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Under Armour, Inc. (UA)

Q1 2018 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Under Armour First Quarter Earnings Webcast and Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] And as a reminder, this conference may be recorded.

I would now like to turn the conference over to Mr. Lance Allega, Vice President of Investor Relations. Sir, you may begin.

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

Thank you and good morning to everyone. Thanks for joining us on today's call to discuss Under Armour's first quarter 2018 results. Participants on this call will make forward-looking statements. These statements are based on current expectations and are subject to certain uncertainties that could cause actual results to differ materially. These uncertainties are detailed in this morning's press release and documents filed regularly with the SEC, all of which can be found on our website at uabiz.com.

During our call, we may reference certain non-GAAP financial information, including adjusted and currency-neutral terms which are defined in this morning's release. We use non-GAAP amounts as the lead in some of our discussions because we feel they more accurately represent the true operational performance and underlying results of our business. You may also hear us refer to amounts in accordance with U.S. GAAP. Reconciliations of GAAP to non-U.S. GAAP measures can be found in the supplemental financial tables included in the press release, which identify and quantify all excluded items and provide management's view of why this information is useful to investors.
Joining us on today’s call will be Under Armour Chairman and CEO, Kevin Plank; President and COO, Patrik Frisk; and our Chief Operating (sic) [Financial] (1:36) Officer, Dave Bergman. Following our prepared remarks, we’ll open the call for questions.

And with that, I’ll turn it over to Kevin.

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

Thanks, Lance, and good morning, everyone. I’d like to start today’s call by revisiting something you’ve heard us say a few times over the past year. Under Armour is a great brand and a good company. As a growing global brand, our core purpose and reason for existing is athletic performance. Through a relentless pursuit of innovation and compelling experiences, our vision is to inspire you with performance solutions you never knew that you needed and can’t imagine living without.

And in this pursuit, our mission is to make you better. As we deliver on this mission, and the Under Armour brand continues to gain even greater visibility, respect and consideration globally, we are amplifying our investments in innovation to ensure our product pipeline is in a better position to constantly delight our consumers moving forward.

As a company, there’s no question that 2017 and 2018 make up one of the most challenging, yet opportunistic, periods in our history. In the midst of this inflection point, we are holistically transforming the company to ensure that the consumer is always first, simplifying our operations, increasing speed across our global ecosystem, and prioritizing investments based on return; the ultimate goal, greater agility, decisiveness and ability to drive long-term profitability through consistent and repeatable executions.

Over time, we have every of confidence that the work we are doing to reposition and engineer our company will deliver an even stronger brand for our consumers and retail partners, while simultaneously creating greater consistency and, therefore, confidence in Under Armour as an investment choice for our shareholders.

Our first quarter results should be taken as an indicator that we are making solid progress against these goals. Global revenue was up 6%, driven by a 17% increase in our direct-to-consumer business and a 27% increase in our international business. These strengths were tempered by a relatively flat result in North America. While Dave will dive deeper into the quarter and balance of the year, at the highest level, we are executing well against both our transformation and operating plans. Accordingly, with today’s report, we are reiterating our full year 2018 outlook.

Using the four pillars of our long-term strategy, product, story, service and team, I’d like to take a few minutes to run through some examples of the progress we’re making. Starting with product, with our category management structure now in place and putting the consumer at the center of development, design, and usage occasion, we are obsessing every stitch, function and finishing detail of our products through the distinct sport category lens of the consumer athlete. Equally important as creating innovative product, are our distribution and segmentation strategies. Going to market with significantly less SKUs, optimized margin targets, and meaningfully shorter calendars means our ability to segment gets sharper with each new season.

Given historically long lead times, 2018 sees a hybrid of both old and new processes coming to market. As we get deeper into this year, we’re excited to unlock the power of the category management structure, combined with our
improved go-to-market process, all of which strengthens our ability to execute more effectively across innovation, design, supply chain, marketing and sales.

A few examples of how our go-to-market has changed during this hybrid period include our ColdGear Reactor and Unstoppable apparel collections, as well as our signature Curry 4, Curry 5 and Speed II footwear releases. Additionally, UA HOVR Phantom and Sonic running footwear, along with the new UA Project Rock collection, have already virtually sold through. There are other examples as well and certainly more to come in the second half, but all-in, it’s good validation of what we’re capable of when we’re firing on all cylinders.

