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Under Armour, Inc. (UA)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Lance Allega

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GAAP AND NON-GAAP FINANCIAL MEASURES

- On today's call, we may reference non-GAAP financial information, including adjusted and currency-neutral terms, which are defined under SEC rules in this morning's press release
- You may also hear us refer to amounts in accordance with US GAAP
- Reconciliations of GAAP to non-GAAP measures can be found in the supplemental financial tables included in this morning's press release, which identify and quantify all excluded items as well as providing management's view about why we believe this information is useful to investors

Patrik Frisk

President, Chief Executive Officer & Director

BUSINESS HIGHLIGHTS

coronavirus Pandemic

- Before we discuss our second quarter results and significant impacts that the coronavirus pandemic continues to have on our business, I'll start by underscoring the incredible resilience and fortitude our teammates are demonstrating in these uncertain times
- By staying true to our strategy, mission, and values, we're prioritizing safety while advancing our eCommerce and retail capabilities, proactively managing costs, and working to execute smarter, faster, and more efficiently for our consumers and retail partners
    - While our top line results did come in a little better than we originally anticipated for the quarter and we're encouraged by some of the initial comp and conversions we've seen, we continue to anticipate significant impact to our business in the near term due to the pandemic, based on a high level of uncertainty around consumer sentiment and shopping behaviors

Dynamic Environment

- I'll leave the financial details of our quarter to Dave and will center my comments on the actions we're currently taking to navigate this dynamic environment
- There are four main areas Under Armour is hyper-focused on right now
    - First, we're working to rebuild the brand through increased engagement and consideration with our target consumer, the focused performer
    - Second, we're further evolving our operating model to simplify the way we work and collaborate, including accelerating the digitization of our go-to-market process to drive greater efficiency and speed
    - Third, we're prioritizing a DTC first approach to elevate our brand experience and deepen our connection with Under Armour's consumers

  - And finally, through all of these efforts, we're heightening the discipline on profitability and reconstructing our ability to drive sustainable shareholder value over the long term

Dramatic Migration

- Starting with rebuilding the brand, amid a dramatic migration to at home and outdoor training, running and fitness, we're focused on elevating our digital connection with our consumers
- Utilizing our Through This Together platform, we've been able to drive increases in brand engagement and consideration through targeted content, social events, and key influencer workouts
- As a result of connecting these dots, we've seen a significant increase in usage in our digital lab community, as well as steady meaningful increases in new users throughout the quarter
- After six months of activating our reengineered marketing and brand platform, we believe that consumers are gaining more consistent clarity about who we are and what we stand for, a human performance company with products designed to make you better

Marketplace

- Given the success we've seen with our quick adaptation to consumer shift in H1 2020, I feel that we are well positioned to continue to manage through this period of uncertainty around the consumer and the overall marketplace
- So wherever training may take athletes, whether at home, on the field, or back to the gym, we'll be there to connect even more deeply through premium product content and experiences

North America

- Premium has been and will continue to be core to Under Armour's brand positioning
- In this respect, we are working both to strengthen and, in some cases, earn back that consumer promise, one innovative product and premium experience at a time
- Retrenching from the past few years, especially North America, requires prudent purposeful marketplace management with the right balance of product and service to meet consumer demand

Pre-COVID

- Pre-COVID, we entered 2020 with the healthiest global inventory position that we've had in several years
- Wanting to protect that aspect as best as possible, we acted decisively and aggressively to cut originally planned back half inventory buys
- For example, in April and May, we reduced our inventory purchases for the back half of the year against our original plan by nearly 30% in response to COVID-impacted demand expectations
- So while undoubtedly punitive to our top line, given expectation of higher discounting and promotions across our space in H2 this year, we believe this strategy to be prudent to ensure continued progress towards rebuilding our premium brand positioning
  - This doesn't mean, however, that we have paused our innovation agenda or postponed new product releases for this coming fall and winter
- We're on track – same plan, same discipline, with our product pipeline and a long-term strategy focused on protecting and ensuring Under Armour as a premium athletic performance brand

Operating Model

- Now, moving to our second area of focus, which is the continued evolution of our operating model

- Before COVID, work was well underway to further streamline our business to increase our ability to execute more quickly by simplifying the way we work, collaborate, and make decisions
- Using this pandemic-impacted period as an accelerant, we're going even deeper, identifying the areas of opportunity within our business, along with additional strengths, so that we can maximize the value we create for our consumers, customers, and shareholders

Go-to-Market Process

- Instilling a digital-first approach throughout Under Armour is critical to this evolution
- In this respect, we have continued to build on the progress we made with our go-to-market process
- After moving through a 17-month calendar, the first fully redesigned season of which launched in H1 this year, we knew that additional digitization could drive even greater efficiency and agility into the way we work
- And that's been the plan, with the exception that this more digitally integrated go-to-market vision was supposed to take place more holistically in 2021

3D Digital Environment

- Making the most out of the current environment, the team stepped up and we got to work
- And I'm extremely proud to say that we're now well ahead of schedule in this respect
- So what does this mean exactly? It means that more of our products are designed and developed in a 3D digital environment, that we're transitioning to fully digital sampling and now have completely digital sell-in capabilities across all of UA
- And much of it has already been put into action as we held our first virtual sales meeting for spring, summer 2021 just last month
- From materials, product creation and global vendor partners, to retail space visualization, sell-in, training and the communication of key features and benefits, our external buyers overwhelmingly agreed that it was a very positive sell-in experience

