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Under Armour, Inc. (UA)

Q3 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 items, which are defined under SEC rules in this morning's press release
- You may also hear us refer to amounts under U.S. GAAP
- Reconciliations of GAAP to non-GAAP measures can also be found in this press release, which identify and quantify all excluded items and provides our view about why we believe this information is useful to investors

Patrik Frisk
President, Chief Executive Officer & Director

BUSINESS HIGHLIGHTS

Ongoing COVID-19 Pandemic

- Before we discuss our results, I'd like to pass along Under Armour's well wishes and the hope that you and your loved ones are staying healthy and safe during the ongoing COVID-19 pandemic
- For this and many other reasons, 2020 has proven to be a challenging and transformational year for Under Armour
- In an uneven global economic environment, we've continued to make tough decisions across our business to ensure that our base is stable and we have the agility to return to profitability in the near term

Operating Model

- Over the long term, we are confident that the actions we've taken have created an operating model that we believe can deliver consistent value to our consumers and customers, as well as sustainable return to our shareholders
- And backed by a stronger foundation, enterprise-level discipline and green shoots across many areas of our business, we believe that we are well-positioned to compete for premium brand-right growth as we work to fulfill our mission and vision in 2021 and beyond

North Star

- In this respect, you've heard me speak many times over the past year about our mission, vision and values
- These elements unify our global culture
  - They're why we are here and what we do, what we do, our North Star
- And excitingly, as we work to close out this body of work and install the final cornerstone of our reimagined house, we are shifting to become a purpose-led organization

- In our transition from being product-driven to purpose-led, we didn't have to go very far to find our purpose
- At the intersection of our distinct strengths and an obsession with improvement, Under Armour's purpose is: we empower those who strive for more
- For those who show up with relentless persistence, day-in and day-out to train, compete and recover, pushing themselves past the limits of what they thought was possible and being just a little bit better than they were before
    - This is why we exist and why Under Armour's athletes know we've always got their backs

Transformational Challenge

- With 2020 nearly complete, I am proud of our team's work and believe that the critical mass of our transformational challenge is behind us
- Our target consumer and operational playbook are well-defined and understood
- And while I'll leave the financial details of our quarter to Dave, our third quarter results are tangible evidence of the progress we've made with our business

Premium Athletic Performance Brand

- To be sure, we have more work to do
- And, of course, it remains a highly uncertain environment with a pandemic
- So to that effect, we're staying focused on the things we can control
- This includes four key areas that will fortify our company and empower our ambitions as a premium athletic performance brand
    - First is continuing to strengthen the brand through increased engagement and consideration with the focused performer
    - Second, are further refinements to our operating model to drive efficiency across all end-to-end processes for our consumers and customers
    - Third is prioritizing a direct consumer-focused approach to elevate our brand experience and deepen our [ph] connection (5:10) with Under Armour's consumers
    - And finally, through all of these efforts, we're continuing to amplify our discipline around profitability to drive sustainable shareholder value over the long-term

Global Brand Marketing Platform

- Starting with strengthening the brand, our global brand marketing platform and the execution continues to fuel a well-orchestrated singular voice that is driving greater engagement and consideration among focused performers
- We are successfully activating our assets more effectively across physical and digital touch points, allowing for more personalized activation through a sharper data-driven point of view
- A couple of areas where this momentum is showing up is in our women's and footwear businesses, two of our largest long-term growth opportunities

Key Innovation

- Taking a moment to touch on each of these, I'll start with our women's business
- Within our train category for the quarter, key innovations like the Infinity Bra and Meridian Pant showed continued strength, making their case for the most popular Under Armour women's product of 2020

Footwear

- Within footwear, authenticating ourselves as a premium player remains paramount to our long-term success
- By more deeply understanding an athlete's performance journey, whether it's training, competing, or recovering, our innovation pipeline and ability to elevate our offerings continue to fuel our product engine

UA HOVR Breakthru

- One highlight of the quarter was the launch of our first-ever women's specific basketball shoe, the UA HOVR Breakthru
- To-date, it's been well received in the marketplace and demonstrates our commitment to delivering innovative performance solutions for the focused performer
- We're also very excited about the upcoming launch of the Curry 8 basketball shoe, which will be the first footwear to feature Under Armour's newest and fourth cushioning platform, UA Flow

UA Flow

- As the most technical cushioning offering in Under Armour's history, UA Flow performs precisely as it sounds, fluid, light, and unfailing as it eliminates all distractions for the athlete by using a revolutionary material and streamlined design that removes a typical rubber outsole
- In translation, the UA Flow technology allows us to create our most obedient and highest traction footwear yet
- UA Flow is also set to launch in our running platform in early 2021 as Under Armour's most pinnacle running footwear expression yet
    - We're very excited about bringing this innovation into running, as we believe it will help strengthen our consideration among consumers, while elevating our premium performance positioning
- And finally, I would be remiss not to mention our Connected Footwear platform, which a couple of weeks ago hit an incredible milestone, surpassing 1mm pairs of shoes that have been connected to our MapMyRun app
    - This is an accomplishment that we are incredibly proud of as we drive deeper into the intersection of data, connectivity, product, and experiences

Operating Model

- Turning to our second area of focus, on highlight our operating model evolution
- Throughout 2020, we have continued to refine how we work to ensure we are appropriately positioned from a strategic, operational and financial perspective for the size company we are today, while being set up to scale responsibly along with future growth
- All of this, of course, is centered around an absolute focus on profitability

Go-to-Market Process

- And with that, our improved go-to-market process and highly disciplined inventory management has afforded us flexibility as we navigate these uncertain times, including dynamic changes in consumer demand
- In Q3, demand proved to be much higher than we had anticipated, especially in North America

- Fortunately, our second quarter carryover product, meaning inventory that went unfulfilled due to store closures during that period, allowed us to meet part of this unexpected demand
    - Additionally, inventory sold through at lower-than-expected discounts and markdowns
- These factors helped us post flat revenue results in Q3 vs. our previous expectation of being down 20% to 25%

