Corrected Transcript

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Under Armour, Inc. (UA)

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Under Armour, Inc. first quarter earnings webcast and conference call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

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

Lance Allega

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

Thank you and good morning to everyone joining us for Under Armour's first quarter 2020 earnings call.

The information being made available on today's call includes forward-looking statements that reflect Under Armour's view of its current business as of May 11, 2020, as well as considerations for future events that may impact our business moving forward. These statements are subject to risks and uncertainties that are detailed in documents regularly filed with the SEC and the Safe Harbor statement included in this morning's press release, both of which can be found on our website at about.underarmour.com.

It is important to note that at this time, the global COVID pandemic has had and continues to have a significant material impact on Under Armour's business. Given an extremely high level of uncertainty about the duration and extent of the virus's near and long-term impact to the global retail environment, content discussed on today's call could change materially at any time. Accordingly, future results of operations could differ materially from historical practices and results or current descriptions, estimates, and suggestions.

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 the 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.

Joining us on today's call will be Under Armour President and CEO, Patrik Frisk; and CFO, Dave Bergman. Keep in mind that we are individually each in different locations this morning, so please bear with us as we work through this call and apologies in advance for any glitches should they arise. Following our prepared remarks, we'll open the call for questions.

And with that, I'll turn it over to Patrik.

Patrik Frisk

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

Thanks, Lance. Good morning, everyone, and thank you for joining us during these unparalleled times.

Before we discuss Under Armour's first quarter results and the significant factors continuing to impact our business, I'll start by underscoring how incredibly proud I am of our company and our teammates. Along with our retail customers and factory and vendor partners around the world, the extraordinary leadership, humanity, and collaboration that continues to transpire during this global health and economic crisis is incredibly humbling and inspiring.

Specific to Under Armour, I'd like to highlight a few COVID-19 response efforts that exemplify our priorities and values. Amid this accelerating event, we mobilized the focus on the most immediate needs of our local communities, including healthcare professionals and first responders. Within days of the pandemic designation, we had repurposed the innovation lab at our headquarters to begin producing masks and gowns. To-date, we're on track to produce and provide nearly 5 million face masks and 200,000 gowns to Johns Hopkins and nearly 40 other healthcare organizations, including hospitals and senior care facilities on the front lines of this fight.

We've also donated Under Armour performance products to numerous healthcare professionals in certain hard-hit regions around the world that are fatigued from long, challenging hours fighting this horrible virus. In the US, we've deployed our talented teammates to provide logistics expertise and distribution center space to organizations that needed to scale quickly storing and staging PPE and medical supplies to meet demand for their respective fulfillment efforts.

We've also partnered with Feeding America and local food banks here in Baltimore, including a new delivery model that ensures food and other critical items are delivered safely and timely to our neighbors struggling with needs in this time of crisis.

These are just a few of the things we've been involved with during this period. All of this, of course, is a group effort across our universe of teammates, partners, and communities. We are all in this together, and Under Armour will continue to respond.

Turning to our business, clearly, this will be a considerably different earnings call than those of the past. And while we will review our first quarter results, today's conversation will focus more specifically on this point in time, updating you on the actions we're taking to navigate the uncertainties that we're all confronting.

These uncertainties are what every company is currently facing with respect to duration of the closures, how deep an economic crisis might persist, how much agility may be needed for possible permanent changes in consumer behavior, shopping preferences, and disposable incomes considerations, and ultimately triangulating what the future state operating environment might look like.

Given that these variables, among many others, remain highly uncertain and inconclusive, we cannot reasonably estimate the operational impacts of the pandemic on our business at this time, so we're not able to provide a financial outlook on today's call.

We can, however, share insights into the things that we are able to control. In this respect, we'd like to provide some color on the strategic, operational, and financial actions we're taking to adjust and manage our business during this period.

First and foremost is our strategy. We are centered in athletic performance and bringing authenticity to the brand by delivering innovative products, solutions, and experiences that athletes didn't know they needed and once they have them, can't imagine living without. There's no change to this purpose, and now, even more clearly, as the world continues to persevere through these challenging times, health, fitness, and wellness are even more center stage. In fact, the balance between physical and emotional well-being and the visceral connection to our capacity to fight, thrive, and restore amid extraordinary circumstances draws directly on strengths from these very elements.

So, while many things are in lockdown, inspiration, wellness, and fitness are most certainly not quarantined. So, as the athletic performance world moves towards social distancing, athletes made a turn towards working out at home and the outdoors, and in the process, had activated more digitally than ever before. By broadening The Only Way Is Through brand platform that launched earlier this year into Through This Together manifesto, our digital, social, and marketing teams worked quickly to activate our robust roster of athletes and key influencers.

From virtual social events, curated at home workouts, an incredibly successful Healthy at Home fitness challenge and free content along with well-orchestrated community give-backs, we've seen exceptional increases in usage within our digital app business. In fact, since mid-March, the record for the number of MapMyRun workouts logged for a single day has been broken six times and new users are up 275%. The momentum has also continued to grow in our connected footwear business as well, with year-over-year workouts up over 200% since mid-March.

With respect to emerging shifts in consumer behavior, this is a unique time to sharpen our digital knowledge by converting real-time data and analytics to drive brand interest and consideration within our largest categories of training and running. From dedicated and casual runners whose habits have picked up significantly due to gym closures to devoted fitness and team sport athletes who are craving opportunities to stay active while their normal routines have been halted, our engagement strategies are driving momentum into our digital channels, all positive factors that we believe are helping directly contribute to the improvements in eCommerce sales that we've seen since the end of March. And although this is still a fairly small part of our business, this validates some of the pre-COVID work coming together with recent strategic adjustments to drive brand consideration.