Initiatives

- Third is the prioritization of a DTC-first approach, specifically elevating the importance of eCommerce and full-price retail to deepen our brand connection with Under Armour's consumers
- This obviously ties back to our first initiative with respect to the premium aspect of our brand
- And although a global effort, we see a more acute opportunity, particularly in North America, in the near to mid-term

eCommerce Perspective

- From an eCommerce perspective, we're continuing to refine our personalization and content to better compete in today's highly dynamic market
- Just last week, we launched our new North American site, which now aligns the majority of our global eCommerce business on one platform that we believe is agile and scalable for the future
- To support the additional functionality, data and processes that the new platform will allow us, we're also working to stand up a CRM program to drive higher engagement with consumers and establish this capability for the brand

UA HOVR Platform

- Turning to product and led by strength in our eCommerce channel during the quarter, I'd start with our run category and highlight the HOVR Machina, which at $150 continues to be a top seller and advance our overall UA HOVR platform
- This is also helping to support our Connected Footwear strategy as well with YTD footwear activations having nearly doubled over the prior year period and customers completing their first connected workout up more than 150% over the same period, a trend that has accelerated throughout COVID.
    - But it's not only Footwear that's doing well

Fly-By

- It's also run apparel, including the Fly-By in running shorts and the Iso-Chill short sleeve shirt, which utilizes a unique material technology to disperse body heat, helping you stay cooler in the heat of the summer
- Overall, we remain very encouraged by the emerging strength of our run category
- And as we look toward the back half of 2020, after years of development, we'll introduce our fourth cushioning platform, which we'll launch first in basketball and then quickly move to run for spring/summer 2021, further capitalizing on the momentum we're building as we offer Under Armour's most pinnacle running footwear expression yet

Leveraging

- We're also seeing positive trends in building momentum within our women's training category, from leveraging deep athlete insights into product creation to targeting consumers through successful marketing activations like our Anthem and product videos, to stunning inclusive imagery, coupled with simple language that explains exactly what our products do, we are speaking directly to the focused performer
- As a result, we saw strong demand in the quarter for a number of women's products, including the Play Up Short, our Infinity and Mid Crossback sport bras and the Meridian Pant, which continues to be a strong seller

UA SPORTSMASK

- Following our efforts to make PPE for Maryland area hospitals, which to date, we've delivered more than 5mm masks and 4mm gowns, we leveraged this expertise into meeting a specific need for athletes
- The result is the UA SPORTSMASK, designed for and tested by athletes
- The UA SPORTSMASK features a three-layer system of high-performance UA materials, including Iso-Chill fabric, engineered for all-day comfort in and out of sports
- Initial demand has been extremely strong, so we are working hard to catch up with orders as quickly as possible

Full-Price Perspective

- And with respect to brick-and-mortar retail, from a full-price perspective, our long-term opportunity to showcase the depth and breadth of our brand in a controlled premium environment remains significant
- And the reset work that we are doing to evolve our store concept toward scalable brand-right formats continues to be a key focus for us

- With a number of new concepts and experiences either being tested or at the ready for deployment, we're looking forward to these expressions helping us to connect even more meaningfully with our consumers

Global Markets

- And finally, through all of these strategies and efforts, whether our own retail or wholesale business, we're working to reconstitute our ability to be profitable over the long-term
- When the global markets stabilize, however the new normal is defined, we believe that the efforts we're putting into building the Under Armour brand, strengthening our supply chain, prudently managing inventory, employing a more favorable cost structure and harnessing a reengineered demand creation engine, puts us in a better position to benefit from shifts in consumer behavior and an increasingly more discerning athletic consumer

David E, Bergman

Chief Financial Officer

FINANCIAL HIGHLIGHTS

Opening Remarks

- To say that this quarter was unprecedented would, of course, be an understatement
- But I would start by saying that I believe that we have the right strategic, operational and financial strategies in place to help Under Armour navigate the short to mid-term challenges, while emerging a considerably more focused brand and disciplined company over the long term

North America

- With respect to our second quarter results, it's important to note that through mid-May, about 80% of the locations where Under Armour is sold globally were closed due to COVID-19
- And even though we believe pent-up consumer demand, combined with accelerated door openings, especially in June in North America, drove more favorable trends than we anticipated, as expected, the pandemic still had a significant impact on our results
- With that, let's dive right in

Revenue

- Revenue was down 41% to $708mm, which was better than the 50% to 60% decline that we previously anticipated
- This was due to more favorable results across both wholesale and DTC.
- From a channel perspective, in the quarter we had a 58% decline in wholesale revenue, a result that was better than expected, primarily in North America, due to quicker than anticipated store reopenings and stronger than expected demand through partners' online sites

Direct-to-Consumer Business

- Our direct-to-consumer business was down 13%, driven by the negative impacts of store closures, offset by strong eCommerce growth
- Our Licensing business was down 76%, driven by demand impacts related to COVID-19 and ongoing challenges with our licensing business in Japan

Regional and Segment Perspective

- By product type, Apparel revenue was down 42%, Footwear was down 35%, and Accessories were down 47%
- From a regional and segment perspective, second quarter revenue in North America was down 45%, driven by owned and wholesale door closures, coupled with significantly lower y-over-y sales to the off-price channel
- As of today, most of our owned and wholesale partner doors have reopened

EMEA

- In EMEA, revenue was down 39%, also driven by the negative impact of COVID-19-related store closures, offset by strength in our eCommerce business
- As of today, most of the doors have reopened in EMEA.