Headwind

- Looking at the balance of the year, as we stated on our last call, we cut our inventory purchases by about 30% for the back half of 2020
- This, along with more planned spring product deliveries in early 2021 vs. late 2020 and a few other drivers that Dave will detail, means we continue to expect top line headwinds in Q4
    - That said, our fourth quarter outlook has improved from our July 30 expectation

Marketplace Management

- As we turn into 2021, we're also focused on prudent marketplace management and working proactively to ensure that we show up in distribution that is brand-right, profitable and capable of elevating the Under Armour brand with focused performers
- Accordingly, we have begun identifying certain undifferentiated retail partners, primarily in North America, to more meaningfully reduce our wholesale footprint starting next year and into 2022 and beyond
- To be clear, wholesale remains a crucial part of Under Armour's future, but as the broader retail landscape continues to evolve, so must we
- Switching gears to our third area, which is prioritizing a direct-to-consumer-focused approach
- Our efforts remain centered around becoming a best-in-class retailer capable of providing a premium Under Armour experience whenever and wherever consumers directly engage our brand

e-commerce

- Starting with e-commerce, which continues to be a bright spot this year, we saw more than 50% growth globally during the quarter
- And now with the majority of our global e-commerce sites on one scalable platform, we are working to unlock a more robust functionality to power our CRM efforts to help us drive more resonant and personalized interactions with our consumers

Brick-and-Mortar Business

- In our brick-and-mortar business, we continue to make progress in evolving our store concepts towards more scalable, brand-right and profitable formats, while continuing to invest in the capabilities needed to operate as a best-in-class retailer
- Across our company, we are holistically embracing a direct-to-consumer focused approach, obsessing every moment along the consumer's brand journey to help us make better decisions to drive greater relevance and connectivity

Investment Thesis

- Tying all of these strategies together brings us to our last priority, which is an ability to deliver sustainable, brand-right, profitable growth and, therefore, returns to our shareholders over the long term

- It's well understood throughout the organization that we must empower our earnings potential as one of the most essential elements of our investment thesis

Cost Structure

- As we sit here today, I believe that our operating model transformation, driven by brand elevating strategies centered on the focused performer and an increasingly more appropriate cost structure is strongly aligned with our long-term goals

MyFitnessPal Platform

- Now before handing it over to Dave, I'd like to touch briefly on another announcement that went out this morning related to our decision to sell MyFitnessPal platform, which is the largest part of our Connected Fitness business segment
- MyFitnessPal has an impressive record of innovation and strong user growth that has enabled it to sustain its leadership position and scale as one of the world's most popular food and fitness tracking apps
    - However, as we worked to more sharply define our strategy over the past few years, it became evident that MyFitnessPal did not fully align as a core asset with our target consumer needs, the focused performer

MyFitnessPal Perspective

- In this regard, from an Under Armour perspective, we believe this divestiture sharpens our long-term digital strategy by simplifying our consumers' brand journey and increases our ability to better harness the power of MapMyFitness platform, as we work towards a singular cohesive UA ecosystem
- From a MyFitnessPal perspective, this move provides an excellent home for the brand and its passionate teammates with a new owner, who will holistically focus on driving that business going forward

David E. Bergman
Chief Financial Officer

FINANCIAL HIGHLIGHTS

Revenue

- Considering the current uneven economic environment, all-in-all, I'd say we executed well in Q3 as we worked to meet higher-than-anticipated demand
- Let's take a look at how we did starting with revenue
- Third quarter revenue was flat at $1.4B compared to the prior year, which came in better-than-expected due to higher-than-anticipated demand across our wholesale and DTC channels

Channel Perspective

- From a channel perspective, our wholesale revenue was down 7%
- Lower sales in North America were the primary driver of this decline, despite performing better than our previous expectations due to higher-than-expected customer demand
- Our direct-to-consumer business increased 17%, driven by continued strength in our e-commerce business

- Relative to our previous plan, we experienced better-than-expected traffic trends in our e-commerce business

Licensing Business

- Our licensing business was down 15%, driven primarily by our license business in North America
- By product type, apparel revenue was down 6%, driven primarily by declines in our team sports and training categories
- Footwear was up 19%, driven by considerable strength in our run and train categories
- Finally, accessories was up 23%, with all of the growth being driven by our new sports masks, which we just started selling in Q2 this year

Regional and Segment Perspective

- From a regional and segment perspective, third quarter revenue in North America was down 5%, driven by lower wholesale revenue due to ongoing impacts from COVID-19 and reduced off-price sales
- These headwinds were partially offset by strong e-commerce growth in our DTC business in the quarter

EMEA

- In EMEA, revenue was up 31%, driven by growth in our wholesale business as some shipments with distributors shifted from Q2 into Q3 due to the impact of COVID-19
- Additionally, we saw solid growth in our DTC business
- Revenue in Asia-Pacific was up 15%, driven by growth in both wholesale and DTC

Latin America

- In Latin America, revenue was down 15%, driven by continued negative impacts from the COVID-19 pandemic
- As of September 30, about 80% of locations where the brand is sold had been reopened in this region
    - However, within DTC, our e-commerce business delivered very strong growth for the quarter

Connected Fitness Business

- And finally, our Connected Fitness business was down 6% due to a onetime development fee recognized in the prior year's quarter, partially offset by higher subscription revenue in the current year's period

Gross Margin

- Third quarter gross margin was down 40BPS to 47.9%, due to approximately 130BPS of negative impact from COVID-19-related pricing and discounting and about 20BPS of negative impact related to product mix, as our footwear business skewed higher as a percentage of total revenue
- These items were partially offset by about 60BPS of supply chain benefits, primarily driven by product costing improvements; and 60BPS of positive channel mix, which benefited from lower y-over-y sales to the off-price channel; as well as increased DTC mix
- Relative to our previous expectations for gross margin in Q3, our results were significantly better than expected as we experienced higher than anticipated demand, which allowed us to sell in and sell through with considerably less discounting and markdowns than we had initially anticipated