From an operational perspective and more specifically business continuity, as the virus began to rapidly spread during the first quarter outside of China, which we had already closed down, we implemented teammate protocols following government recommendations to increase social distancing, avoiding large gatherings, and requiring our office-based teammates around the world to work remotely.

Within our global supply chain, COVID-19 continues to cause large impacts and disruptions. Not only are there meaningful shifts in demand, but we're also seeing significant swings in supply due to factory closures. Over the past couple of years, we have made significant changes to our supply chain in how we plan, develop, source, and distribute product. These changes will certainly help us as we manage through these disruptions.

Additionally, as we discussed previously, we worked to establish integrated strategic relationships with considerably fewer partners. This has helped to accelerate our transition to digital sampling and virtual modeling, which is increasing product accuracy, helping to reduce lead times, and in turn allows us to quickly evolve how we're selling product into our accounts and customers. Also, because it's digital, we haven't missed a beat working remotely during this time.

Last year, we also stood up a new demand planning function that has allowed us to execute and leverage our go-to-market process much more efficiently within our operating model. This move has provided us with greater insight into demand and our ability to create product supply solutions, two elements we're leveraging tremendously during this time.

As an example of this work, as the virus gained momentum in China, we recognized the potential impact on global markets and product supply and immediately pivoted our teams to redesign our product supply plans. As a result, we quickly adjusted future planned buys to reduce potential impacts on our business.

Next, since the vast majority of owned stores and wholesale locations remain closed globally, we have shifted our distribution networks' prioritization to eCommerce. This, along with our multiyear investments in our ERP system, has provided us with the necessary flexibility to service increased digital demand. All together, the previous actions we've taken and the investments that we've made over the past few years are helping us to be more efficient during this state of suspended animation.

Speaking of which, I'd like to take a minute to give some year-to-date color on the status of store closures around the world to provide better transparency into our current business. Starting in Asia-Pacific, which as a reminder, was 12% of global revenue in 2019, both owned and partner doors began closing in China in late January and remained largely closed through early March when a slow progressive reopening process began. By the end of March, more than 80% of these locations had reopened. And as of today, substantially all owned and wholesale locations in China have reopened. That said, traffic in these locations, while continuing to see progressive recovery in recent weeks, continues to be down year over year. Outside of China and South Korea, which combined makes up about two-thirds of revenue in APAC, the rest of the region has been effectively closed since mid-March.

In the rest of our regions, North America, EMEA, and Latin America, the closing timeline was similar with substantially all of our owned stores and wholesale partner locations shutting down in mid-March, which as of today is still the case.

In our global eCommerce business, our sites are active and revenue has continued to show consistent strength since the start of the second quarter, including eCommerce sales that have trended back to year-over-year growth in North America and EMEA with outpaced strength in our women's business. So although only a low double-digit percentage of global revenue, we're encouraged by the emerging strength of our eCommerce business.

Wrapping all of this together means that since mid-March, about 80% of our global business has been at a standstill. As we look to close out the second quarter, we're continuing to assess the environment on a local basis and have begun opening a very small number of owned doors, so still very early.

Particularly in this time, our brand DNA, which is based in grit and tenacity, is precisely the North Star that will give us power to go through this storm. And within this determination, we will continue to drive through the necessary changes, and now in an even more accelerated manner to make the no-regret decisions necessary to serve our consumers, customers, and shareholders better over the long term.

So, before handing it over to Dave to walk through some of the financials, I'd like to close by acknowledging COVID-19 has changed our lives in unprecedented ways, a pandemic that has emphasized how the health and safety of our families, friends, and communities cannot be taken for granted.

Over the past few months, I've been inspired by countless examples of the resilience, witnessing the courage, love, and humility of the human spirit. Led by our committed teammates and incredibly talented management team and a fiercely unique brand, we are in control, well prepared, and positioned to stand strong through this, yet we will do more than endure. I believe through all of this, we will ultimately emerge stronger.

Dave?

David E. Bergman

Chief Financial Officer, Under Armour, Inc.

Thank you, Patrik.

In the first quarter, through early March, we were tracking well against our plan, demonstrating that our strategies were delivering appropriately against our expectations. In the last two weeks of the quarter, as the pandemic accelerated dramatically outside of China and social distancing and shelter-in-place mandates took place globally, we experienced an unprecedented decline in consumer demand, especially in North America.

For the quarter, our revenue was down 23% to $930 million. It's important to note that in our February 11 earnings call, we stated that we expected that our revenue would be down 13% to 15%, with about 5 points of the decline attributable to the China-only COVID-19 impacts, about 5 points due to significantly lower sales through the off-price channel, and about 3 points due to service level improvements that allowed us to deliver more product in the fourth quarter of last year.

However, as we closed out the first quarter, we ended up with even lower than originally anticipated off-price sales and significant unforeseen impacts of COVID-19 on our businesses outside of China, which together contributed to about 12 additional points of the first quarter decline. All in for the quarter, we saw about 15 points of negative impact from COVID-19.

Now, taking a look at first quarter revenue by channel, we had: a 28% decline in sales to our wholesale customers, driven predominantly by our North American business; a 14% decline in direct-to-consumer revenue, also driven primarily by our North American business; and an 8% decline in licensing.

By product type, apparel revenue was down 23%, footwear was down 28%, and accessories was down 17%.

From a regional and segment perspective, first quarter revenue in North America was down 28%, with nearly half of that decline due to door closures associated with COVID-19 in the last few weeks of March, coupled with nearly a quarter of the drop being attributable to lower year-over-year sales through the off-price channel.

In EMEA, revenue was up 3%, driven by timing shift in our wholesale business, offset by about 10 points of negative impact from COVID-19 in addition to reduced sales through the off-price channel.

