence.

While Dave will go into the financials of the plan a bit deeper, from an architectural perspective this was a holistic evaluation that covered products, marketing, supply chain, geographies, our customers and the broader market landscape. By identifying specific opportunities to reduce complexity and streamline processes, we are working to position a more responsive organization, capable of fueling and self-funding our own growth more effectively. As you've heard me say a few times today: stronger, faster, smarter, that's the goal; that's our objective.

So what specifically are we focused on? First, driving a stronger go-to-market strategy, directly led by Patrik: all aspects, team, process, tactics, execution, digital and interconnectivity with all relevant internal players from product design to sourcing to marketing and retail; second, increasing speed around market discipline, better managing supply and demand with an evolving distribution model, ultimately maintaining the highest possible levels of brand presence, health and desirability; and third, becoming smarter to ensure that resources are aligned and leveraged strategically against our annual and multiyear planning processes with increased accountability to drive the highest return opportunities.

Another pivot, one that is central to our move toward efficiency and effectiveness, is prioritization within our financial model. After six-and-a-half years of more than 20% top line growth that ended in the fourth quarter of last year, we are clearly operating in a different environment, particularly in our largest market, North America.

With our largest growth drivers including international, footwear and DTC continuing to scale but still not yet large enough to offset the magnitude of North America on our overall business, the terrain has changed and so must we.

As we execute against our restructuring plan, there are three main disciplines we are underscoring across our operations. First, we've restructured the company around category management with the goal of streamlining operations to increase speed across all parts of our business. Within this, we are building an integrated global model with shared accountabilities between regions, categories and corporate functions; second, we're implementing clear and broad-based SG&A savings initiatives and embedding new practices to encourage stronger stewardship of how, when and where our investments do or don't align with our growth strategies; and third, building into the stewardship on an elevated focus on return on investment and the cost of capital to safeguard that we are seamlessly linking and matching priorities with financial plans and targets.

As our model evolves and we establish more flexibility into our P&L, our goal is to be able to invest most heavily against our highest growth, most profitable areas of our business. This will in turn drive our top line and ultimately create leverage elsewhere in our expense structure, setting the stage for operating margin improvement.

We are not standing still. In addition to streamlining our organization for greater operational efficiency, we've already taken proactive steps throughout the first half of 2017 to address our short and long-term opportunities; enhancing, upgrading, restructuring and leadership. They play out like this; enhancing merchandising across pricing, style and assortments; upgrading our ERP system with SAP's Fashion Management Solution to increase our speed, visibility and efficiency across the organization, giving ourselves the tools to get even closer to our consumer; restructuring our organization around category management to maximize our go-to-market strategy as well as aligning the entire company around digital; and finally, strengthening our leadership team by bringing on a new President and COO.

All of this enables and inspires our team to consciously pivot toward becoming a stronger, faster and smarter branded company. We have line of sight and are committed to taking all actions necessary to capitalize on our existing strength to address opportunities to run an operationally excellent company and position Under Armour to deliver sustainable, long-term growth and returns for our shareholders. We are in this fight.

Dave?

David Bergman

Chief Financial Officer, Under Armour, Inc.

Thanks, Kevin. Before we get into the quarterly results and our updated outlook for 2017, I'd like to provide a bit of context around the restructuring plan that we announced this morning and the one-time items that will impact our full year P&L.

In conjunction with this plan, we anticipate taking pre-tax restructuring and related charges of approximately $110 million to $130 million in fiscal 2017, including up to $70 million in cash related charges consisting of approximately $25 million in facility and lease terminations, $15 million in employee severance and benefit costs and $30 million in contract termination and other restructuring charges. And up to $60 million in non-cash charges comprised of approximately $20 million of inventory related charges and approximately $40 million of intangibles and other asset related impairments. With respect to timing, we anticipate taking the majority of these charges in the third quarter.

Moving to our second quarter review. Revenue was up 9% to $1.1 billion. This was slightly stronger than our outlook due to timing shifts we cited on our last call associated with upgrading our enterprise resource planning system. To give a quick update on that effort, in early July we went live with SAP's FMS or Fashion Management Solution. This system, along with our evolving category management structure and Connected Fitness business, creates a powerful unique and data-driven connection with our consumers. One month in, we are pleased with our progress so far.

Back to revenue. Let's take a look at how the 9% increase breaks down. By product type, apparel revenue increased 11% to $681 million driven by strength in men's training, women's training and golf.

Our premium innovation platforms led by Threadborne, combined with our focus on improved assortments and newness continue to resonate with our consumers around the world.