SG&A Expenses

- SG&A expense was generally in line with last year's third quarter at $554mm
- In Q3, we recorded $74mm of restructuring charges and certain impairments related to long-lived assets
- As a reminder, we expect to incur total estimated pre-tax restructuring and related charges under this plan in the range of $550mm to $600mm, primarily in 2020
- YTD, we have realized $410mm in restructuring and related impairment charges and $140mm from impairments of long-lived assets and goodwill
- We continue to expect about $40mm to $60mm of related savings for the full year

Operating Income

- Our third quarter operating income was $59mm
- Excluding restructuring and impairment charges, adjusted operating income was $133mm
- After-tax, we realized net income of $39mm or $0.09 of diluted EPS.
- Excluding restructuring charges, as well as the noncash amortization of debt discount on our senior convertible notes and deal costs related to the planned sale of MyFitnessPal, our adjusted net income was $118mm or $0.26 of adjusted diluted EPS.

Balance Sheet Perspective

- From a balance sheet perspective, we ended Q3 with $866mm in cash and cash equivalents, with no borrowings outstanding under our $1.1B revolver
- And finally, inventory grew 17%, ending the quarter at $1.1B.

GUIDANCE

Revenue

- Turning to the balance of the year
- I would like to take a moment to provide some color on our fourth quarter expectations
- In Q4, we expect revenue to be down at a low-teen percentage rate
  - This outlook reflects meaningful improvement from the previous expectation that we gave on our last earnings call, driven, in part, by the more robust consumer demand trends we experienced in Q3 that have continued into October

Impacts from COVID-19

- With that being said, in addition to ongoing general uncertainty around COVID-19, there are a few areas we see as revenue headwinds in Q4
- First, as mentioned on our last call, timing impacts from COVID-19 related to customer order flow and changes in supply chain timing is expected to result in more planned spring product deliveries in early 2021 vs. late 2020
- We anticipate this change will negatively impact our fourth quarter by approximately 9 percentage points compared to the prior year fourth quarter
  - Additionally, we expect our fourth quarter licensing revenues will be down about 50%, due to significantly lower contractual royalty minimums along with contract settlements meaningful in last year's fourth quarter on a comp basis

Global Revenue

- Finally, as we continue to manage the marketplace with a keen focus on brand-right premium growth, lower y-over-y sales to the off-price channel will also serve as a revenue headwind
- That said, we now expect off-price as a percent of global revenue to be approximately 4% for the year, which is at the lower end of our previously disclosed range, so excellent progress there
  - While promotional activity levels in Q4 have improved relative to our prior outlook, we continue to expect them to be significantly higher than last year
- As such, we believe this will put meaningful downward pressure on gross margin in Q4

Revenue Perspective

- Now, before transitioning to Q&A, while it is not our typical practice to provide color for the upcoming year on this call, we would like to make a few initial observations about how we see our business developing in 2021
- Of course, all this is predicated on our business continuing on the same general path and macros that we've seen most recently and moving them forward into the new year
- Meaning, we're assuming no major retail or other business shutdowns or other adverse economic impacts related to any accelerated COVID-19 flare-ups
- With that said, from a revenue perspective, there are a few things that we currently anticipate will serve as headwinds in 2021, as we work to drive premium brand-right growth

MyFitnessPal

- First is the sale of MyFitnessPal, which today represents nearly all of the Connected Fitness segment revenue
- So following the close of that deal, that revenue goes away completely
- Second, as we alluded to earlier, we will begin to exit certain undifferentiated wholesale distribution, primarily in North America, starting next year
- And over the next couple of years, we expect to more meaningfully reduce our overall North American distribution points by about 2,000 to 3,000 doors, so heading toward about 10,000 doors by the end of 2022 in our largest region

DTC

- And finally, within DTC, we plan to continue to pull back on promotions and discounts to drive our premium brand positioning, which we'd expect will result in some near-term implications on top line results, yet continue to support healthier margins as well
- Next, when framing up gross margin and SG&A, it's still too early for specific color
- But given our expectations around improving quality of revenue and our disciplined focus around cost management, we expect to have more agility in the interplay of these line items to manage our bottom line better as the year develops
- And with respect to our bottom line, and arguably one of the most critical parts of our turnaround, we have line of sight to delivering slightly positive EPS in 2021

CLOSING REMARKS

- In closing, we're proud of the progress we've made

- And to reiterate once again, we believe that the critical mass of our transformational challenges is behind us at this point
    - That's not to say we necessarily expect smooth sailing from here on out
- But from a strategic, operational and financial perspective, we believe that we are better positioned to capitalize on our strengths moving forward

QUESTION AND ANSWER SECTION

Edward Yruma
KeyBanc Capital Markets, Inc.

Q

So, Patrik, as you start to – you clearly rebased the business, built a healthier base of business and are now kind of seemingly orienting toward growth long term. Are there particular categories that you think are well suited for this focused performer, where we should start to expect some outside growth? And then also, as you introduce this new cushioning technology, is this a product that will be at scale next year or is this a pinnacle product that will take a while to work through the line-up? Thank you.

Patrik Frisk
President, Chief Executive Officer & Director

A

Good morning. Yes. As it relates to the categories that we are looking to be our growth drivers, so to speak, going forward, we still believe that there is a tremendous amount of opportunity for us in some of our core team sports and men's training categories. But what we've seen this year that we're very excited about is the energy in our women's business.

We have a number of different products, both in apparel and footwear, that are working very well for us now. Infinity Bra, Fly by Shorts, Meridian Pants, Meridian Infused, the Machina shoe for women, the Phantom 2, et cetera, et cetera. So, we see definitely women's continuing to be a big part of our growth and footwear.