Revenue in Asia-Pacific was down 34% due to our owned and partner doors being substantially closed for the majority of the quarter, resulting in about 50 points of negative impact from COVID-19.

In Latin America, revenue was up 8%, driven by growth in wholesale, and offset by about 7 points of negative impact from COVID-19. And finally, our connected fitness business was up 9%, driven by continued subscription momentum.

Turning to gross margin, we saw 110-basis-point improvement to 46.3% in the first quarter, with benefits including approximately 330 basis points of channel mix, including lower year-over-year sales to the off-price channel and increased DTC mix and 20 basis points of product mix due to lower footwear sales, which carry a lower gross margin rate. This was partially offset by about 200 basis points of COVID-19-related pricing and discounting impacts and 30 basis points related to changes in foreign currency.

SG&A expense was up 8% to $553 million, driven by higher legal expenses in addition to increased marketing investments to support The Only Way Is Through brand platform that launched in January.

Next, I'd like to provide details on the restructuring and impairment charges line item within our income statement, which captures both charges associated with our 2020 restructuring plan as well as the recognition of non-restructuring-related impairments of long-lived assets and goodwill.

First, I'll start with our 2020 restructuring plan. As detailed on April 3, we're expecting to incur total estimated pre-tax restructuring and related charges in the range of $475 million to $525 million, primarily this year, consisting of approximately $175 million of cash-related restructuring charges and $350 million of non-cash charges.

In the first quarter, we realized $301 million of restructuring and related impairment charges within our 2020 plan, including $298 million in non-cash and $3 million in cash-related charges, with nearly all of these Q1 charges relating to our New York City flagship store.

The second component is non-restructuring-related impairments for long-lived assets and goodwill. Due to the negative effects of COVID-19 on our business, we performed an interim analysis for long-lived assets and goodwill as of March 31, 2020. Using undiscounted cash flow analyses for our global retail fleet of owned stores, we determined that some of these long-lived assets had net carrying values that exceeded their estimated undiscounted future cash flows. Accordingly, we recognized $84 million of impairment charges in the quarter.

Additionally, we also performed interim goodwill impairment analyses for each of our reporting segments. Following this review, we determined that the estimated fair values of our Latin American reporting segment and a portion of our North American reporting segment related to our Canadian business no longer exceeded their carrying values. This resulted in a $51 million impairment of goodwill. All of this translates to a reported first quarter operating loss of $558 million.

From a tax perspective, we recorded $21 million in tax expense, primarily driven by valuation allowances recorded on certain US and China deferred tax assets, partially offset by five-year net operating loss carryback benefits provided under the recent CARES Act. After-tax, we therefore recognized a net loss of $590 million, or $1.30 of diluted loss per share.

Excluding restructuring and impairment charges, our first quarter adjusted operating loss was $122 million and adjusted net loss was $152 million, or $0.34 of adjusted diluted loss per share.

With respect to our 2020 outlook, the high level of uncertainty related to an inability to determine the duration and scope of the COVID-19 pandemic and its economic ramifications means that we cannot reasonably estimate impacts on our full year at this time. We do, however, expect these conditions to have a significant adverse impact on full year financial and operating results.

Now, moving on to some high-level color on our second quarter, with approximately 80% of our global business having been closed since April 1, we currently anticipate that revenue could be down as much as 50% to 60% in our second quarter. Although we do anticipate that our business will gradually reopen in the coming weeks and months, we believe there will be a number of challenges ahead for us and a greater global retail space, including the slow and progressive return to normalization, a highly promotional environment, and significant uncertainty in brick-and-mortar traffic and conversion as consumers return to stores.

Earlier in the call, we detailed the strategic and operational elements of what we're focused on to manage our business during this crisis. To round that out, I'd like to discuss the financial part of these efforts.

As we further manage our cost base, we are targeting a reduction of our originally planned 2020 operating expenses by approximately $325 million, which includes the operating expense benefits from the $40 million to $60 million of expected pre-tax restructuring plan savings.

Outside of the expected savings from restructuring efforts, I'd like to touch on the other larger expense reductions. Relative to marketing, with limited visibility into the larger impacts of the virus on consumer demand and behavior, we are reducing certain marketing efforts during this interim period and focusing funds predominantly on digital activations.

In mid-April, we temporarily laid off teammates in our US retail stores and distribution centers. We are reducing incentive compensation for the year. We are also tightening our hiring, contract services, travel, and other discretionary and variable costs. And we are reducing planned capital expenditures, which contributes to reduced depreciation.

As a reminder, this targeted $325 million in operating expense benefit does not represent a year-over-year variation, but again, is rather a change to our original 2020 annual operating plan.

Next, I will touch on our actions to prioritize liquidity, cash preservation, and inventory management to enhance our ability to navigate potential short and mid-term challenges and cash flow needs.

Within cash and cash equivalents, we ended the first quarter with $959 million, of which approximately $600 million was related to borrowings under our revolving credit facility. In early April, we borrowed an additional $100 million and now have $700 million outstanding under this facility.

Additionally, we have negotiated an amendment to our credit facility that is on track to close tomorrow. Given the ongoing disruption throughout our industry, we expect this amendment will provide us with improved access to liquidity going forward.

Quarter-end inventory was up 7% to $940 million. Moving forward, in anticipation of significant changes in future demand, we are proactively reducing planned inventory receipts to continue to manage this asset as efficiently as possible given expected compounding global factors.

We have also been prudently balancing the negotiation of extended payment terms with our customers and our vendors to mitigate risks. We're also working with retail lease partners to defer or abate applicable rent during store closure periods.