Revenue for our footwear business was down 2% to $237 million as we lapped a 58% increase in the second quarter of last year, which had significant strength in basketball sales. Additionally, our efforts to manage inventory appropriate to the North American marketplace negatively impacted us in the quarter.

Revenue for accessories increased 22% to $123 million in the quarter with solid results from men's training, women's training and youth performance.

Looking at revenue by channel, our wholesale business was up 3% to $655 million reflecting strength in international, partially offset by an uneven North American business.

Direct-to-consumer revenue grew 20% to $386 million with growth in all three concepts; factory, brand house and e-commerce and in each region around the world. As a percent of total, DTC was 35% of global revenue in the quarter. Our licensing business grew 20% to $25 million in the second quarter driven primarily by strength in our sock business.

On a regional basis, the dynamic and promotional retail environment in North America tempered results to be in line with last year's same period. As previously noted, we are proactively managing our inventory levels in our largest market, while continuing to protect brand health as we navigate the uneven consumer landscape.

Our international business delivered strong topline results posting a 57% increase in revenue to reach $235 million, or 22% of total revenue in the second quarter. Currency neutral revenue was up 54%.

Clicking down into our international geographies, EMEA revenue was up 57% to $104 million, driven by balanced growth across wholesale and DTC. Here, we continue to drive strong momentum in our key markets, the UK and Germany, while also expanding our presence through newer markets for the brand, including Italy. Asia-Pacific revenue increased 89% driven by strength in China, Taiwan and Korea as we continued to see our brand resonate with consumers across key categories like run and basketball. Our Latin American business was up 10% led by strong growth in our DTC channel. And finally, our Connected Fitness business was down 2% to $23 million.

Turning to margins, second-quarter gross margin was down 190 basis points to 45.8% due to continued inventory management efforts, air freight and foreign currency impacts. These headwinds were partially offset by channel and product mix, which included a lower composition of liquidations.

SG&A expenses increased 10% to $503 million as we continued to invest in our long-term growth drivers, DTC, international and footwear. This increase was better than planned due in part to expense management efforts and some timing shifts and demand creation and other expenses.

Second quarter operating loss was $5 million and interest and other income expense was $11 million. Our tax rate was 21% in the quarter compared to 41% last year due to discrete items taken in certain foreign markets. Taking all of this to the bottom line, we had a net loss of $12 million in the second quarter or a loss of $0.03 in diluted earnings per share.

Turning to our balance sheet. Cash and cash equivalents was up 37% to $166 million. Inventory was up 8% to $1.2 billion, closely in line with our revenue growth. Accounts receivable was up 31% due to timing of shipments around the company's ERP implementation and comparisons against last year's same period, which included the bankruptcy of one of our largest wholesale partners. And finally, CapEx was down 45% to $82 million.

Turning to our full year 2017 outlook, we now expect revenue to be up 9% to 11% for the full year, reflecting the expectations for our North American business. To provide a bit of color on our quarterly revenue cadence, in the third quarter, given last year's strong growth comparison, as well as shift of revenue into Q2 due to our ERP implementation, and into Q4 due to timing of shipments, we expect Q3 revenue to be essentially flat against last year same period. As a result, in the fourth quarter, we expect revenue to be up at a low to mid 20s percentage rate. This imbalance between Q3 and Q4 is based on several key factors. Let me take you through them.

From a distribution perspective, new North American distribution is extending our ability to reach a segment of consumers not previously serviced. And, internationally, we have expanded distribution of both wholesale and DTC, and we are seeing strong sell through in comps. From a product perspective, we believe new launches, improvements in our assortments and segmentation position us competitively going into this holiday season. From a channel perspective, the fourth quarter is our largest DTC quarter and is expected to deliver measured growth. Within marketing our focus and approach is sharper and our frequency is increasing. Undoubtedly more spend, more presence, and a stronger more consistent brand voice will be heard from us in the second half. And finally, we're up against our lowest quarterly comparison from 2016 in this year's fourth quarter.

Moving to gross margin, due to the higher expected growth of our footwear and international businesses, which carried lower margins than the overall company, we expect mix will be working against us in the second half of 2017. This, combined with our increased actions to manage our inventory, should more than offset benefits from improved product costs. We expect these factors, along with impact from our restructuring activities, should cause our gross margin to be down approximately 160 basis points in 2017.

Excluding the restructuring plan, full year adjusted gross margin is expected to be down approximately 120 basis points with about a point decline in each of the third and fourth quarters. With respect SG&A, due to timing shifts and spending around marketing campaigns, international retail investments and other expenses, on an absolute dollar basis excluding the restructuring plan our spend in the third and fourth quarters should be fairly equal.