Footwear is going to continue to help drive the growth going forward. And, as you talked about the platforms, we now have four platforms in the marketplace. And they all play a role in terms of how we think about the positioning of the brand.

And one of the things that we're very proud over the last three years to have accomplished is really the ability to start to build franchises. And you've seen that through our HOVR franchise. Flow will be another franchise that sits on top of HOVR at the most pinnacle expression of the brand.

Randal J. Konik
Jefferies LLC

Q

So, Dave, you gave us some good perspective on reducing the wholesale doors, I guess, by 10,000 by 2022. So, just medium term, what does the – what should we be thinking about, again, from a mix perspective on revenue by wholesale vs. e-comm vs. your directly owned stores. How do we think about that? And how do you think about that impacting – obviously, it should be a positive margin shift. But how significant can we expect that to be over the medium term?

David E. Bergman
Chief Financial Officer

A

Yes. I mean, we're not at a point where we're going to give a lot of details as we go into 2021. We're just trying to stay high level. We still got a lot of work to do to fine-tune next year. But we are looking as a company to lead more from a DTC approach, focus on consumer-centricity to drive best experiences, unlock potential full price retail, leverage factory house for inventory management, et cetera, and definitely invest in digital across owned and wholesale partners.

I think the one thing that's a little bit tricky for us, though, to remember is even though we're going to be focusing a lot on DTC, the mono-branded stores in APAC are mainly partner-owned, and that runs through our wholesale revenue. So, from a mix of DTC to wholesale, you may not see a significant change in the coming years, but the actual mono-branded stores and kind of full view of the brand in those stores will increase as well.

Randal J. Konik
Jefferies LLC

Q

Got it. Can I ask one more question? It sounds like, Patrik, you're being much more bullish on the wins that you're seeing lately in the women's business. What's kind of been the breakthrough there? Has it been more marketing or just noticing on the product?

And then just relatedly – just separately, I should say. On the mask side, as an owner of a ton of these masks, are you seeing – is that mask also helping to drive attachment within the e-commerce business where you saw a lot of growth in the quarter and how we should be thinking about the mask at least for the foreseeable few quarters helping to drive other channels of distribution and attachment going forward? Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Okay. Thanks, Randy. So, I'll start with the women's and then I'll switch over into the masks. With women's, it's a result of what we've done starting at the beginning of this year. Remember, again, 2020 was the first year that we were able to fully deploy our go-to-market strategy across all categories of the brand. But, more importantly, with a very strong singular message that we knew was going to resonate with both men and women.

On the back of that, we also knew that we had better product that was delivered on time with the right marketing. So this is really what you're seeing is our go-to-market really starting to fire. And as it relates to women, we have been, as I said before, successful across many different products. So it isn't just one product here or there. It's the entire head-to-toe approach.

And ultimately, it is execution through our go-to-market that you're starting to see play out. And it's been consistent through the year. So it isn't something that just started lately. It was there in spring. It was there in summer. It's now there in fall. And we believe it's going to continue into next year. And I think for us, women's is definitely one of the growth engines, but it's really nice to see how our brand is now resonating across both genders.

The mask is an interesting one for us because we decided very early on that the mask was going to be something that we made for athletes. So our approach to go with the mask and make it a sports mask and actually market it as a tool that you use when you're working out has been the differentiator for us.

It's a high-quality product with high functionality, great fit and now also with a number of different colors. And the last one that we just released with The Rock has been really successful as well, which is more kind of an upscale version, if you like, of the mask. So for us, we're going to be looking at that as a segment in itself, if you like, inside of accessories, where we have more products coming out around that.

And in terms of whether you're able to convert the people that are coming on to our platforms to buy just a mask. That's one of the things that we are working to do based on the new e-commerce platform that we have and the capabilities we're building with CRM and loyalty, so big opportunity there for us going forward.

Simeon Siegel
BMO Capital Markets Corp.

Q

Patrik, as you guys continue to elevate the brand, can you speak to how you're thinking about the AUR opportunity from here? It doesn't have to be next quarter, but just as you're thinking about where that opportunity lies. And then, Dave, along those lines, any help on taking a step back and thinking through the longer-term EBIT margin recapture opportunity? Thank you.

Patrik Frisk
President, Chief Executive Officer & Director

A

In terms of – one of the things that we're very proud of this year is that we'll be able to grow our margins in a year where we're taking a lot of revenue out of the top line. And to be able to do that, you've got to be able to command a price for your product. And we're clearly able to do that with less discounting, more premium pricing, more premium positioning.

In some of the areas that you're seeing that, especially, I would say, is in our footwear. This year, we've launched – we started by launching the Machina early in the year, which was a big success for us, our highest price running shoe ever at $150. We actually then came in with two more $150 shoes, the Phantom 2 and the PR3 Rock training shoe, all of them selling through really well.

So, for us, being able to now compete at that premium level also in footwear, and in combination with less discounting and more premium across the board, is going to help drive everything up for us. And the most important bellwether there, of course, is the margin, something we're very proud of. Maybe you want to add some color on that, Dave.

David E. Bergman
Chief Financial Officer

A

Yeah. And I think relative to the longer-term EBIT, we're excited about kind of returning to that long-term profitable growth journey next year. And we're going to keep marching that forward. There's a fair amount of opportunities across all fronts as we think about gross margin with the business going forward relative to DTC mix, relative to running a much healthier percentage of off-price channel sales and, overall, just continuing to execute so much more cleanly than we may have done in prior years.

And then, as far as wrapping up this restructuring plan, we're very excited about how deeply we've been able to go and how well we've been able to transform our operations to be more effective and efficient and be able to draft off that more next year and into the next few years after that. So from gross margin percentage to SG&A percentage to revenue, there's opportunities across the board there. So longer term, our absolute plan is to march that up to 10%-plus. Which year we hit that is something we'll get to at our next Investor Day, but we're excited about the progress we're making and stepping into next year.