With the deferral of certain investments, our planned capital expenditures are now expected to be approximately $100 million compared to our previous expectation of approximately $160 million in 2020. When more favorable business conditions materialize, we would expect to resume many of these investments with adjustments based on new considerations as warranted.

With all these measures, we believe that we will be in a solid position to manage our business throughout this pandemic.

With that, I'll turn it back to the operator for your questions, and I do want to reiterate that we are unfortunately not in a position to provide additional quantitative detail on our outlook for 2020. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Matt McClintock with Raymond James.

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

Q

Hi. Hi, guys. Good morning, everyone. I guess, high level, Patrik, could you maybe give us your thoughts about launching new product into this type of environment? Clearly, there is an inventory overhang that needs to be worked through, not only on yourself, but through your competitors and retail in general. But how should we think about fresh new product and your merchandising plans going forward given this environment? Thanks.

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

A

Yeah, hi, Matt. We will continue to release new product. One of the things that we didn't talk specifically about in the script here was how well, for example, our women's business is doing right now. And that's attributable to new product.

I think the balance of thinking through the inventories you'll come out of especially Q2 with and how you're thinking about the introductions that you're currently planning to do in the back half of this year, and I would say even leading into early 2021 is going to be exactly just that, a balance. You're going to need to work through rebalancing the remainder of the year the current inventory levels as well as, of course, wanting to get freshness on to the floor.

We're intending to continue to give freshness in every category where we compete. I think the amount of freshness that you might be looking at as it relates to spring 2021 is something we're still working through, but in terms of the back half of this year, we'll still have freshness on the floor. Especially as you think about categories like footwear and running as well as in our training category, there would be a lot of freshness there.

I think having said that, we are actually, in terms of inventories, coming out of Q1 with only 7% of inventory, I think that is at the lower end of what the market has seen so far. And of course we'll have inventories building in Q2 as 80% of our stores around the world are still closed, but ultimately, because we came in with a well-managed inventory position, we think that we're going to be able to rebalance the rest of the year and continue to provide freshness into the marketplace too. We need to incentivize the customer to come in and buy new stuff, for sure.

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

Q

Thanks for that. And just as a quick follow-up, just the off-price channel, you spent several years cleaning up that channel, reducing sales into that channel. Does this environment just push you back another year in terms of your plans, your broader plans to trying to get your channel mix correct? And how should we think about the off-price channel in general as we go into the back half of this year? Thank you.

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

A

Hey, Matt, this is Dave. We definitely are continuing down the road of trying to work kind of back off of that channel. I think the impacts of COVID-19 are going to make that a little bit harder to take it as far as we wanted to take it obviously in 2020, but we will continue to step off of that. We're not expecting to grow that channel due to COVID-19, but it will take us a little bit longer this year than we originally wanted to potentially to step off as fast as we wanted. But we're still on the right track.

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

Q

Thank you very much. Best of luck, guys.

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

A

Thanks, Matt.

Operator: Your next question is from the line of Edward Yruma with KeyBanc Capital Mark (sic) [KeyBanc Capital Markets] (00:29:02).

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Good morning. And I hope that you and your teams are staying healthy at this time. I guess just a broader question. Historically, you don't really participate a lot in mark-down support, but I guess given the environment, what are your initial conversations with your retail partners like? Do you think that you're going to have to help them clear existing inventory that they have in the channel? And would you consider taking back inventory? Thank you.

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

A

Hi, Edward. This is Patrik. Yeah, it's an interesting time, and we are dealing with reopening our home stores of course and we're trying to do our very best to be good partners to our big wholesale accounts out there that are also trying to reopen their doors. And I think in general, you're seeing a balance between the inventory that's already in the channel and then future demand.

One of the things that I called out in my script is the work that we've been doing, Under Armour specifically, on building up a very strong demand planning functionality over the last 18 months. We think that we've benefited from that as we think about the back half of this year and also going into 2021, working with our accounts and with our own internal direct-to-consumer teams to ensure we're trying to balance how much we take back versus how much more we order and how people are going to be able to reopen again.

But again, we're about two months into what could be a, of course, a longer, a slower trajectory here in opening, and also in terms of the consumer coming back. We're a little bit advantaged we feel because we're a global brand, so we've had the opportunity of seeing what's happened in China. And the good news is, I guess, that the consumer is coming back. I think the bad news is that it's taking a little longer than we would wish.

And I think this whole balance between future demand and current inventory levels and how that plays out is something that we're working on day in and day out. But we're trying to be good partners here because ultimately, we need everybody to win that we do business with, and we feel that we're in a situation right now where we have control of the situation in terms of understanding all of those components. The next three quarters are going to be about rebalancing all of that before we turn into 2021. So there's a lot of work ahead of us, but we feel that we have a pretty good handle on things at this point.

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Q

Thank you.

Operator: Your next question is from the line of Alexandra Walvis with Goldman Sachs.

Alexandra Walvis
Analyst, Goldman Sachs & Co. LLC

Q

Good morning. Thanks for all the commentary this morning and thank you for taking my questions here. So my first question is around eCommerce. I wondered if you could talk us through in a little bit more detail the cadence of your eCommerce growth through the first quarter and into the second quarter. Did you see immediate acceleration in eCommerce as those stores closed in North America, or was there a little bit of a lag there?

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

A

I think that as we saw the stores closing down in North America and EMEA in mid-March, there was probably a little bit of a delayed reaction before consumers really realized what they needed and how they were going to have to get it from e-com. And so the real ramp up for us on e-com, especially in North America and EMEA, was coming in as we started to kick into April, and we've seen it all the way through April and into May. So we're really excited about that. We're not quantifying that right now, but definitely very favorable trends there, especially on the women's side too from a product perspective, which we're excited to see as well.