Turning to operating income, our team remains committed to maintaining the right level of investments to protect the long-term sustainable growth of the brand with an eye towards streamlining processes and driving towards a leaner and more responsive organization.

That said, operating income is expected to be approximately $160 million to $180 million in 2017. Excluding the restructuring plan, adjusted operating income is expected to reach $280 million to $300 million. Interest expense and other expense net combined is expected to approximate $40 million for the full year, with the third quarter being the largest quarter. We're expecting our full year and third quarter tax rate to be approximately 31% to 32%. Taking this to the bottom line, we expect full year diluted earnings per share in the range of $0.18 to $0.21. Excluding the impact of the restructuring plan, full year adjusted diluted EPS is expected to reach $0.37 to $0.40. And finally, we expect full year CapEx to be approximately $350 million down from the $400 million we cited in January.

So in closing, with a restructuring plan and an updated outlook based on moderated expectations for our North American business we're confident we are taking the right steps in the long run to become stronger, faster and smarter.

With that, I will turn it back to the operator for your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our next question comes from the line of Bob Drbul with Guggenheim.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Hi. Good morning.

Kevin A. Plank
Chairman & Chief Executive Officer, Under Armour, Inc.

A

Morning, Bob.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

I have two questions, I think, the first one is when you look at what's happening with the business and some of the trends especially the top line, can you just give us an update where you think the brand health is and the vision for the business today? And I think the second question that I'd like to ask is, when you look at the Q4 assumptions, you know, the breakdown between Q3 and Q4, will you have wholesale growth ex the new distribution in that third quarter and fourth quarter?

David Bergman
Chief Financial Officer, Under Armour, Inc.

A

Yeah.

Kevin A. Plank
Chairman & Chief Executive Officer, Under Armour, Inc.

A

Thanks, Bob. Let me take the first part, and I'll let Dave take the second. As far as what we see for our business and what we've got out there, we're incredibly proud I think of what's been built and it's a brand that's basically been built on performance and authenticity has become a bit of a cliché word, and a lot of people talk about going for authenticity and there are some companies that are just authentic. And we really view that as being a strength of our business and our brand. What we know though is that being built on performance, and frankly we're not going to apologize for our performance heritage and where and who we are, but continue to innovate while bringing more wearing occasions to our business.

So we think there's a lot more places that people can wear the Under Armour brand and it's a matter of us getting the right product to consumer at the right place at the right time. The one thing we know though is that it is all about the product. UA is special because we've represented performance, and that gives us permission to go into lifestyle and we feel that there's a lot of people that are in our space and category right now that don't exactly have the staying power, the ability to be there. We see our performance heritage as a benefit not a hindrance; authenticity actually is the hard part, and meanwhile we're bringing lifestyle into our assortments across the brands.

This isn't a new division or just one line that we have coming out, but style, innovation, lifestyle, things that look like people want to wear are the things that we're driving across our brand to make us a better business. And of course, making products for consumers that especially kids want to wear. When you look at the brand I think we've got a lot of products that we're proud of. I mentioned, in my script, the Threadborne and the Reactor, then you have exciting things like the Curry 4 on the footwear side, exciting things to come. But when you think about our business as a whole, we absolutely – we see incredible opportunity, and we're not pleased with where we're positioned right now. But we see that what today's actions are and a lot of things we're doing are putting us in a position for the long term is how we're thinking about 2017.

With an International business that's grown more than 50%, with the roster of athletes we have from Jordan Spieth winning the British Open, the Super Bowl MVP in Tom Brady, the former NFL MVP, Cam Newton, Misty, Lindsey, Stephen Curry, two-time NBA MVP, the number one ranked tennis player in the world, boxing champs, Dwayne The Rock Johnson, and frankly, kids everywhere is probably my favorite MVP.

The partnerships we have with more than 40 all-school deals that will be taken to field this fall across the United States including Cal Berkeley and UCLA that – we'll just kick off relationship this year, and then setting us up for our new deal with Major League Baseball coming up in 2019.

We have all the pieces in place. It's a matter of our execution. And so I think what today is about is laying out a plan of how exactly we're going to do that with the confidence that we have to march forward for our business. So I can't tell you exactly how people feel, but what I do know is how our athletes, our team, our partners and I feel about the future and the brand that we've built.

We certainly have a lot of work to do, but we have this incredible base. And now today as we sit here as the world's third-largest athletic brand, it's up to us to execute and deliver on that. Our performance heritage is an asset for us, and we need to bring the easy things to bear into the forefront. And that's what we're focused on right now. David?