Simeon Siegel
BMO Capital Markets Corp.

Q

Great. Thanks a lot. Nice job and best of luck for the rest of year.

Alexandra Walvis
Goldman Sachs & Co. LLC

Q

I had another question on the plan to pull out of 2,000 to 3,000 undifferentiated wholesale doors. I wonder if you could share with us what percentage of North America revenues those represent and what the profile of those doors are. Are they predominantly small chains or larger chains, department stores? What do those look like?

Patrik Frisk
President, Chief Executive Officer & Director

A

Sure. Hi, Alex. This is Patrik. So for the next couple of 3 years, it will be work in progress and it will be across every size of customer, I would say. Part of it is larger customers. Some of it is the tail that you're cutting. Ultimately, for us, it's important that our brand shows up the right way and that we're able to drive the brand the way that we feel the brand should be driven. And that will be the approach that we take.

Alexandra Walvis
Goldman Sachs & Co. LLC

Q

That's very clear. And then, my second question is related to e-commerce. You've continued to see strong growth in that channel. It continues to be a priority. I wonder if you could update us on where we are in terms of profitability of that channel and what further investments need to be made in the offer there?

Patrik Frisk
President, Chief Executive Officer & Director

A

Yes, I'll start and then I'll hand over to Dave. One of the great things that we were able to accomplish in this quarter, I'm very proud of, is we were able to switch over from our aging, very aging – something that we actually put into the market in the early 2000s are our old homegrown platform onto our new e-commerce platform that we had already been running for a few years in Europe.

We did that in July without missing a heartbeat. And I'm very proud of the ramp-down; ramp-up took only 7 days. Team did a phenomenal job. The benefit of that is that we're now, more or less, on one platform around the world, apart from China. And the second benefit to it is that we'll be able to benefit from, of course, best practices across the world but also an ability to merchandise and ultimately drive our new CRM and loyalty programs onto that platform as well, which is the added benefit. That is something that will start to happen throughout 2021. And we'll ramp as we get into the back half of the year. Dave, do you want to add something?

David E. Bergman
Chief Financial Officer

A

Yeah. I'll just add a little bit. I mean we were super excited with how well the new platform is performing. And globally, having growth over 50% in e-comm in Q3 is a great testament to that. So the team has done just a phenomenal job cross-functionally on standing that up and around the world driving forward on that platform. And we expect that to continue to be a strong growth area for us in Q4 as well and as we move into 2021.

And to Patrik's point, I think the key investment areas that we've been really, really diving into a little bit last year, a lot this year and continuing into next year is on the CRM front, the personalization front, the loyalty program front, where we're going to be rolling out various pilots around the world and then expanding it globally. And then also, overall, just really expanding our omnichannel capabilities as well and leveraging e-comm through that also, so a lot of fronts that we're investing there. Digital is a massive area of opportunity for us. So we're excited about it.

Matthew R. Boss
JPMorgan Securities LLC
Q

Patrik, maybe to circle back on North America, and not to beat a dead horse here, on the 20% door count cut that you guys are making and maybe to size it up relative to the $3.6B revenue base in 2019, is it best to think of that revenue base in North America now as a peak or how best to think about the market size you're targeting by the end of 2022? I guess, really, the question is about the sales transfer you see as you cut these doors relative to direct-to-consumer growth.

Patrik Frisk
President, Chief Executive Officer & Director
A

Yeah. I think, first of all, I just want to make it very clear. We're going to grow in North America. I think that's incredibly important to state. I think the composition of that growth is going to change over time. The exact measurement of what grows and what goes back, we're not prepared, of course, to talk about here today. But we believe that we're going to be able to execute growth with a different mix going forward.

David E. Bergman
Chief Financial Officer
A

Yeah. And I think we quoted 2,000 to 3,000 doors coming down, but – and I know you're equating that to a percentage of total doors that we may have at this point in North America. But I wouldn't translate that to a same correlation relative to revenue because there is a big piece of that that is kind of a tale of smaller partners.

Patrik Frisk
President, Chief Executive Officer & Director
A

Yeah, and I would also...

David E. Bergman
Chief Financial Officer
A

So we'll give more color on that at our next call as well.

Patrik Frisk
President, Chief Executive Officer & Director
A

Exactly. And I think I would say the other thing is, of course, everybody on the call here, there is this overhanging hedge for all of us, right, around COVID. What we're talking about here is pending any massive flare-ups of COVID around the world, right? So that's, of course, an unknown at this point.

Matthew R. Boss
JPMorgan Securities LLC
Q

Great. And then, just a follow-up on the SG&A front. So you've guided $40mm to $60mm cost savings this year from restructuring. As we look to next year, you've said expect multiyear cost savings. I guess, how should we think about SG&A next year in terms of flow-through vs. reinvestment? Would SG&A dollars next year be down y-over-y?

David E. Bergman
Chief Financial Officer
A

At this point, we're not ready to give a lot of color on next year. I mean, we led in here with a little bit of tidbits just on top line to be able to frame things up for you. But as far as more detail down below on the line items, we want to be careful there. It's still early.

To your point, we are looking to invest in certain areas on the digital front, on the innovation front, et cetera, also with international growth. But the amount of cost savings we're driving out of the restructuring plan will be significantly higher next year than the $40mm to $60mm that we're quoting this year. So we will absolutely see a pretty nice development there as far as SG&A to revenue next year. But whether or not it's going to be flat or grow a little bit or go backwards a little bit, we'll leave that to the next call.

Matthew R. Boss
JPMorgan Securities LLC Q

That's great color. Congrats again.

Erinn E. Murphy
Piper Sandler Companies Q

I just had a question following up on e-comm, the growth up over 50%. Could you just share how that breaks down by region? And then, where do you see the digital mix by the end of the year?