Asia-Pacific, North America and EMEA

- Revenue in Asia-Pacific was down 20%, driven by lower traffic in brick-and-mortar locations, offset by strength in eCommerce
- And similar to North America and EMEA, most of the doors in this region are also open
- In Latin America, revenue was down 72%, driven by the negative impacts of COVID-19, as less than 50% of owned and partner retail locations were open by the end of June
- And we estimate that as of today, about two-thirds of doors have now reopened in this region
- And finally, our Connected Fitness business was up 3%, driven by subscription growth

Gross Margin

- Turning to gross margin, we saw a 280 basis point improvement to 49.3% in Q2, with benefits including approximately 480BPS related to channel mix, including significantly lower y-over-y sales to the off-price channel and increased DTC mix, primarily from our eCommerce business; and 130BPS related to APAC and Connected Fitness representing a larger mix of total revenue
- This was partially offset by about 280BPS of COVID-19-related pricing and discounting impacts and 70BPS related to changes in foreign currency

SG&A Expenses

- SG&A expense declined 15% to $480mm, primarily driven by reduced marketing spend in addition to other cost-cutting initiatives to mitigate top line impacts from COVID-19, including lower incentive compensation and reduced variable expenses tied to revenue

Restructuring and Related Impairment Charge

- In the quarter, we recorded approximately $39mm in restructuring and related impairment charges, including $28mm in non-cash and $11mm in cash-related charges
- As a reminder, our restructuring plan covers estimated pre-tax restructuring and related charges in the range of $475mm to $525mm
- YTD, we have recorded approximately $340mm of charges, of which $326mm is non-cash and $14mm is cash-based

Operating Loss

- Our second quarter operating loss was $170mm
- Excluding restructuring and impairment charges, adjusted operating loss was $131mm
- After-tax, we realized a net loss of $183mm, or $0.40 of diluted loss per share
- Excluding our restructuring and the non-cash amortization of debt discount on our convertible debt, our adjusted net loss was $141mm, or $0.31 of adjusted diluted loss per share

OUTLOOK

COVID-19 Pandemic

- With respect to our 2020 outlook, as Patrik mentioned, given the ongoing high level of uncertainty related to the COVID-19 pandemic and its potential economic ramifications, we cannot reasonably estimate impacts on our full year at this time
- Therefore, we are not providing detailed outlook on today's call
  - We do, however, expect these conditions to continue to have a material impact on full-year financial and operating results
- With that said, I will provide some high-level color on how we are thinking about the back half of the year
- Although recent consumer trends, from what we believe is pent-up demand, have been more positive than we anticipated, especially during June and July, we believe, in the near term, there will continue to be challenges and uncertainty with respect to consumer demand and the overall marketplace

Marketplace

- For Under Armour, there are three main areas we believe are likely to impact the back half of our year
- First, as consumers return to stores, it is difficult to forecast the rate at which normalization might take place, as well as demand relating to shopping behaviors and conversion
- It is also difficult to predict the course of the pandemic in the US and other parts of the world and whether there could be a retrenchment within the marketplace
- All of this means that we are planning for our business to continue to be significantly impacted during the back half of the year

H2

- Second, as Patrik mentioned, we acted quickly in H1 this year to proactively and significantly reduce planned inventory purchases amid the quickly evolving landscape
- As a result, if H2 recovers at a rate higher than we're planning for, we may not have adequate supply to meet higher demand

Retail Landscape

- And finally, given the dramatic impacts across the retail landscape due to store closures and inability to reduce supply as fast as demand, we're anticipating that a highly promotional environment will materialize in H2
- This aspect, combined with the critical mass of sales to the off-price channel being planned in the third and fourth quarters, should contribute to a meaningful gross margin pressure for the balance of the year

- That said, it is important to note that we are continuing our strategy of reducing our exposure to the off-price channel and are planning this channel to represent a mid-single-digit percentage of overall global sales in 2020, another meaningful y-over-y step down
- All-in, we're planning that revenue could be down as much as 20% to 25% in the back half of the year
- Within this window, we anticipate a larger decline in Q4, due to expected year-end timing impacts from COVID-19 related to customer order flow and shifts in supply chain timing, which should result in more spring product deliveries in early 2021 vs. late 2020

DTC Business

- With respect to SG&A dollars, we are currently planning for it to be a bit higher in H2 2020 compared to H1, due to higher marketing investments and variable expenses associated with our DTC business
- Before opening up for Q&A, I'd like to briefly touch on some of the great work our team accomplished to preserve cash and further prioritize liquidity to strengthen our ability to navigate short and mid-term challenges and cash flow needs

Credit Facility

- Two items we executed quickly on were an amendment to our credit facility and the issuance of convertible bonds
- Related to the credit facility, the amendment was negotiated in May and provides improved access to liquidity during this period
- With our convertible bond offering, we were able to successfully raise additional capital to provide even greater liquidity
    - It is important to note that the cash generated from this transaction was used to pay down part of the outstanding balance of our revolver

Cash and Cash Equivalents

- We ended Q2 with $1.1B in cash and cash equivalents and $250mm outstanding on our amended $1.1B revolving credit facility
- So when looking at our net cash and debt position from March 31 to June 30, we were able to essentially hold flat
- Our ability to maintain the same level of cash during a quarter with a 41% decline in revenue speaks to the point and purpose of our strategic actions and the confidence we have in our ability to manage our business through these uncertain times

QUESTION AND ANSWER SECTION

Edward Yruma
KeyBanc Capital Markets, Inc.