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

Yeah. And I think, Bob, relative to the question on wholesale growth without new distribution, it's a great question. We don't really give that level of detail on channels, but you can assume that within North America our wholesale expectations aside from new distribution is tempered in our forecast. However, International wholesale growth is still very strong. So, hopefully that helps you a little bit.

Robert Drbul Q
Analyst, Guggenheim Securities LLC

Great. Thank you very much.

Kevin A. Plank A
Chairman & Chief Executive Officer, Under Armour, Inc.

Thanks, Bob.

Operator: Our next question comes from Matt McClintock with Barclays.

Matthew McClintock Q
Analyst, Barclays Capital, Inc.

Yeah. Good morning, everyone, and welcome, Patrick. Kevin, there's a lot going on here. I was curious about the industry backdrop as you execute this restructuring. How do you think about North – the North American environment as it stands today, particularly given your more moderate outlook? And then maybe since you're changing up your game, can you give us your updated thoughts on the ongoing evolution of retail as a whole? And how you're positioning yourself to address that shift? Thanks.

Kevin A. Plank
Chairman & Chief Executive Officer, Under Armour, Inc.

A

Yes. Thanks, Matt. 2017, it's a unique moment in time for retail, and I think a lot of the things that we've seen and lessons that we've learned so far this year, and really going back over the last nine months or so, have really given us pretty great perspective. And we're using 2017 frankly as the opportunity to position ourselves for the long term.

It's the only way for us to think about our business right now, is there's a lot of sort of short term in this, I think, that is happening, but we need to be understanding of that. And we need to be – react to it, and more importantly, we need to be proactive about what we're doing there.

In 2017 though, we're really focused on, I used the words, stronger, faster and smarter, and we're doing all those things to remind people, all the while adding about $0.5 billion in revenue at the same time. Now admittedly making less money, but we're using that to invest in our business.

We want to be a business that has a lot more flexibility, I think, than we've demonstrated in the past, is that going from being a North American business to being a global business, an apparel business to being a footwear business, a men's business to being a women's business, a performance business to being a lifestyle business.

So all these strokes are things that we believe we have developed muscle for them, they just need to get stronger. So when we talk about being a better business as well, we're really focused on that this year, and we're going to focus on the executional opportunities that we have in the near term, I think, while building a bigger engine for the long term. And so I want to just sort of lay out how the first half of this year we haven't been standing still, and this is nothing that is [indiscernible] (36:33) catching us by surprise. It's something that we are taking the proactive steps to move forward.

And whether it shifts on July 1 having flipped the switch on our new SAP fashion management solutions system that just upgraded all of our systems to put us in position of scale for the future, the new organization structure that we announced, breaking out a go-to-market strategy with a clear digital strategy as well, driving through category management which will put us through to consumer, which is then going from apparel, footwear and accessories organization to truly having leaders that are over top of our running business, our women's business, our training business, our basketball business, et cetera.

And that's something that again puts us in position for the future. Streamlining our organization [indiscernible] (37:19) one of the things that we outlined on the call today of just how we can get lean to be in position to grow and do it in the best way and the most efficient way, and then I think just from a leadership standpoint and having Patrick join the team and a little less than a month on board but we feel really good about the direction. We spent a lot of time going through in the conversations of getting to this point. So none of these things, I think, are reactionary. I think, we are ahead of it, but I think we're just seeing some of it come out right now.

And finally, if there's one thing I can say just about the current environment and sort of where we are is that Under Armour is a great brand, and we also have an executive team that has certainly been battle tested. Of course, the ones that you know, but many that you don't know that are behind the lines on this team, and I think that we've demonstrated through any undulation in our business our ability to persevere. It's been a fight all along as we sit here in our 12th year as a public company, and reminding people back to what it was like in 2008, 2009 and 2010.

But this environment is certainly different, and I want people to know that we're ready and we're emboldened with our new structure, our clarity and especially our leadership. So, we're ready to march forward, and as I said in my prepared remarks, we're certainly in this fight.

Matthew McClintock
Analyst, Barclays Capital, Inc.

Q

Thanks for all that color, Kevin.

Operator: Our next question comes from Randy Konik with Jefferies.

Randal J. Konik
Analyst, Jefferies LLC

Q

Yes. Thanks a lot. So I really appreciate this added focus on the cost discipline and the efficiency. So I guess, Kevin, what I wanted to ask you is you talked about the word empower and the leadership bench that you've built here, and you've continued to build out with Patrick, et cetera. Can you give us some perspective on how you're thinking about delineating the responsibilities of the different areas of focus?