David E. Bergman
Chief Financial Officer A

Yeah. I mean, the e-comm growth is really broken down pretty well across all of the regions. I think that we're seeing pretty healthy growth in every single region. There's not one region that's really struggling at all from an e-comm perspective, especially in this current environment with COVID. So we're pretty excited about the investments that we've made there and how well we're moving forward.

Erinn E. Murphy
Piper Sandler Companies Q

And just on the digital mix by the end of the year?

David E. Bergman
Chief Financial Officer A

We're not actually giving a full kind of digital mix at this point.

Erinn E. Murphy
Piper Sandler Companies Q

Okay. Got it. Understood. And then in the fourth...

David E. Bergman
Chief Financial Officer A

But it would be higher.

Erinn E. Murphy
Piper Sandler Companies Q

Okay. Yeah. That's good. And then in Q4, it was helpful context. I know there's a lot of moving parts that you gave, but I'm curious if you can contextualize a little bit more on your comment on the demand improvements quarter-to-date, particularly given the recent lockdowns in Europe. Thank you.

David E. Bergman
Chief Financial Officer

A

Sure. A couple of different things there. I think that when we had our last call, we got to remember back in July, we were still getting our arms around the COVID uncertainties. And, therefore, we were very conservative in that previous planning. We ultimately saw much better demand than expected, as did our wholesale partners. So it was both on the wholesale front and on our own direct-to-consumer front.

So we had the better sell-in, better sell-through. We were able to use some of Q2 2020 unfulfilled inventory from the store closures at that point. And also, this actually ended up translating to less than expected cancellations on the wholesale orders.

Even when product was, in certain circumstances, slightly delayed due to COVID, they weren't canceling those orders, which we had anticipated maybe they would. And that was because, again, the sell-in and sell-through that was going well. And we also did so at meaningfully less discounts and promotions than we originally anticipated.

From a regional perspective, the majority of the upside in Q3 came from North America, which we mentioned, but also better momentum than expected in EMEA as well. So all told, as a result, we have also increased our Q4 expectation from what was originally the down 20% to 25% to now down low teens, so really excited about the momentum there.

Jay Sole
UBS Securities LLC

Q

I want to ask about the comment that off-price is going to be down to 4% of sales. Can you tell us what off-price was at the peak, whether it was – whether 2015, 2016, like what percent of sales did off-price represent at the peak?

David E. Bergman
Chief Financial Officer

A

Yeah, Jay. This is Dave. We won't give the exact percentage, but it was – it never exceeded 10% in any of those years. So it was below 10%, but certainly, it wasn't all the way down to the 4% that we're estimating to land this year.

Jay Sole
UBS Securities LLC

Q

And do you think that number from 4% can go lower as we get into 2021 and beyond?

David E. Bergman
Chief Financial Officer

A

I think there's probably a little bit more opportunity there. I think we're getting into a healthy spot here this year. Can we push it a little bit further next year? I think we probably could. That 3% to 4% range is a pretty comfortable range as we leverage our outlet stores the right way, but make sure we have the right mix of newer product in the outlet stores as well, just to have a good merchandising experience for our customers. So, we don't want to overly rely on the off-price channel. So, we think that 3% to 4% range is a pretty healthy spot.

Patrik Frisk
President, Chief Executive Officer & Director

A

Yeah. And I would say, just to add on the back of Dave's, if you think about that volume from the brand like Under Armour compared to other people, that's a pretty healthy mix, we think. It's hard to not have some of it, of course, as long as you have a wholesale business. And we think that that 3% to 4% is probably the right number for us.

Michael Binetti
Credit Suisse Securities (USA) LLC

Q

David, I guess, just high level as we look, you did over $200mm of EBIT last year. Sounds like you've got a meaningful quality sales initiative here that you've got good line of sight on. We've seen the impact that can have on margins around the sector.

Based on the early planning you're doing, do you have line of sight back to that level of $200 million-plus EBIT in the planning period you referenced, the 2022?

David E. Bergman
Chief Financial Officer

A

So, definitely appreciate the question. We're excited about the future, too. But, look, it's early. We typically don't even speak to 2021 on this call and we wanted to give some color. So, we got to be careful there. There's a lot of work still to do. We're absolutely planning to grow in 2021. We're absolutely planning to grow in North America in 2021 and continue to move forward relative to EBITDA dollars and rate.

I think we do need to just keep in mind, too, as we think about next year, at least, what some of those revenue headwinds would be as we work to drive premium brand-right growth. The exits of the undifferentiated retail, we talked about. We talked about also less promotional activity on the DTC front.

And then, don't forget the sale of MyFitness platform (sic) [MyFitnessPal platform] (45:54). So, that means that assuming that that's executed late in this quarter, closes late in this quarter, that revenue essentially goes away completely next year. So, we got to keep all those things in mind as you size up 2021 growth expectations.

But we're excited to have in line of sight the slightly positive EPS and being back on the path to long-term brand-right profitable growth. And we'll give you more details on the next call and then longer-term at the next Investor Day.

Michael Binetti
Credit Suisse Securities (USA) LLC

Q

Let me follow-up. On Q4 gross margin guidance, obviously, very smart to remain as conservative as you can, given what's going on. But with third quarter much better than you feared, I'm curious where you see the pressure as you look at the quarter.

I know some brands have said that – and I'm sure I see you're doing some of this, too. But I think you – some brands have said they're taking some actions to start showing the customer some holiday-type initiatives early in October. Are you seeing promotions in the marketplace ramp at all in your categories?

David E. Bergman
Chief Financial Officer

A

Yeah. We certainly are. And as we look forward to closing out this quarter, we do think that the promotional environment is going to be pretty heavy this quarter, a fair amount heavier than it was in Q3, so bigger pressure in Q4 than Q3 y-over-y.

We also think that even though we're decreasing off-price sales in Q4 y-over-y, we think the pricing on that off-price sales could be challenged based on so many other brands trying to push into that channel. So that's probably a little bit of a headwind in Q4 gross margin as well.