Alexandra Walvis
Analyst, Goldman Sachs & Co. LLC

Q

Fantastic. And then two follow-up questions on the same theme, one, any comment on eCommerce trends within China and how that's performing? And then two, any comment on how eCommerce is performing at your key wholesale partners? Thank you.

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

A

eCommerce in China continues to do pretty well for us. I would say the more dramatic increases in April have been in EMEA and North America, which we're really excited to see, but APAC is doing well also.

And from a wholesale perspective, that has been a nice benefit as well that a lot of our larger wholesale partners that have pretty good e-com sites have been driving good business as well, so we've been doing more kind of our drop-ship revenue supplying them to be able to fuel their e-com sites. So that's been going pretty well also mainly in April and into May here.

Alexandra Walvis
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. I appreciate the answers, and all the best.

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

A

Thank you, Alex.

Operator: Your next question is from the line of Fenny (sic) [Paul] Lejuez with Citigroup.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Hey. Paul Lejuez, Citi. I'm curious what you're hearing from your larger retail partners just in terms of how they're planning the back half of 2020 even into 2021, also curious if you could remind us or frame for us perhaps who your largest retail partners are and what percent of sales they make up. And I guess along similar lines, what percent of your retail partners are smaller in size, maybe what might be described as mom-and-pops versus the larger more well-capitalized retailers? Thanks.

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

A

Maybe I'll start off here, Dave, and just talk a little bit about how we're thinking about the back half and early next year in terms of the business that we're doing with our retailers.

I think, as I said before, 2020 is going to be a year of rebalancing, and not just for us, I think our larger retail partners as well as our smaller retail partners, and this both goes for North America as well as Europe are in the same situation that we're in. They're trying to figure out how fast they can open and how fast the consumer is going to come back. And again, we've had the advantage and we've certainly shared this with our partners what we have seen happen in China in terms of the return of the consumer and how they are thinking about shopping at this point in time. And for the very few stores that have been open in the US with some of our retail partners, you'll certainly see a similar pattern in the US.

I think over the next two, three weeks as we get into the back half of May, that will give us a better indication of the appetite and the speed of recovery that, say, in terms of traffic and conversion in the US. But I do think that, again, there's so much uncertainty in terms of the timing and trajectory of return that I would say that we think about it in terms of rebalancing as you think about the back half of the year because you have inventory in different places and you have the unknown of the speed of ability to reopen and the speed of recovery in terms of the consumer coming back shopping and the type of behavior that will show during that shopping coming back in terms of conversion and other things, so a lot of variables there in terms of how we're looking at modeling our back half of the year.

And, Dave, I don't know if you want to give any more color there on any of the financials?

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

A

Paul, we don't normally disclose the names of our wholesale partners, but I will say that we are monitoring all of our medium to larger ones in a pretty extensive basis around the world. We have good longstanding relationships with most of them. And in general, a lot of them are hanging in there fairly well, and we're continuing to kind of work through when they're opening their doors and what that means to our business in the future.

Right now we don't see any significant medium or larger-sized customers that are having any larger than average challenges based on what everybody is dealing with with COVID-19, but we're continuing to monitor that, and we'll work with them going forward.

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

A

I would say the next 24 to 36 months will be, I think, what you could perhaps call a forcing mechanism for many retailers, especially in the US, where there's still a lot of stores and there's still a lot of square footage, so there are certainly going to be winners and losers in this environment going forward. And I think that's not just in our sector. I think that's in general in retail. And there will also be, of course, as everybody is predicting right now a distortion to digital.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. And then just to follow up, Dave, on the smaller shop size, just what percent, perhaps, if you could share it, is coming from a single shop or maybe a couple shops sort of chains out there, if you could share that?

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

A

We don't normally give exact percentages on that, but I would say it is a smaller portion of our business. The lion's share of our dollars are going to be with the medium partners and the larger partners.

One thing that I was going to mention too that, I think, plays in a little bit to our distribution is we are seeing that those stores that are opening, the more stores that are in open air, free standing locations are seeming to do fairly – a little bit better as far as returning traffic than some of those that are maybe in malls. And we don't have a lot of mall business. So, there's a little bit of an advantage there that we're seeing so far as well as stores start to open.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks, guys. Good luck.

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

A

Thanks, Paul.

Operator: Your next question is from the line of Bob Drbul with Guggenheim.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Hi. Good morning. Just a couple of questions, on the SG&A opportunities, in terms of demand creation or endorsement contracts, that sort of thing, are there clauses that you can sort of pull back on payments required to some of your athletes? And, I guess, I was just also wondering on the inventory side, can you talk a little more just like how far out you have made adjustments to the receipts, exactly what you've been successful sort of canceling or delaying? Just maybe a little bit more color on sort of how you are adapting to sort of the factory situation? Thanks.

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

A

Yeah, Bob, this is Dave. A couple things. Relative to sports marketing contracts and endorsements, we've got pretty good relationships with a lot of those assets obviously, and we have been moving kind of our non-inventory vendors and relationships out a little bit further in payment terms. And then sports marketing contracts are part of that. So, we've been negotiating and working with them, and we've been able to get some extended payment terms there, which are helpful just in general with our overall capital preservation efforts.

Relative to inventory, we were able to jump in pretty quickly and start to reassess demand and be able to adjust our buys and our strategy there with production for the back half of the year, so a lot of the fall/winter 2020 product, we've been able to get ahead of that pretty well. It wasn't as easy to adjust some of the spring/summer 2020 because a lot of that was already in production, are inbound. And so to Patrik's point, we expect a higher inventory level as we round out Q2 with the store closures knowing a lot of that spring/summer 2020 product was still inbound. But we've been able to affect and adjust a lot of our fall/winter 2020 back half inbound, which is really helpful relative to the capital preservation efforts.