And what are like the three or four yardage markers that you're going to be looking at on a – I don't know, if it's a weekly basis or monthly basis, or whether it be inventory turns or some other metric? What do we – what are you looking at to try to make sure that this – the firm is getting into a better place from an execution standpoint, so that we can and the market can get that greater confidence in what you're building there? Thank you.

Kevin A. Plank
Chairman & Chief Executive Officer, Under Armour, Inc.

A

Yeah. Thanks, Randy. Well, first of all, I'm sitting with two partners that are going to help me do that, so it's nothing I'm going to be doing by myself. I think, it's the most important thing is reliance on the engine that's built this company has been team all along. But when I look at where we need to go, the operational I think people would say is it's probably some of the easier things to do. And I think what I highlighted in some of my earlier answers were more about the difficult thing is having the stable of athletes like we have that we're so proud of. It's having the positioning of being an authentic brand. It's having the list of assets that we have across teams and leagues that we've put to place. But at the end of the day, it comes down to one very simple thing, and it just comes down to product.

I mean, we think about how we're going to grow, and what we're looking forward as a company. There's three real important things that matter. It's, of course, product, the storytelling that we do, and the way and where of where we meet consumers. So, from a product standpoint, I think it's important to understand that we have always demonstrated one of the strongest points of view in our industry and the product combining innovation with style in things like Unstoppable, a new line that we crashed this year that we'll be rolling out exclusively with Dick's Sporting Goods, for instance.

Our Reactor, Threadborne, sleepwear, Bandit, the Curry 4 that's coming out, and so many more in the back half of the year. And so the one thing that we need to do is ensure that we are a product engine, that when we look at our business is that we just have this relentless flow of innovative products. And I can tell you I've been spending the majority of my time inside of that pipeline and am incredibly enthused by what we see and the things that we have coming out.

So in doing that all with beyond just the performance eye, but doing it with the stylistic eye as well. And so ensuring that that happens for us; and then, of course, making sure that the consumer just loves what we do. You know, updating our assortments, and particularly, I know, a big word for us has been segmentation. I want to be clear that we feel really good about the product that we have and that we're putting in the marketplace and we're excited that it gets better and better every single season. And so our job is to take the consumer to a place that they didn't know that they could expect a athletic brand to be for them, and I think, we've done that throughout our history and we're excited about what the future looks like for that happening as well.

I also wanted to say, in the near term, how we've adjusted the balance of product that we've had, which is decrease many of the core and key items that we've had. We used to have – we're a very much a key item focused, a big logo hoodie and things in-store, and now we've got a lot of balance of that around versatility, layering, newness, and then also, frankly, what happened to us in the fourth quarter of last year and one of the things I've been watching really closely is just how we're proactive with things like our pricing strategy out in the marketplace. It's that – it's been a competitive environment and that people have been basically predatory out there, and we feel the ability that we weren't in a position to fight. And so, while we feel good about the products we'll have in the marketplace, we have lots of levers, and we will not be caught off guard, that is for sure.

From a storytelling standpoint, I want to overemphasize is that a large part of what we're talking about today is how we will be investing in this brand. We will be telling our story in the back half of this year, and you'll see increased brand heat coming from us, frankly spending against that. Of course, those are things as obvious as spending against social and digital to create the more always-on experiences like we just did with our Unlike Any Campaign for Women, featuring Misty Copeland, amongst a number of other athletes.

But it's also going to be the storytelling that we have around some of these moments in time that occur, with Jordan Spieth going for the Career Grand Slam as the youngest golfer to be able to do that, are some of the extraordinary things we have. I mentioned the teams that we have taking to field this year with the fall sports, and then, of course, some of our new athletes coming on.

So I think, we feel like we are positioned to give you some of what – we can play a little bit of free bird, when you think about Under Armour marketing is that there are things where people come back that they're looking for and they're expecting from us, and we also know that it's our job of delivering them, and part of that what they expect from us is delivering them the unexpected.

Finally, what I'd say as I look at the back half of the year is just monitoring what we're doing and thinking how successful we are from the segmentation standpoint with our distribution. Just looking and making sure is that I've said for a while that we are officially out of acquisition mode in activation mode. That's never been more true than anything around our distribution to grow wholesale distribution, and how we are out in the marketplace. We feel really good about it, and our job now is just making every place we do business great. And if our consumers – if our customers win, Under Armour is going to do just fine, and that's how we view the world.

And then, we also have, I think, this opportunity with our international growth from EMEA, where we're seeing great growth in Europe right now, and then China continues to be a bit of a juggernaut for us. So, the North America imbalance that we have of 80% of our business roughly coming from this continent is something that we look to build that diversity, just like we look to build diversity to lifestyle from performance, and from men's to women's and from footwear to apparel. So we feel like we're just getting going and really just beginning there.