Plus, on the revenue side, I mentioned licensing potentially being down 50% y-over-y in Q4 based on lower MRGs and some true-ups that were in Q4 of last year that we're comping. And that's obviously an extremely high gross margin piece of business. So those three are kind of the bigger headwinds for Q4, with the promotional environment being the biggest.

We'll get a little bit of a tailwind from channel mix with DTC and also the lower mix of off-price sales, but also continued product costing benefits that the supply chain has been driving. So a couple of favorable items there, but they're going to be definitely more than offset by the negatives I mentioned, especially the promotional environment as far as our current view.

Kimberly Conroy Greenberger
Morgan Stanley & Co. LLC

Q

I was wondering if you can think about team sports potentially coming back in 2021, is there any way for us to understand the potential revenue benefit that that might carry for you? And then secondarily, I wanted to just ask a little bit about the inventory. I think you mentioned you cut fall inventories by around 30% – or H2 inventory by around 30%. And I'm looking at the inventory balance here at the end of third quarter at up 10%. Is that leftover spring/summer product? And what's the strategy or the plan with any sort of prior season merchandise that you might have on the balance sheet? Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Thanks, Kimberly. I'll start this off and we'll tag team here a little bit here with Dave. In terms of team sports, it's been a really emotional roller coaster, I think, for Under Armour in terms of the support that we've been trying to give to our athletes and teams out there. It's been really, really rough for the athlete going through this whole pandemic and a lot of the kids out there that are not able to do their sport or weren't able to do their sport. So the whole back-to-school kind of normal team sports and seasonality of our business has really been thrown off this year.

I would say, though, that some of it has come back a little bit, as we've seen in the back half of Q3 and into Q4. But, of course, in a totality for a season of this back half and also to a large extent, the spring, team sport has been really in flux. We are trying, of course, to understand what that means for next year. But I think the reality is nobody really knows.

I mean, the teams are still making decisions, as we speak, around winter sports. And I think it's going to be the same situation when they talk about spring sports later on. So it's something that we're going to be trying to dial in, and we're going to dial it in a little bit later than normal, simply because we don't know how the seasonality of things are going to play out.

And I think in terms of inventory, I would just say that the quality of inventory that we have today is good. And then I'll let Dave fill in the blanks.

David E. Bergman
Chief Financial Officer

A

Yeah. From inventory perspective, we finished this quarter at 17% up, which was a little bit better than we anticipated because we obviously had a lot bigger sell-in and sell-through than we anticipated. There is a larger portion that's tied to spring/summer product that we couldn't affect in time from the pandemic that was still coming in in Q2. We were able to use some of that to fuel Q3 overdrive, which was nice. We are comfortable, though, with the mix of inventory with demand vs. excess and our ability to utilize the off-price channel to a lower degree and also definitely leverage our factory houses for a more brand-right approach to dealing with that.

There's still a lot of uncertainty out there right now, but we do believe that we'll end the year around 10% growth with inventory. The decision to reduce back half inventory purchases certainly will benefit us as we progress through the quarter. But we feel very comfortable with where we're going to land and being able to address that remaining inventory in a healthy way throughout next year.

Omar Saad
Evercore ISI Group

Q

I wanted to ask about the divestiture of the digital assets. Maybe, Patrik, you can put it in context how the organization's view of how to use digital technology and how to use data has evolved over the last several years and where the focus is now. And I also would love for you to touch on the new Flow cushioning platform, maybe give us a little bit more detail. I think it said it didn't need a rubber outsole, maybe a little bit more detail around that platform. Thanks.

Patrik Frisk
President, Chief Executive Officer & Director

A

Sure. Hi, Omar. So first of all, the sale of MyFitnessPal is, of course, something that we considered at great length. And the whole idea is really that, as we get more and more focused and we get dialed into the focused performer, it was clear to us that actually the consumer that was on the MyFitnessPal didn't skew necessarily as strongly towards the consumer that we're targeting as our other apps did. And I'm talking about now MapMyFitness and the success we've had there with our Connected Fitness and Connected Shoe.

So the decision was hard, but it's the right thing to do because it also enables MyFitnessPal to get a great home and for that team to be able to grow their business without having to be under Under Armour, so to speak. So for that team, for that business, I think it's a great decision. For Under Armour, it's also a great decision because we can now focus on what we've been intent on doing the whole time, which is building one ecosystem for Under Armour.

So for us, MapMyFitness will be at the very core of that. And I was just talking earlier about the fact that we just had our 1mm shoe connected. And we continue to see, especially through this pandemic, an incredible gravitation to that app. And the work that that team has done there has been phenomenal.

And we think that all the things that we've learned while we've owned these apps over the last four, five years has led us to this decision where we now feel that we can accelerate that part of the business and integration to do a better job for the consumer ultimately to connect and engage.

David E. Bergman
Chief Financial Officer

A

One thing I'd also clarify in MFP is just that we anticipate closing that deal late in Q4. So the outlook that we're giving today for Q4 does include a full quarter of full Connected Fitness revenue. So it is definitely comparable to Q4 2019, just if there was any questions on that. And then, Patrik, I think there was a question on Flow.

Patrik Frisk
President, Chief Executive Officer & Director

A

Yes, there is. I would say that with Flow, we're very excited. It's right. It's not a traditional shoe because we don't actually have a rubber outsole on the shoe. So it is actually 1 unit. That gives us a lot of advantages in terms of weight but also the performance of the shoe, both in terms of cushioning and what we would like to call separation ability is going to be like no other shoe out there. So there's a lot of advantages that we have in weight, in flexibility, in traction that goes beyond anything that we've built before. We think it's going to be a real advantage in certain sports, especially in basketball, as you think about separation ability.