Q

I guess as we look forward, obviously some innovation in the product pipeline. As you start to meet with some of your wholesale partners, given their current inventory situation, what's their receptiveness to taking a chance on some of the newer product that you've got coming? And then, I guess, as it relates to off-price, are you having to take back inventory from your existing wholesale partners? Thank you.

Patrik Frisk
President, Chief Executive Officer & Director

A

Hi, Ed. I think I'll start it off and if you want to add some color, too, Dave. In general, as I said in my script, we're very happy with how we have continued to plan our innovation and product to launch through the back half of this year and into spring of next year. And, as I said, we've had numerous products working really well for us across our training and run categories as we've gone through this spring. And subsequently, I think that gives perhaps our partners out there an indication of what could be in 2021. And we're happy with how we're thinking about the innovation pipeline because, as I said, we're now going to layer on another platform in our footwear offering, and that's also going to help us continue our journey here in the run space.

So, overall, very happy with our ability to execute our go-to- market. And that, I think is probably the main thing that gives our partners confidence in our abilities going forward. And I think as we think about the landscape right now, I think – I don't know if you wanted to add a little bit of color there, Dave – I think it would be better if you -

David E, Bergman
Chief Financial Officer

A

Yeah, Ed, relative to – you asked about the liquidation and returns. From a returns perspective, it's really different region-by-region and account-by-account, but because we were very strategic, I think in our sell-in and our sell-in expectations, the weeks of stock that our wholesale and retail partners have is very reasonable right now. So – although there could be some returns and we're obviously planning for that in certain regions, we're not expecting a massively larger amount of returns than before, I think because we were very strategic and coordinated in how we sold in and what the current environment is. So we feel like we're in a reasonable spot there. We also feel that we've got enough availability within our outlets to be able to move any of the returns that we do get without having to overly rely on the third-party off-price channel, which we're continuing to step down as a mix of our business y-over-y.

Randal J. Konik
Jefferies LLC

Q

I guess, Patrik, can you give us some perspective on how you're thinking about balancing marketing and impact on the consumer for the brand in terms of you've seen a lot of, I guess – we've seen press that talks to the company continuing to look at its different marketing contracts or different items that you have out there, trying to pull those back. You did talk a little bit about upping the marketing a little bit in the back half. Just curious on how you think about long-term marketing as it relates to the level of marketing dollars, but also how you're placing those marketing dollars in different buckets, perhaps going forward than you have in the past. That'll be super helpful. Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Hi, Randy. Thank you for the question. I first I would like to say that we really are empathizing with our athletes out there right now. It's an incredibly difficult time for them. They don't know when they're going to back on the pitch, on the field. And we're trying to do the best we can to support them in this really difficult time. But as it relates to the contractual agreements we have and the assets that we do have, Under Armour is a brand that is grounded in team sports. And it's one of the unique things for us is that we're one of the three, four brands in the world that actually have permission to be on field. It's at the core of what we do. It's where we were born. It's where we're going to continue to make our presence felt. So we are very much committed to staying on the pitch, on the field, but also to support our athletes and what we call the focused performers out there in their journey to train, to compete and to recover, that holistic journey.

So as we think about how our marketing will evolve going forward, we're committed to the majority of the contractual agreements we have out there. But we have also talked about the fact that as part of our restructuring, we continue to look at things that make sense and might not make sense for us in that journey going forward. And we're making decisions accordingly.

The reality is that if you want to have an asset, you've got to be able to activate it. And that is the important part of it, right, the equation of what you own and how you then activate that, it really then delivers the potential impact that you might have with the consumer that you want to achieve to strengthen your brand.

And what we're seeing now as we get smarter and smarter with our investments in terms of the tools that are available to us as it relates to understanding how our spend impacts our ability to strengthen our brand, we're making the appropriate shifts in terms of the investments to enable that. And that's looking a little different, quite frankly, to how we used to think about it.

We're much more informed. We're better informed now. We continue to test and understand what we should do and how we make every dollar go longer for us, if you like. And that's really what's going to help guide us going forward to a larger extent than before. We're going to continue to spend on marketing. And Dave mentioned that a little bit here before. We're going to continue to be spending. And we're going to continue to spend smarter going forward. And what we're really encouraged by in H1 is the results that we see in terms of engagement. So that was a long-winded answer, but I thought I'd give you a little bit more color on that.

Matthew J. McClintock
Raymond James & Associates, Inc.

Q

Patrik, just kind of staying on the theme of marketing and strategy, number one, that you've outlined in terms of increased brand engagement, could you maybe talk to about Connected Fitness and how your thoughts around Connected Fitness are evolving? Is that increasingly being viewed as something more of a brand awareness or brand engagement driver, as opposed to something that ultimately will sell more shirts and shoes? Or if you're intending to sell more shirts and shoes through that channel still, can you talk more about conversion and your plans for conversion? Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Yeah, sure. Absolutely. Hi, Matt. We're so excited about the work that we've done on the connectivity of our – especially our MapMyRun initiative that we've had going on this spring. As we shifted from the campaign or the brand platform that we started the year with, the Through This Together platform – The Only Way Is Through This Together, which became a whole digital initiative for us, we were able to activate that through our app world.

And one of the big initiatives there was really around the coaching as it relates to run specifically and the connectivity with our footwear. And, as I said in my prepared remarks, we were able to double the engagement level in this last quarter. So what we're seeing is not just the engagement going up, but actually also the workouts going up. So, we're seeing engagement going up. We're seeing the connectivity in terms of people that are actually activating the app against the footwear to help them run further, faster, longer and better. And that's very encouraging to us.