Operator: Our next question comes from Kate McShane with Citi Research.

Kate McShane
Analyst, Citigroup Global Markets, Inc.

Q

Good morning. Thanks for taking my question. In your guidance, I was just wondering how we should think about Footwear growth in the second half, especially ex the increased distribution with your new customers. And then, just a couple of other questions in terms of better understanding what drove the acceleration in DTC from Q1 to Q2. And then, finally, with regards to inventory, how should we think about the inventory management efforts, and where you expect to be by the end of the year.

Kevin A. Plank
Chairman & Chief Executive Officer, Under Armour, Inc.

A

Hey, Kate. This is Kevin. Let me take the Footwear question first. And if you don't mind, I'm going to give a bit of a broader answer, so I can just expand a little bit about where we are and how we see Footwear. So Footwear remains frankly our largest opportunity, and we talked about lifestyle being a major opportunity. Obviously, Footwear is a part of that, but having our Footwear engine intact and having it ready to run for us is where our company has been focused.

And what we can tell you as we sit here and what seems like year 11, although we spent the first 6 of those introducing new categories from football cleats, baseball cleats, training shoes, running shoes, basketball shoes, et cetera is that we're now finally in a place that we have position, we have design, we have supply chain, merchandising, style and influencers like we feel like we are in that position to do it; we just have to execute on it.

We built global innovation centers around the world that we have now innovation centers where we're making products, as well as innovation centers that we have here in Baltimore, including our new headquarters that we just opened up in Portland, which is something that we're using to really be able to tap into the talent pool that exists there.

We remain now, as we talk about positioning, very much a performance brand, and we continue to build momentum there in some of our on-field, on-court categories like running, basketball, cleated, but we've also learned a lot of lessons, particularly in some of those hardcore places like run specialty is we're a business that where the majority of our distribution was focused below $100 in price points, $80 to $100, we are more focused on $100 and above.

It doesn't mean we're not going to continue to target to make that best-in-class product, and we believe that we have some incredible things in the pipeline that are coming in the fall, and frankly, in the spring of 2018, but it means we also have to rightsize, I think, the product that we have in the distribution where we're selling it.

We're still going to be building high-end premium product with again those exciting launches; things like Curry and things like Bandit that we have. But I think it's important to understand the positioning that we want to do to just be a better footwear company with how we align and the places where we're selling, with the best product for the consumer. But blending that true performance with lifestyle is something that we understand. We're not sitting here tone deaf saying we're just going to make cleats. Like we understand what the market is asking for and I think a good answer that we have, especially most recently is something that was pretty well received was the C1N, the Cam Newton new training shoe that we have, with a lifestyle bent to it but absolutely something that works in the gym. And so what we're not going to do is tear up the script on what's made us an authentic brand and allow us to be able to position to move forward.

So, in Footwear, let me maybe basically sum it up by – there's three things we're focusing on is innovation and building great product, first and foremost. Connected shoe that we launched this year is something that we see has the ability to continue to get better and be able to build a market there. I talked about the UA Icon, the customization, personalization side for the kid who is saying I want to be different, just like my friends. We think we can now answer and have a position in that style and that stroke for the consumer.

And then, of course, lifestyle remains this massive opportunity for us with styles we have like the 24/7, the Encounter, the Threadborne Shift and several others that you'll see coming out from our UAS line as well. At the same time, we've also done a pretty good job of building some franchises and something we think we can build on with that, like Gemini and Slingflex in running; the Highlight and Spotlight in cleated; the Curry and Drive in basketball; things like the C1N as well as the Dwayne Johnson, the Rock Delta shoe that we have coming out. And finally, we positioned ourselves in Footwear, and there's one of two decisions: either being a small company or going for it. And the way that we're thinking about it is the reason that we've expanded the distribution that we have, it particularly affects us on the Footwear side.

We're going to make a meaningful number of pairs of shoes this year that'll give us the attention and the scale that we need in order to be a long-term player in this space. And so a lot of what you're hearing today is how Under Armour's positioning for long-term and I think that plays out in no category more so than Footwear.

David Bergman
Chief Financial Officer, Under Armour, Inc.

A

And, Kate, this is Dave. Relative to your questions on DTC and inventory, DTC Q2 versus Q1, in North America some of that growth is from North America Factory House with some new doors and also I think with some more proactive pricing approaches there. And also North America e-comm did pretty well in Q2. But then there's a big push within international. We've got a lot of new doors internationally, especially in Greater China that are doing phenomenal for us. So it's really a combined effort across all of those areas. And then when you look at inventory growth, obviously in Q2 we're pretty in line with revenue growth for the quarter.