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

A

I think it's important to note here too that as you think about what's happening to the front end of the business, it's also really important to recognize what's going on in the back end, so to speak, in terms of our vendor partners.

We've done a lot of work as we've kept you guys informed about over the last three years to really work with what we feel would be considered better partners, stronger partners. It's incredibly important to us also, of course, that these partners survive. And there's a lot of hardship in the vendor base right now as there is all this fluctuation and kind of distress, and people canceling kind of midway through and stuff like that. So, we're being very thoughtful about how this also plays into 2021.

So, not only rebalancing the back half of 2020 in terms of fall demand, but also thinking ahead to 2021 demand and making sure that we're trying to help our vendors as much as we can also to level load and do other things. Because ultimately, we want to make sure that we come out of this with a strong vendor base, able to accelerate as we go into 2021 and beyond. So, there's a lot of work happening there, where Dave is working on it from the financial perspective and kind of the front end and also working hard on the back end making sure that we're keeping our vendor base alive.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Thank you very much.

Operator: Your next question is from the line of Michael Binetti with Credit Suisse.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, guys. Good morning. Thanks for taking our questions here. Just a quick modeling question or two here, can I ask, you said – I think you said lower off-price sales is a 300 – 330-basis-point lift to gross margin and COVID was about a 200-basis-point drag, around those zones. I think you were previously guiding for the total gross margins for the quarter to be up 120 to 140 basis points. Was there some other larger headwind you were initially thinking about before we knew about corona that didn't happen in the quarter or anything on the trend there?

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

Michael, this is Dave. The off-price came in a little bit less even than we originally expected, but then that was offset by the COVID-19-related pricing and discounting. So, there was a little bit of an offset going on there. But the COVID impact on pricing and discounting is generally what brought it down more relative to our original expectation.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. And then I think that, Dave, I think you said – I want to ask about your comment that off-price in North America will be above plan, above your initial plan obviously before because we have a pandemic now, but not a revenue growth rate this year, it won't be bigger in revenue dollars than 2019 still. Is that a fair – that's what you said, right, as a guardrail?

And then I know you talked a little bit about inventory. Maybe you could just speak to where we'll see that inventory clearing. Will it be in the wholesale channel, or will it skew more to your factory doors and your website?

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

Michael, let me clear up a few things. Relative to the off-price channel, we are going to see that being significantly down year-over-year. But what I was trying to get at is as a mix of business, because we know our overall business will be down year-over-year, as a mix of business, we're not going to make as much progress as far as reducing the off-price channel, the mix of business this year. But we are definitely going to see a continued decrease relative to what we're expecting there. We're not expecting that the North America decrease in off-price is going to be all that different from the overall North America decrease. So again, just the mix isn't going to change as much as we originally probably intended, but we're going to continue down that journey.

Relative to inventory levels, again, we're not giving detailed quantitative guidance, but based on the work we've been able to do in managing our five better to what we think the new demand is for the back half of the year, we don't think that we'll be creating as much excess in the back half of the year relative to fall/winter 2020, et cetera, but obviously for spring/summer 2020 and the impact of the closures late March and through April, et cetera, we will have probably the highest level of our inventory growth will be Q2. Then Q3 will get a little bit better and Q4 will be better than that. But at this point, that's probably about as much color as we're going to be able to provide on that.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. Thanks for the color.

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

No problem.

Operator: Your next question is from Matthew Boss with JPMorgan.

Matthew R. Boss
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. Patrik, maybe higher level, how do you see the demand for athletic product and the overall health and wellness changing post crisis? And any initiatives or actions that you're taking to position the brand out of this on the back end?

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

A

Thanks for the question, Matthew. I think it's an interesting time. What we did well, I think, and we currently see that in some of our digital engagement and also sales numbers is if we were able to switch from what had been originally a 360-degree campaign into a more of a manifesto approach, and what we saw was actually an amazing response from our athletes and our influencers joining us in that. We've had over 60% of our roster help us drive engagement online through our various digital apps as well as our e-commerce, which has been phenomenal.

I think in terms of demand, our strategy hasn't shifted, and I said that in my script in terms of being focused on athletic performance, I think what you're going to see – and this is our take on it – that coming out of this pandemic, we believe that health and fitness is going to continue, especially the staying fit aspect is going to be incredibly important going forward, maybe more so than going into the crisis. So, I think we're positioned really well to be able to capitalize on that.

I think what we're excited about right now is the fact that we're making good progress with women digitally, which has been an area that we've talked to you guys a lot about being an initiative. So, I believe that for us, we're going to be better positioned from a strategic perspective. I think the investments we've made to the store to digital is certainly going to help us. Ultimately, we're also grounded in team sports, and I think that is the one area where there's a little bit of an unknown right now in terms of when does all that start up again. We've seen certainly some activations happening lately here with UFC starting up last weekend and now the Bundesliga in Germany starting to kick off again very shortly. And there's also a lot of talk, of course, in our various leagues around when and how it's going to happen in North America.

But ultimately, I don't think anybody really knows yet exactly how that's going to happen. And there is a big question around back to school, right, in terms of that. But I do believe that what's going to happen is that once we come out of this, there's going to be pent-up demand. I mean, this society loves sports. That's not going to go away with the pandemic. I do think we're really well positioned is the fact that we're grounded in team sports, but we also manifest ourselves through making people better through our mission, and subsequently, the penetration that we have in training and in fitness is going to position us well coming out of this.

And with our new platform for eCommerce and our new site going live in about a month-and-a-half, we're certainly going to be able to tell better stories. And that's one of the things that we have learned during this crisis is how to tell better stories, and clearly, the consumer is resonating because of – we see that through the new consumers that we've been able to get onto our various platforms.