If you then think about what we're doing around CRM and loyalty and how we're going to be able to tie that into keeping the consumer, the focused performer, engaged with us longer and more often, that is then a very interesting future for us as it relates to our digital ecosystem, if you like. So for us, it's all about that journey of train, compete, recover. It's all about keeping the consumer engaged, understanding the consumer more deeply, understanding the moments in time when we can connect with the consumer, deliver against the expectation of the consumer, engage with the consumer, and also not just product, but also content, right, to make them better.

Matthew J. McClintock
Raymond James & Associates, Inc.

Q

Thanks for that. Just as a quick follow-up on the mask business, seems like they sold out pretty quickly. Could you talk about the supply chain for masks and your ability to get capacity to replenish that business? Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Yeah, absolutely. And I think here is one of the areas that's really exciting to us. First of all, I'd like to just comment on the enormous work our teams did to step up to help out in the hospital world, if you like, in the first responder world here in Maryland, especially with Johns Hopkins and University of Maryland. We made about 5mm masks and about 4mm gowns YTD. And we continue to make them to help with that effort.

That sparked this idea. And it was great because this is an area where Kevin jumped in as well and we had a lot of fun with this because we saw a need for the athlete here, of course, because we realized that the athlete was going to have to face the same kind of difficulties in terms of protective gear.

So what we did was, we used a lot of the ideas around our innovation center and the work that we did there and quickly developed this mask, which is a very sophisticated mask in terms of having a three layer construction that is very comfortable to wear and also safe to wear, of course, but more importantly, is specifically done to do sports in. So, you can use it in and out of sports.

What was interesting with that was also the supply chain part of it. So, we actually did not take a simple approach to it. We actually went really deep and used a lot of the technology and knowledge that we also have in making bras, for example, for women, to help us make these masks. So, we've been ramping up the supply chain. Demand is incredibly strong for the mask. And we now have a complete supply chain up and running and we're seeing our ability to meet demand increasing week-by-week. But demand is very strong and it's actually strong across the world.

Matthew J. McClintock
Raymond James & Associates, Inc.

Q

Thanks for the color. Best of luck.

Patrik Frisk
President, Chief Executive Officer & Director

A

That was a long answer. I'm sorry. But I thought I'd give you a bit more color.

Paul Lejuez
Citigroup Global Markets, Inc.

Q

Curious if you could talk about the plan to use off-price in the back half to clear inventory. How much are you going to use that channel relative to H2 last year? And I'm curious, if it was you not wanting to sell goods to them in Q2 or was it them not taking product because their stores have been closed and they had to clear through their inventory? And then, I'm just curious if there's any way you can quantify new customers finding your brand via the online channel. Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Yeah, hi, Paul. This is Patrik. I'll start and then I'll hand over to Dave for a little bit more depth on the financials. First of all, we see in the back half – I'd like to call out three things in terms of how we think about the back half, right. We think about demand variability and the second one that Dave talked to, which is inventory availability, some of the actions we took in the first part of the year to action when we saw demand go down in terms of our inventory buys. And then third is the promotional environment that we see going ahead.

So, for us, in terms of how we think about the off-price and liquidation channel, as you guys all well know, we've been on a journey to make sure that our inventories is something that we manage well and, as a consequence, continuously continue to drive down in that channel. So, we've been doing that as we had thought through about the inventory availability for the back half of the year. And, Dave, maybe you want to give a little bit more color there to give them a better sense.

David E, Bergman
Chief Financial Officer

A

Yeah, relative to the liquidation, a couple things to keep in mind. One, we made excellent process on inventory last year. So coming into this year, we were cleaner than we'd been in a long time. And the inventory that we did have, a lot of it was not order excess. So that basically means that Q1 of this year, we did have third-party off-price liquidation, but it wasn't a huge quarter for us. Then Q2, a lot of those partners, third-party off-price partners, had shut down their doors and most of them were not accepting inbound delivery. So we had essentially little to no third-party off-price sales in Q2 and you see that as a big benefit in our gross margin for Q2.

So what that essentially means is, even though we're stepping down third-party off-price as a channel, as a mix of business this year vs. last year, which is great and we're continuing that journey, it does mean that our liquidation is significantly more back half-weighted than the front half of the year. And so, that will clearly add a lot of pressure on our gross margin in Q3 and Q4.

But and then also on gross margin, just to take that a little bit further, there's going to be a lot of pressure in our expectations around a very promotional environment. We believe a lot of the companies out there have a lot of excess inventory that they're going to be trying to unload in Q3 and Q4, and it's going to make it a very price-pressured environment. And we are planning and expecting for that. And that has a dramatic impact on gross margin y-over-y in Q3 and Q4 as well.

And then, the question you mentioned around eCommerce and new customers, we're absolutely excited about the momentum we have within eCommerce. And there is quite a few new customer responders that we're seeing come through, whether it be some of the new mask business that we see coming through and then also, overall, in general. So we're excited about the new customer attraction there. We're not disclosing the actual rates or quantities there, but we are excited about that momentum and a fair amount of new customers coming in to be part of the brand online with us.

Simeon Siegel
BMO Capital Markets Corp.

Q

Nice performance in this environment. So just to follow up on the gross margin but longer term. As you work to re-elevate the brand, can you talk about where you see that opportunity? And then, Patrik, can you just help us? As you think about the DTC business, maybe to elaborate, can you help frame why you think Under Armour's DTC may have underperformed historically, just as a springboard, thinking about where it goes from there? Thank you.