As we move forward through the year, Q3 inventory growth will be a little bit higher than revenue growth. We talked about this three months back around our strategy of taking some more returns, keeping the floors a little bit fresher and then having to process and move that inventory through brand-right channels for us. And sometimes that means holding it over from a season perspective. So some of that impact you will see in Q3. And then as we get into Q4, you'll see a little bit of that as well but you'll probably see inventory growth a little bit more in line with Q4 revenues as we get to the end of the year.

Kate McShane
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

David Bergman
Chief Financial Officer, Under Armour, Inc.

A

Thanks.

Operator: Our next question comes from Jonathan Komp with Robert W. Baird,

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Yes, hi. Thank you. Kevin, a bigger picture question on the commentary around shifting to more of a returns-focused and disciplined financial model. I would assume even most growth companies kind of long term are at least cognizant of returns. So could you maybe just comment more specifically on what that shift means for Under Armour? And maybe beyond 2017, does that mean you're expecting kind of a permanently slower growth rate as you prioritize returns, or how to think about that?

David Bergman
Chief Financial Officer, Under Armour, Inc.

A

Jon, this is Dave. I mean, I'll take that. I mean, high level, and we talked about this a little bit three months back as well. But again, as we look at working with our accounts and really wanting to make sure that we're keeping the floors as clean as possible and renewing with fresh product and making sure it's season right and whether right products, we're just being a little bit more proactive in bringing that inventory back.

And then also looking to move that more through our Factory House stores as we bring it back, and a lower percentage of that going to third-party liquidation. Again, we're continuing to protect the brand as much as we can and work down kind of that made-for-outlet percentage in our Factory House stores going forward. So as we move forward into future years, we're going to continue to monitor and make sure that the stores are fresh and we're giving them new product. But I wouldn't think that that has any real significant impact on long-term growth rates.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. And sorry, just to clarify, I actually meant more along the lines, one of the six pivot areas you mentioned from a financial returns model, more from kind of a P&L driven focus to ROIC returns driven focus. So maybe if you could address that topic?

David Bergman
Chief Financial Officer, Under Armour, Inc.

A

Yeah. I'm sorry. I apologize. From that perspective, we are definitely evolving. It is a pivot for us. Not that top line is any less important, but there's definitely a more significant focus on profitability and on return of investment in every way we look at our business and being much more strategic from that perspective.

And I think with Patrick and I working together, we're going to continue to drive that with Kevin's partnership, and we're pretty excited about what that can mean. As we work through this restructuring plan this year and think about the go forward of that and how we move forward, we are pretty excited.

So I think whether it's looking at different aspects even just on our balance sheet relative to working capital improvements, relative to more strategic prioritization of CapEx and really trying to move that return on invested capital needle back up, but then also again looking at how we spend, where we spend and making sure that we have the ability to reallocate spending to the right places that are really going to support the long-term sustainable growth of the company in areas like digital, in areas like international, women's, lifestyle, our new SAP system, et cetera.

So some of it is about getting leaner and focusing on profitability, but some of it is also trying to free up as much funding as possible to reinvest in the rights areas for the longer-term growth while maintaining that improved profitability.

Kevin A. Plank
Chairman & Chief Executive Officer, Under Armour, Inc.

A

So that renewed focus, Jon, it's not likely we were running blind before. None of this was ill-intentioned or some of us being irresponsible. It was just a matter of taking a new lens of – taking stock of what we have today, I think the assets list that we have today and just saying how can we run it more efficiently.

So there's a lot of good reasons as to why we got to sort of how we've been operating in the past. But frankly, now that you just look and saying our position is the third-largest brand, the $5 billion-plus in revenue, I think just the cost structure that we've built and the opportunities we have, there's a chance for us to be a much better company, to be able to create and drive more through the bottom line I think while delivering more to our consumers because everything for us comes back to one basic thing, and that's the brand, the brand, the brand. So as long as we protect that, as long as we drive that, there'll be a lot of growth in front of us, and we see I think delivering back to the kind of growth that the consumer, that our shareholders would expect from us.

David Bergman
Chief Financial Officer, Under Armour, Inc.

A

And, Jonathan, one thing I would also add to that is as we continue to grow extremely well internationally, that percentage of our business is increasing significantly each year. And with that scale and with that leadership, those regions are becoming much more profitable each year as well. So as that mix of business continues to help with our growth rate overall as a company, it's also going to be helping us become more profitable as well and that's a bigger part of the equation in the future years.