Our second pillar is story and how we connect, demonstrate and inspire athletes to make them better. On our last call, we spoke about being a louder brand and we’re doing just that. To support the launch of our UA HOVR technology platform in the first quarter, we used the first two expressions of Phantom and Sonic to drive a technical cushioning story for the running category. In this effort, we have three objectives: increased brand awareness; establish deeper credibility with runners; and drive reverence through experience and conversion.

As our first-ever synchronized and digital-only global launch, this effort has far exceeded our initial goals for engagement, ua.com visits, perception scores and sell-through, building our credibility and awareness in these important long-term growth drivers, running and footwear. And at just three months in, we couldn't be more pleased.

And when you factor in our training campaign which just launched, an effort featuring a number of UA athletes, including Dwayne The Rock Johnson, Natasha Hastings, Dennis Smith Jr., Zoe Zhang and Jesse Graff, to name just a few, we've realized more than 1 billion impressions between these two campaigns.

We are definitely focused on being a louder brand this year. Both products and launches for UA HOVR and training were executed under our new go-to-market framework and continue to elevate our brand by engaging consumers globally in ways that delight and inspire to make them better. Looking out over the year ahead, and we're excited that this is just the edge of a flywheel that will continue to build momentum from here forward.

With respect to service and how we deliver to our consumers directly and to our key wholesale customers, we are working under the objective of continuous improvement. Following last summer's ERP upgrade, we have greater visibility into our business in ways we did not before, from factory orders and warehouse receipts to sell-in and sell-through, we’re gaining greater clarity with respect to forecasting and inventory management. All of this is working toward optimizing our ability to reach consumers as quickly and effectively as possible through better service levels.

This is a work-in-progress, and I am very proud of the effort our team is putting forth to make service once again a center of excellence for our brand.

And speaking of team, as competitors, we like to win, but also know that winning isn’t a given. The tough decisions, hard work and incremental improvements that we are making are moving us in the right direction. This team is hungry, knows what we’re capable of becoming, and we are putting in the effort day-in and day-out to ensure that we deliver on the expectations among all stakeholders, including consumers, customers and shareholders.

In summary, our operational transformation and long-term strategy to architect a global operating model capable of driving sustainable and profitable growth is on the right track with where we expected to be, heads-down and
focused, executing smartly, and building muscle to win. We are playing the long game, and we are the best at getting better.

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

Patrik Frisk  
President & Chief Operating Officer, Under Armour, Inc.

Thanks, Kevin. Since I joined Under Armour last July, we’ve gone through a significant amount of change. Change in business is constant, inevitable and necessary, especially when you grow in scale as quickly as we have. How a company and its culture choose to embrace change determines its ability to succeed. In this respect, our entrepreneurial roots and athletic DNA continue to serve us well in executing against our aspirational and operational goals. We know who we are, where we are, and what it will take to emerge as an even stronger brand and company.

This resolve, along with strengthening competencies and the agility necessary to better advantage the scale we’ve built, puts us in increasingly better position to win. Fundamentally, this transformation starts and ends with athletes and our ability to solve their needs through the innovative performance product we create. With insights and analytics from our global consumer segmentation study, we continue to prioritize our resources and investments to support our largest global growth opportunities, while also driving toward higher long-term rates of return across the entire portfolio.

Understanding our consumers’ journey, the way they workout, eat and sleep, and how they engage the Under Armour brand digitally, socially and as a purchase consideration, further validates our strategy and gives us permission to capitalize on our strength in athletic performance.

Accordingly, we have identified white space occasions in the existing market landscape, as well as opportunities to increase marketplace capacity, or more directly, fight for incremental parts of the pie, while driving growth in the overall pie. It’s important to note that we consider this approach to be fairly channel and region-agnostic, especially given the size of our most direct competition and their existing distribution, direct-to-consumer and international footprints, let alone an incredible distortion toward footwear.

No matter how the data is cut, there’s substantial difference in size, scope and scale, and regardless, being smaller affords agility as a company, and more directly, authenticity and community as a brand.

So to support all of this, we’re also driving meaningful improvements in our supply chain and our overall speed to market with several initiatives geared at improving elements in both the income statement and the balance sheet.

From vendor-based consolidation, flow optimization and tighter inventory buys, this translates to considerably fewer SKUs, improved capacity utilization and a reduction in lead times. For customers, this means less complexity to merchandise our product, better service and a healthier business model. For consumers, it means increased product flow with performance solutions they didn't know they needed and can't imagine living without.