Patrik Frisk
President, Chief Executive Officer & Director

A

In terms of the direct-to-consumer, in general, I'll answer it a little bit of a different way and I'm not – going to try not to be too long-winded. It's about consumer-centricity. So the journey that we're on, and have been on for the last three years, has been around truly understanding where to compete, who we're for and, as a result of those two, hone our brand positioning.

So the decisions we make in terms of how to invest and how to drive our business going forward will be decided ultimately by how the consumer chooses or would like to – or best engages with us. And, as a consequence of that, we are tuning all the different abilities and capabilities that we have in our quiver of tools to execute against that.

And I think ultimately, what it also will enable us to do is build a more premium brand, which is ultimately what we're in the business to do. So that's what we've been doing. And I think what you're starting to see now is an ability for us to execute through go-to-market and to actually do that on better platforms, our new eCommerce site that just launched, for example. I hope you guys have had a chance to look at it. It's wonderful, much faster, much better, better content, better product descriptions. Everything is great on that site. That's one of the things that you now seeing coming from Under Armour, our CRM that we're building to support that, the new store concepts that we have in the pipeline that are about to roll out. All of that playing in cohort to support our go-to-market, and it's all based on consumer-centricity. So really that's the way to think about it.

David E, Bergman
Chief Financial Officer

A

And could you repeat the first question you had before the DTC question? I'm not sure we heard you.

Simeon Siegel
BMO Capital Markets Corp.

Q

Sure. Yeah, sure. Just as you – where's the gross margin opportunity as you re-elevate the brand in the long-term, so looking past this year?

David E, Bergman
Chief Financial Officer

A

Yeah, I mean, we do see continued gross margin opportunity longer-term. We've talked before about the great strides our supply chain has made in consolidating our vendor base and then also just from a GTM and supply chain perspective, all the SKU rationalization work we've done, which helps our gross margin as well. So there's a fair amount of costing improvements that we're still continuing to see. Unfortunately, this year, that is more than offset by the promotional environment that we believe we're going to be experiencing here. But we expect those benefits to continue.

And then again, as we continue to work down that journey relative to the third-party off-price channel, that'll have a little bit of a gross margin tailwind as well as a mix of our business as that goes down.

And then we are focusing very heavily on DTC and, in general, with that continued pursuit, whether it be eComm, whether it be better brand houses from our commercial concepts around the world, that mix will also be a little bit of a tailwind on gross margin for us.

And then, the other thing that we've mentioned in the past, too, is that APAC continues to be, for a full year basis, growing faster than the rest of our regions. And that's our highest gross margin region. So we see multiple tailwinds that'll help us as we move forward longer-term. The one item that we mentioned that'll be a little bit of a headwind is as we continue to increase footwear at a little bit of a higher rate than apparel going forward, that still has a lower gross margin for us.

Now, we've been improving that as we scale up and as we work with our vendor base and supply chain's doing a phenomenal job with that, but, at this point, there is still a gap between our apparel and footwear gross margin. So as footwear continues to grow a little faster than apparel, that'll be a little bit of a headwind. But we're excited about driving forward in the future.

John Kernan
Cowen & Co. LLC

Q

Congrats on managing through a tough environment, good to see the progress. So, I guess, Dave, could you walk through the channel assumptions, and maybe even the geographical assumptions embedded in the revenue outlook for the back half of the year between DTC and wholesale and then also in North America and international?

David E, Bergman
Chief Financial Officer

A

Yeah, I mean at this point, kind of like we said on our prepared remarks, it is very fluid still. Really trying to understand how this pandemic is going to impact region-by-region, channel-by-channel, if there's going to be increased outbreaks or not, is not easy to be able to drive through. So we're not going to give detailed outlook, from that perspective.

Again, we continue to be very excited about the momentum that we have on the DTC front, especially eComm. So you would probably – it's probably safe to anticipate that we'll be able to drive DTC a little bit better than wholesale as we run through the back half of the year. But we are being cautious. We're trying to be as prudent as possible.

And then just as a reminder, with the amount of inventory production that we cut back on early on as we saw the impacts of COVID and estimating what that would be to demand, that means that we could have supply constraints in the back half of the year if things actually go more favorable than we currently anticipate. But at this point, we're not giving detailed region-by-region or channel-by-channel guidance for the back half.

John Kernan
Cowen & Co. LLC

Q

Got it. Thank you. And then, maybe just a follow up on international. Obviously, if we go back to the Investor Day in late 2018, international was a big top line opportunity and margin opportunity. It looks like international faced a much more difficult margin profile in H1 this year than North America. How do we expect international profitability to fit into your overall outlook in the back half of the year? And will that continue to face more headwinds from a margin standpoint than North America?

David E, Bergman
Chief Financial Officer

A

I think that the easiest way to probably summarize that is our strategy and our belief in our long-term plans and the increased ability to drive a lot further into all those opportunities internationally and become much more profitable internationally all remain the same. I would say that I'd be cautious in looking at 2020 as a year to base anything off of. It is such an abnormal year relative to the COVID impacts, how each of the regions are dealing with that, how we're working with our account base, how we're focusing so much on DTC.

But I think as we move forward into 2021 and beyond, you can expect us to continue to drive international growth with the massive amount of opportunity that we still have there, and continue to be much more profitable in future years from an international perspective, which is going to help in a lot of ways. So I wouldn't look at H1 as any indicator. In our minds, we're still sticking to the plan. We believe in that plan, and the opportunities are still there.