So, there's a bit of unknown there in terms of the team sports aspect and the start-up phase of that, but the individual desire to become more fit and to be better positions Under Armour, we believe, really well for what comes next.

Matthew R. Boss
Analyst, JPMorgan Securities LLC

Q

Great. And then, Dave, maybe on gross margin, as we think about the first quarter components of mix, discounting and foreign exchange, how best to think about the magnitude of discounting headwind if we were to think about the second quarter versus the back half of the year? Or even maybe just higher level, how would you best instruct us to think about the headwinds versus tailwinds on the gross margin line as the year progresses to the best that you can?

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

A

Yeah, I mean, I would definitely say that we believe the second quarter will be the most challenging quarter for us, and that would be on a revenue front and on a gross margin front as well. We're not providing detailed outlook for 2020, but we do expect significant Q2 through Q4 impacts from a very discounted marketplace across the globe.

So, although we anticipate continued benefits from a higher DTC mix, continued benefits from product costing improvements from all of the past and current supply chain initiatives, however, we anticipate those benefits are going to be significantly outweighed by having to navigate a very promotional environment through the rest of the year along with what we would expect in some rising inbound logistics costs.

So, unfortunately, you're going to – we would expect to see some pretty significant gross margin basis point decreases Q2 through Q4 because of the outweighed impact of the promotional environment.

Matthew R. Boss
Analyst, JPMorgan Securities LLC

Q

Thanks for the help, best of luck.

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

A

Thank you.

Operator: Your next question comes from the line of Jay Sole with UBS.

Jay Sole
Analyst, UBS Securities LLC

Q

Great, thanks so much. I just want to follow up on the comment on the $325 million operating expense benefit. You said it doesn't represent a year-over-year variation, but it's a change to the original 2020 annual operating plan. I think if I remember, the guidance was for SG&A to be flat as a percent of revenue and the revenue guidance was down low single digit. So, should we think about the $325 million as sort of an addition to the already down plan that you had, or how should we just think about the year-over-year change for SG&A this year?

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

A

Jay, this is Dave. I appreciate trying to understand the year-over-year change, but again, we're not providing quantitative outlook for 2020 at this time. So what we're trying to identify here is that we are digging deep. We are trying to make sure that we can pull out the right amount to be able to preserve the right cash flow for this year. But it is a balance. We want to be careful here around not just how we drive through this pandemic but how we come out of this. And so could we go deeper than that? Do we have flexibility to go deeper? Yes, we could, but we want to be careful as far as protecting brand investments in other areas so we come out in the right way.

From a magnitude perspective, of the $325 million, the marketing and the restructuring savings are probably the larger portions, and then some of the other pieces with incentive comp and US retail and DH [Distribution House] temporary layoffs, those are pretty reasonable sized benefits as well. But when you add it all up, it's all meaningful as we continue to drive through.

From a timing perspective, the restructuring and the marketing-related initiatives, those are mainly back-half weighted. So when you think about that $325 million coming out of our original planned expenses, probably about two-thirds of that $325 million will come out more towards the back half of the year.

Jay Sole
Analyst, UBS Securities LLC

Q

Got it. And then maybe, Patrik, you hired Lisa Collier to be the new Chief Product Officer. Can you just talk about what the reasons were that you – what she brought to the table that you're excited about and sort of how you feel about the product team in general as we head into the back half of the year?

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

A

Hi, Jay. Yes, we're excited about Lisa. Lisa has, of course, been onboarding digitally, which is an interesting exercise in itself. But the reason we felt that Lisa is going to be able to contribute further to the team are a couple of different things.

I think first of all, she has a wealth of experience in merchandising. She started her career in merchandising, and we think that she can add depth and dimension there. I also believe that she's had a great opportunity to lead cross-functionally, not just at Levi's but also later as the CEO of a smaller company, so she truly understands end-to-end. And in our world of go-to-market of today, that's incredibly important to ensure that we're driving through and understanding the process from end to end. I also believe that in terms of the work that we've done over the past year with our new head of design, Lisa will be able to complement the design aspect with this merchandising capability to drive the teams and elevate both of those things for us. So I think she's a proven leader.

She's also got great global experience. She understands the globe. I think she's well versed in transformation, something that we're continuing to go through. So she's a multi-dimensional leader, and I think she's also a proven leader. So we're sad, of course, to see our previous CPO leave us, but I think that we will add a new dimension with Lisa, and we're very excited about that.

Jay Sole
Analyst, UBS Securities LLC

Q

Okay, thank you so much.

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

A

Thanks, Jay.

Operator: Your next question comes from the line of Paul Trussell with Deutsche Bank.

Paul Trussell
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you and good morning.

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

A

Good morning, Paul.

Paul Trussell
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you for taking our question. You outlined earlier how you are reducing CapEx, understandably so, in this environment. Maybe just talk a little bit bigger-picture about how you're thinking about balancing strategic investments versus cash preservation. And also, is there anything else that we need to be mindful of as it relates to your balance sheet covenants and other kind of liquidity actions? Thank you.

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

A

Paul, this is Dave. As we look to the CapEx as one of the components for the capital preservation, we felt that the reduction from the $160 million down to $100 million for this year was prudent and was well balanced to be able to protect the key investment areas. So we've expected slower DTC expansion around the world, and obviously with COVID-19, so some of the store builds and openings are pushing out. We reduced wholesale fixtures and shop-in-shop CapEx, especially in North America. We also reduced some of our global headquarter office investments. All those things are helping with lower depreciation as well.

But we're definitely protecting the digital side relative to the new e-com platform that we're launching, protecting the work we're doing with CRM, loyalty, and also continued international support. So within that revised $100 million, almost 75% of it is aimed solely at digital and international. So I think we're protecting the right areas relative to continued growth and strategic areas for us.