So we're very excited about it. Curry is very excited about it. We're going to be starting that product in basketball, as we said, and then we're going to flow it into running in early 2021. And that's also very exciting for us because it gives us a pinnacle technology in running, not that HOVR isn't doing a phenomenal job for us, but this is really a shoe that will give you superpowers. So we're very, very excited about it.

John Kernan
Cowen & Co. LLC

Q

Wanted to touch on international, it hasn't come up as much, and it was a source of upside surprise for sure this quarter and appears you're gaining some share in EMEA and both Asia-Pac vs. some of your bigger competitors. Wondering if you could just talk to the demand sensing you're seeing there. I know there was a shift in EMEA that benefited the quarter. But even with that, it feels like you had a pretty good quarter internationally vs. your own expectations and certainly vs. your peers. So how should we think about international in Q4 and then as we head into 2021?

Patrik Frisk
President, Chief Executive Officer & Director

A

Yes. Hi, John, this is Patrik. So I'm very proud of the work that the teams have done. And I think the strategy is the same, right? So there's a more premium approach for us, both in APAC and in EMEA. It's a very strong focus around the focused performer based on all the work that we've done over the last three years. We're deploying that now into the market with the go-to-market in 2020.

And what's really very good is the fact that the same products that we're marketing across the world are working. So, for example, the Machina, it worked across the world. The Phantom 2 worked across the world. The women's Infinity and Meridian Pants, they worked across the world. So the product teams have done a phenomenal job making sure that our key stories are really resonating across the world.

We've also spent the last three years cleaning up the market in Europe. And the team there has done a really good job repositioning the brand, doing it from a premium perspective, doing it from the focused performer head-to-toe perspective in both men and women. And we're seeing now also success in our run category, not just in EMEA, but in APAC.

So having said all that positive stuff, I would say that in APAC in the back half of the year, we have been conservative in terms of opening partner doors, simply to make sure that we're doing what's right for the brand in this pandemic. So even though we had a great performance, we believe that there is very good prospects for continued growth in the APAC region as it relates to mono-branded stores, as well as e-commerce, of course, but really what you're seeing play out now is a coordinated, orchestrated play with innovation and go-to-market playing to our strengths across the world and really validating our focus and our approach at a more premium level.

So what I'm especially excited about actually across the world is the quality of sales. And that's really important to us right now. Dave, do you want to add something?

David E. Bergman
Chief Financial Officer

A

Yeah, John. I'll just give a little more quantitative color to your Q4 question. When you think about what we mentioned on the spring 2021 product shipping more in early 2021 vs. late 2020, that does impact wholesale in a pretty big way, as we mentioned.

And so, when you think about international businesses, for us, EMEA and Latin America have a bigger percentage of true wholesale. So they're definitely going to have a bigger negative impact in Q4, whereas Asia-Pacific, even though it has a big mix of wholesale, that wholesale is really more mono-branded stores.

So they technically wouldn't have as big of an impact on that spring/summer 2021 timing shift. So just to give you a little bit of color, you probably see more favorable Q4 APAC and more challenged EMEA and Latin America, just because of that flow change, as we move through the balance of Q4.

Jim Duffy
Stifel, Nicolaus & Co., Inc.

Q

Just a couple of other questions for me. First, I'm hoping you can provide more color on where you stand with realigning the cost structure. It seems like there's more to come in 2021. How much of that data is just elimination of the MyFitnessPal and Endomondo associated expenses vs. incremental? And then, Dave, I'm particularly interested in your comments looking forward to 2021 about the greater agility on the expense structure. Can you elaborate on what you mean by that?

David E. Bergman
Chief Financial Officer

A

Yeah, Jim, I guess, a couple things. One, I commented that relative to our restructuring plan, we expect to be able to execute through the majority of that and most of those charges in 2020. However, there probably will be a little bit of spillover of that into Q1 and maybe a tiny bit into Q2 of next year. So that's part of it and how well we execute and the timing of that does impact the ultimate savings of those activities.

But then, across the board, we're really, really digging deep here and understanding each of the details of our cost structure. We've been benchmarking it against three different providers to be able to really triangulate what would be the best goal for us to go after in each of our different spend areas. And we're going to continue to leverage that and the discipline into next year.

So I'm not necessarily saying you'll see SG&A go backwards significantly next year, but you will see us continue to prioritize where we spend and really understand the return on those spends and be very, very diligent in where that goes to be investing in the areas for long-term profitable growth. And that's really what we're excited about.

And I think when we talk about the agility for next year, it's really just stepping back and understanding that we have done so much transformational work over the last few years, and we're finally getting to the place where those final pieces are coming together. And we can start to leverage that operating model in a really solid way going forward. And that's what we're really excited about. And so that does speak to the SG&A and improving significantly from an SG&A percentage of revenue next year.

But also, as far as gross margin, we continue to see the benefits of what the incredible supply chain team has been doing relative to working with our vendors and with volumes increasing, being able to drive better costing there, better visibility. The SKU rationalization work that we've talked about over the last year or so is continuing to come to fruition in better costing. And then, continued DTC mix. And then, also, we still feel longer term, APAC is going to be one of our higher growth regions. And APAC is a higher gross margin and a higher operating or EBIT rate region for us as well. So, a couple of different things going on there, but we think that we're going to be able to be more nimble, more agile. And we've done a ton also to solidify the balance sheet and be able to drive through there. So, we've got a lot going for us as we step into 2021.

Jim Duffy
Stifel, Nicolaus & Co., Inc.

Q

Just one more quick question on the balance sheet. Can you speak about plans for use of proceeds from the MyFitnessPal divestiture and cash flows and how are you thinking about reducing debt balances?

David E. Bergman
Chief Financial Officer

A

So, we're going to hold back on that until the next call. We've got a lot of different things that we're working through. But at a high level, obviously, we're planning to end the year in a very favorable position, from both a cash on the balance sheet perspective and zero continuing to be outstanding on our $1.1B revolver. And then, how we move forward relative to that cash and use of that cash, we're going to wait and discuss more on the next call.