Jay Sole
UBS Securities LLC

Q

Patrik, I wanted to just ask you about your wholesale channel distribution. If you just take a step back, how does the pandemic impact your view of how you'd like to see the company's wholesale channel distribution maybe evolve over time? And how do you feel about the number of brand houses that you currently have in North America? Would you see an opportunity to increase that or are you pretty happy with where it is?

And then secondly, for Dave, could you just sort of clarify your views on gross margin for H2? Are you saying that the pressure that could happen from the very promotional environment will result in overall gross margins being down y-over-y, or is that a piece of the overall gross margin picture, or maybe some other components like mix or whatever could have an offsetting effect on gross margin? Thank you.

Patrik Frisk
President, Chief Executive Officer & Director

A

Yeah, hi, Jay. So, I'll kick it off. In terms of how we think about that, I'll come back to the consumer-centricity idea again, right. I mean, we're so focused around how the consumer prefers to engage with the brand and what makes sense for the consumer, that ultimately that's going to guide how we think about our distribution. And again, we're on a trajectory here to rebuild more of a premium approach for the brand in general. That's where we're playing. That's how we look at ourselves, that how the consumer looks at us. So, ultimately, that will guide our decisions.

Having said that, do we believe that there's going to be some contraction in terms of wholesale distribution in general? Yes, there will be winners and losers, for sure, in this marketplace. And we will make, for sure, some adjustments in how we think about our distribution going forward, based on how we see the brand continuing to make progress going forward. So we've already talked about the liquidation channel here a little bit today. I think there are other areas that we're looking at, tightening up our distribution, that makes more sense for us going forward.

As it relates to our own direct-to-consumer, yes, absolutely. We believe that there's an opportunity for us to open more full-price retail actually around the world. We still have a fairly small amount of full-price stores. And I think for us, that is an opportunity. And we're doing that through the initiative of new store concepts, different store concepts, to be able to address that. So, ultimately, it's an omnichannel fulfillment model that we're building towards that is going to enable us to better engage and meet end consumer expectations. So, Dave, do you want to add a little bit of color around the gross margin?

David E, Bergman
Chief Financial Officer

A

Yeah, I mean, relative to gross margin, there's definitely a lot of uncertainty there. We're doing our best to try and read the tea leaves and see what we think is coming. But as we look at the back half, or Q3, Q4, yes, we do think there is going to be a pretty promotional environment out there, with a lot of the brands moving through a lot of inventory. So we are expecting that to be a pretty big impact, negative, y-over-y, for Q3 and Q4. And then the other piece again is the fact that our third-party off-price, again, even though a lower mix of our business this year and we're continuing that journey, is all back half-weighted.

And in addition to that being back half-weighted, which creates gross margin pressure in Q3 and Q4, we also anticipate that the pricing on that off-price channel liquidation could be a little bit lower as well, based on all the inbound they might be getting from various brands. So those are the two biggest pressures we see in Q3 and Q4 gross margin. And, yes, we do believe that that could drive the full year to be down y-over-y from a gross margin basis point perspective for us.

Paul Trussell
Deutsche Bank Securities, Inc.

Q

I wanted to circle back to the top line. Is there any additional color you can give on how you exited Q2 and some of the momentum you saw into July, maybe just discuss overall eCommerce growth or the response that you saw from the Chinese consumer vs. that of the European and North America consumer? Thank you.

Patrik Frisk
President, Chief Executive Officer & Director

A

Hi, Paul. This is Patrik. I'll kick it off and then hand off to Dave. It's interesting when you look at what's going on in the world right now. And I think that the current environment is really what's driving a more conservative view from us because of the variability in demand that we see developing. What I mean by that is, there's pockets here and there where things are opening up, closing down. And it's going to continue to happen, we believe, in the back half of the year, at least in the foreseeable future. What that actually means is, I think, really hard to predict right now, because there is a general sense of encouragement, but at the same time, very inconsistent.

So, for us, when we think about what we see in China, that is really two months ahead of the curve of the rest of the world, certainly, the consumer's come back and they're shopping again, but the traffic levels are still not back to where they were before. The consumer is hesitant, but when they do shop, they convert better, which is generally what's happening across the world.

So most of our stores, as we said in our script, are open now, but traffic hasn't returned to the pre-COVID levels anywhere in the world yet, and it continues to be inconsistent. So, for us, that means it is appropriate to take a conservative view going forward, because I don't believe anybody can read in the tea leaves right now. So, that's how we're thinking about our business and that's how we're managing it.

Dave, do you want to add anything?

Paul Trussell
Deutsche Bank Securities, Inc.

Q

Okay. Understood.

Kimberly Conroy Greenberger
Morgan Stanley & Co. LLC

Q

Patrik, I just wanted to follow up on your marketplace management commentary. I'm wondering if you're thinking of refining or maybe reducing your wholesale partner list, particularly here in the US. And then, just a follow up for Dave on inventory. When you look at the back half of the year this year, is it possible to quantify how much you had reduced receipts in the back half of 2020 as compared to the back half of 2019? Thanks so much.

Patrik Frisk
President, Chief Executive Officer & Director

A

Okay. Well, I'll start with the marketplace Thank you, Kimberly, for your questions. I think what you see right now playing out, as I said before, there are winners and losers. And our job, I think is, as we build the brand stronger, is to make decisions that are considering that. So, we will try to win with the winners; that's the approach that we're taking. But it's got to be done in a brand-right way for us, right. So we've got to be able to grow our brand, our presence, stronger wherever we're being distributed and that's part of our growth strategy going forward. And we'll make the appropriate decisions based on where we feel it is the right place to be.