Relative to the overall liquidity management, we really worked well together and with our partners, really from late March all the way through today, in negotiating better payment terms with our non-inventory vendors, also negotiating better payment terms with our inventory vendors, working with our landlords as well, the CapEx reductions we've talked about, so a lot of great progress there.

And as we thought about relative to our credit facility, we closed 03/31 well within our covenants, but looking forward, we knew there could be pressure in the future with all the unknowns that are out there. So we've been working with our bank group and negotiating an amendment to our facility. We're literally on the goal line as of today to close. The amendment will favorably modify the financial covenants all the way through the end of next year, and you'll see the details of that when it comes out in the 8-K, which will probably come out in a few days.

But we believe the revised covenants will give us a lot more and sufficient liquidity to manage our business through the pandemic. And when I say that we're at the goal line, meaning we've literally got 11 out of 11 of our syndicate bank consents in as of this morning, so we're in a good spot to be able to close probably tomorrow.

Paul Trussell
Analyst, Deutsche Bank Securities, Inc.

Q

That's very helpful color. I appreciate that. And then as it relates to the business going forward, obviously you're not giving guidance and visibility is quite low in general. But just curious if there is any detail or things that we should keep in mind as it relates to the various regions in terms of what may be expectations in EMEA, APAC, Latin Am, as well as anything you could discuss from a segment standpoint in terms of product type as well as we should think about first half and second half views. Thank you.

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

A

Again, we're not giving – yeah, I was just going to say that unfortunately we're not going to be providing quantitative outlook for the rest of the year. But as we've said, APAC is up and running fairly well, especially China and Korea. The countries outside of China and Korea are a little bit behind as far as reopening of stores. But then EMEA, North America, and Latin America are somewhat on similar trajectories right now as far as plans to start reopening. Some have actually opened a few stores, we're continuing to kind of feel that out. But Patrik, I don't know if you want to give any more color on that.

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

A

I would say probably out of the EMEA, LatAm, and North America picture, I would say EMEA is probably a little bit, just a tiny bit further ahead. We've started opening stores in EMEA last week. And what's really interesting for us is that we've seen a similar trajectory in our eCommerce business in North America and EMEA both in terms of the performance of our wholesale accounts and the drop shipments that we've been able to do with them as well as our own eCommerce acceleration. Both – and it's not just at the eCommerce part, it's also on our digital platforms.

MapMyRun was one of the top three apps in the UK for several weeks running here at the end of April, which we found was incredibly encouraging for us. So, I think that what you're going to see is a very similar picture in Europe that you're seeing in the US right now, where it's kind of a country-by-country play in terms of reopening. And here in the US, of course, it's going to very much be a country-by-country play. I think Latin America for us is the region that's actually furthest behind and they were also the last region to kind of get into this thing. So, they're lagging a little bit.

In terms of segments, I think I said a little bit before, the whole personal training, fitness that's going on right now in terms of working out at home, we've certainly been able to drive that with higher engagement, better content, and new, fresh product. So, we've been doing very well there online in our own eCommerce and also in the drop-ship that we have with our wholesale customers.

So, time will tell. I think we're in the very early stages of reopening both EMEA and North America, and if China is any indication, it's going to be a gradual build-back in terms of consumer confidence.

Paul Trussell
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Best of luck.

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

A

Thanks, Paul.

Operator: And your final question comes from the line of Erinn Murphy with Piper Sandler.

Erinn E. Murphy
Analyst, Piper Sandler & Co.

Q

Great. Thanks for sneaking me in. I guess, Patrik, just for you, a follow-up on that last question. As you think about reopening, as your retail partners are reopening, have you started resuming shipping to any of them?

And then I guess the second question is just in APAC, there's still a number of countries that are under lockdown. I'm curious if you're seeing any current challenges in your supply chain. Thank you so much.

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

A

Hi, Erinn. First one in terms of shipping, yes, we have started to open up shipping again. All the customers are starting to request product again, which we find really encouraging. And actually, we have shipped a little bit due to the fact that we've been drop shipping. So, there's been some additional opportunity even though we haven't shipped it straight to the customer.

I think in terms of the disruptions in our supply chain in Asia due to closures, it's been an on and off thing. We've had countries closing down, opening up, and it's been a little bit challenging also because in some cases, you have certain countries actually having management coming from China. So, you've had this interesting dynamic where the country might be open, but it's hard to get everything to function properly because you don't have necessarily the management in place as an example.

So, right now, we feel really good. And I think part of that is because of the work that we've done over the last three years to really focus on stronger partners. Those partners have been able to manage through this crisis we feel better, and as a consequence, we haven't seen any real impact in terms of major delays as we think about the rest of the year, even though we've been shifting product around and it's been a little bit of a moving target. And a lot of that has to do with the great work our supply chain is doing in terms of partnering with our vendor base.

But it's going to continue to be, I think, a challenging situation because a lot of those countries are still in that zone of having some of the functionality and the infrastructure locked down and hopefully doesn't get any worse and it gets better from here. And if that's the case, then we're going to be absolutely okay. But, of course, this pandemic is an unknown for all of us, right? So, everybody is trying to work through it. But I feel like we're in control right now, and we feel good about the back half of the year in terms of what we're seeing in terms of our ability to meet demand.

Erinn E. Murphy
Analyst, Piper Sandler & Co.

Q

Thank you.

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

A

Operator?

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

A

Lance?

Lance Allega

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

Yeah. That will conclude our prepared remarks for our Q1 2020 earnings call today. I'll turn it back over to the operator and we will close out. Thank you.

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

David E. Bergman

Chief Financial Officer, Under Armour, Inc.

Thank you.