Operator: Our next question comes from Michael Binetti with UBS.

Michael Binetti
Analyst, UBS Securities LLC

Q

Hey, guys. Good morning. Thanks for taking my question. David, just one quick housekeeping question. Can you add some color on the wholesale revenue shifts that you mentioned that impact third quarter, please? I think you mentioned some shifted into Q2 out of 3Q? And some into 4Q out of 3Q? Do you mind helping us put some context to the dollars associated with those shifts?

David Bergman
Chief Financial Officer, Under Armour, Inc.

A

Yeah. I mean we won't give the exact dollars, but as we were approaching the SAP FMS go-live, we were proactively talking with accounts and making sure everybody was comfortable with the transition. And even though the transition has gone very well as planned, some of those accounts obviously have some angst maybe from other partners that have gone through transitions, and they wanted to get some of that product early in case there would end up being delays in July or August because of the actual conversion.

So that was part of what drove the Q2, Q3 conversation there. And then also as we're ramping up processing in our distribution facilities in North America and in Europe, which have now gone live on SAP FMS, we're trying to be prudent around processing and making sure we're going through that in the right way with the new system. So that's involved as well in whether or not there's going to be a little bit of that that ekes into Q4 from Q3. So those are a couple different factors that get into that Q3 growth rate that we discussed.

Michael Binetti
Analyst, UBS Securities LLC
Q

Okay. I guess, just to focus on one thing, as we look through the numbers here, the international business has certainly been a bright spot and very resilient. You talked with us a little bit through the quarter about profitability in that business. It's moving along a little, but it's really hard for us to assess from the outside with all the moving parts. Can you talk to us about how you think the margins in that business scale based on the plan you have in front of you today for the international side?

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

Yeah. I mean, in general, again, from a top line and then we'll talk about bottom line, top line has been very, very strong for us. I mean, international has grown over 60% last three years in a row. We're moving to over 20% of our business in 2017, exceeding $1 billion mark this year is where were heading. So growth rate has been great. I think when you break it down by region, Asia Pacific has been really strong for us. China growing very well. We're adding in Korea. Taiwan doing very well. And it's also one that's becoming the most profitable for us, so the combination of that high-growth rate and the higher profitability and fairly-decent gross margins there is really giving us some momentum on the bottom line.

Also, when you look at EMEA, they've had almost a renewed or re-accelerated growth rate as we're going into Q3, Q4 with some of the partnerships and relationships that they have. And really also gaining a lot of traction with the right marketing investments there with the EPL teams, as well as offices in Amsterdam, Manchester, Munich and also getting France online. So we're seeing increased brand awareness there and increased profitability.

You probably didn't see it as much with EMEA in Q1 and Q2. We had some costs that came through in Q1 relative to moving to a subsidiary in one of the countries from a distributor. And then, in Q2, with their go-live of SAP as well, they had a little bit of heavier cost of goods sold due to some airfreight and timing to be ready for that ERP system implementation. But when you think about full-year profitability for EMEA, it will be increasing significantly over 2016.

And then, when you look at Latin America, which is our newest international market, it's going to take time, but we're going through a lot of great steps there to drive forward. They're gaining momentum, and they are increasing from a bottom-line perspective, but it's going to take a little bit more time there versus Europe and Asia Pacific.

Michael Binetti
Analyst, UBS Securities LLC
Q

Okay. Thanks for all the help, guys.

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

Thank you.

Operator: And that concludes today's question-and-answer session. I'd like to turn the call back to Mr. Plank for any closing remarks.

Kevin A. Plank

Chairman & Chief Executive Officer, Under Armour, Inc.

Yeah. Thank you. To close it out, I just wanted to tell you we enjoyed hypergrowth for several years, and I want to be clear that we still believe we remain a growth company. The restructuring plan that we spoke about is a demonstrative sign that we're not standing still, but acting quickly to evolve Under Armour to become a stronger, faster and smarter company.

The decisions we've spoken of today support our vision of building the best athletic brand in the world. Some of the growing pains that we feel while difficult are the ones we believe necessary in securing the infrastructure, systems, processes, leadership and discipline to realize the full strength and potential of the Under Armour brand.

Reinforcing and building the Under Armour brand remains a vision for our company, and we're in this fight. We've got a couple of competitors in front of us, there's a number behind us, and you'll see us continue to separate ourselves as we move forward in building the brand that we believe is the brand of the future.

Thank you all for your time today. We look forward to talking to you next time in 90 days. Bye-bye.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program, and you may now disconnect. Everyone, have a great day.