And I think the market, what you see now, is kind of self-regulation going on. And the consumer will ultimately also help that because of traffic and the inconsistency that you're currently seeing. So we'll continue to see, we believe, this play out in the back half of the year in terms of winners and losers. But our aim, ultimately, is to have a distribution that reflects our brand and the opportunity. And, ultimately, we'll do that by understanding the consumer better.

So, Dave, do you want to pick up on that?

David E, Bergman
Chief Financial Officer

A

Yeah, Kimberly. Relative to the inventory and production, we haven't given y-over-y back half changes in production levels. But we did mention the 30% that in April and May we were pulling out of production for this year vs. our original plan. And again, we'd also mentioned that DTC is probably going to be in a little bit better place for us than wholesale. We're making sure that we're planning our business very cautiously.

We think we have the right inventory levels inbound to meet what we think is the adjusted COVID-19 demand. But, again, there's a lot of uncertainty, so it's difficult to really call the ball there. But we think that we've lined up the production reasonably well with demand. And we did that very, very quickly to try and get ahead of it and also to make sure that we weren't leaving our inventory vendors hanging. We wanted to make sure that we were adjusting things well ahead of time to make sure that they could adjust for that themselves. So, it's been a collaboration with our vendors.

Brian Nagel
Oppenheimer & Co., Inc.

Q

So I'll merge maybe a couple of questions together here. But clearly, a very, very fluid environment. But how are you thinking about or dealing with back-to-school? And then, the second question I have, a lot of talk of price promotion – the potential for price promotions in the back of 2020. Are you seeing price promotions now? Is that a factor now or is that something more you're just anticipating within the channel? Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Yeah, thanks for that question. That's a really good question, Brian. I think that's one that we're all really trying to understand at this point. We're kind of, in some states in North America right now, in back-to-school timeframe. And I think the question here – a couple of different things playing into this. First is, are schools going to be opened? Second is, are sports going to be played, for us, specifically, as it relates to Under Armour? And there is a lot of uncertainty about both of those. And I think, we think, that this will affect the shopping behaviors, to some extent, of back-to-school.

Sometimes, it could be a sport. Sometimes, it could be a category. A little early to be able to give you color around that, but I can tell you that that is an unknown in the marketplace right now. So it could be that what happens instead is that people become more weather-inclined in terms of shopping, potentially. So it's hard to tell. It's still so early in the season, that we don't have any really good reads on it yet. But it's going to be different, that's one thing that's certain. Dave?

David E, Bergman
Chief Financial Officer

A

Yeah, and, Brian, I think relative to price promotions so far, we experienced some of that in Q2 already, as we mentioned in my gross margin walk vs. prior year. So we already saw some pressure from that in Q2. And we expect to see more pressure from that as we go through Q3 and Q4, as more of the doors are open and more people are trying to push through inventory. So, again, we're seeing some of that and we expect it to increase more as we go further into Q3 and Q4.

Christopher Svezia
Wedbush Securities, Inc.

Q

I hope you're all well. I guess, just to go back, Dave, for you, just on the SG&A for one moment. I'm just curious. You expected it – or do you expect it to actually increase y-over-y in dollars or are you expecting it to increase relative to the trendlines that you saw in Q2 or maybe, more specifically, where those SG&A dollars are going to, more specifically, into the back half.

David E, Bergman
Chief Financial Officer

A

Yeah, I mean, we are expecting to manage SG&A down y-over-y. But, again, there's a lot that's going on there. We are working through a lot of different reductions that we started in Q2 and that we continue to work through around how we approach incentive compensation, how we approach CapExs and the depreciation from that. Obviously, we've been very strategic in how we go about our marketing, and that was definitely lower in Q2.

So there's a lot of work behind the scenes. We're also driving through all the restructuring efforts as well. And, again, we're excited about the fact that we were already down that road in January with the restructuring plan and could really leverage the expertise and the momentum from that during this COVID period to make sure that we continue to dig deep to get our cost structure into a better place, so a lot of work still to do. We're not happy yet with where we are, to be honest.

We do see SG&A being higher in the back half than the front half, which I mentioned. Again, a lot of that is continued marketing investments that Patrik mentioned and feeling really good about the return on those investments and the prioritization of those investments, which are a lot focused on brand and a lot focused on digital. But also with DTC ramping back up and having so many stores closed in Q2, there's a lot of variable SG&A that comes along for the ride with having most of those doors now open and expected to be open for most of the time during the back half of the year.

So definitely expecting SG&A to be higher in the back half than the front half. We are continuing to work at it. We're continuing to identify opportunities. We're continuing to address the fixed costs within our restructuring to be able to run into next year in a more efficient way and continue to focus on overall profitability.

Christopher Svezia
Wedbush Securities, Inc.

Q

Got it. Okay. Thank you. And just housekeeping, just on the Fifth Avenue store. I'm just curious. I know there's some special accounting treatment for that. But just curious if there's been any progress on subleasing that facility and any thoughts on the time horizon on getting that done.

David E, Bergman
Chief Financial Officer

A

Yeah, we are working through that. We have some pretty reasonable assumptions in the charge that we took the prior quarter to make sure that we're not going to get really surprised there. And we're out in the market. We're working on it. Nothing big to report yet at this point in time. The COVID environment is a little bit of a tough timeline for that, but we feel optimistic, and we're staying at it.