Switching gears, I would like to add some color into you how we performed across our business globally in the quarter. First, revenue in North America was essentially flat at $868 million or 73% of global revenue, with a slight wholesale decline being offset by growth in our direct-to-consumer business. This result was better than we had expected, primarily due to inventory management actions and higher service levels. And this does not impact our full year expectation for this region. As we continue to work through inventories coming out of the second half of
2017, we are confident in our ability to become a healthier business in North America, but it will take time and a
disciplined execution against our plan, which is exactly what we're doing.

In EMEA, revenue was up 23% to $127 million or 11% of global revenue, with balanced growth across wholesale
and direct-to-consumer including particularly strong growth in the UK and solid results in Spain and Italy. As we
continue to build our presence in this important market, we're proud to officially welcome Massimo Baratto on his
first day as Under Armour's Vice President and Managing Director of the region. Based in Amsterdam, we look
forward to Massimo grabbing the reins and helping to drive more profitable growth, brand awareness and
strategic partnerships across the region.

Revenue in Asia-Pacific was up 35% to $116 million, representing 10% of global revenue in the quarter. This
region also saw strong balanced growth in both the wholesale and direct-to-consumer sides of the business and
continued significant momentum in China. Building off Kevin's earlier comments on the global campaign for UA
HOVR, I'd be remiss not to point out that China got the largest allocation of product at launch time. This is a
testament to knowing our consumer and their demand profile, investing in areas with the highest rates of return
and overall utilizing our global scale to significantly amplify our brand. With the combination of adding more than
200 doors this year and the highest distortion of e-commerce as a percent of revenue of any of our businesses
around the world, we remain bullish on China.

And finally, revenue for Latin America was up 21% to $47 million or about 4% of total revenue. In this region,
we're focused on optimizing our mix of the right partners and businesses with certain countries to better control
the brand and drive high return. The continued momentum in Mexico and Chile, along with expansion in Argentina
and Colombia, give us a wide berth to tackle these dynamic markets while protecting the brand.

So to close, a little less than a year into my role here at Under Armour, knowing what I today, what I see ahead,
and how this company, this team, and this brand are building best-of-class professionalism into everything we
execute against, I'm thrilled with the progress we're making and the opportunity to help lead this brand.

Dave?

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

Thanks, Patrik. Given today's results and the reiteration of our full year outlook, we feel confident in the progress
we are making against our short-term strategies to become more operationally efficient and, thus, the foundation
we are setting to become a more sustainable and profitable business in the long run.

Before we dive into the first quarter, I'd like to provide some context around the 2018 restructuring plan and the
one-time items that impacted us. As announced on February 13, we are estimating pre-tax restructuring and
related charges of approximately $110 million to $130 million in 2018. In the first quarter, we recognized $45
million of these charges, comprised of $32 million in cash and $13 million in non-cash-related charges. Revenue
in the first quarter was up 6% to $1.2 billion, or up 4% if you exclude the impacts of foreign currency. Clicking
down, let's start with revenue by channel.

Our wholesale business was up 1% to $779 million, driven by strong results in our international business. This
was tempered by a slight decline in North America, which was a better-than-expected result, due primarily to the
factors Patrik noted. Direct-to-consumer revenue grew 17% to $352 million, driven by continued strong results in
our international and global e-commerce businesses. DTC was 30% of total global revenue in the quarter.
Licensing was up 9% to $26 million, primarily driven by growth in our youth and Japanese businesses.
By region, revenue in North America was essentially flat at $868 million, which was better than our expectations for the quarter, based on factors we mentioned earlier. On a currency-neutral basis, North America revenue was down 1%.

Our international business continued its strong and balanced growth, posting a 27% increase in revenue to reach $289 million or 24% of total revenue in the first quarter. On a currency-neutral basis, international revenue was up 20%. And finally, our Connected Fitness business was up 34%, driven by increases in subscription and advertising revenue.

Turning to gross margin, on a GAAP basis, we saw a 120 basis point decline to 44.2% in the first quarter. Excluding the restructuring, which contained about 60 basis points of inventory impacts, adjusted gross margin was 44.8%. To walk through the components of the decline, adjusted gross margin was negatively impacted by approximately 130 basis points of channel mix due to a higher composition of off-price sales related to inventory management initiatives. This was partially offset by about 70 basis points of tailwinds from changes in foreign currency.

SG&A expense increased 3% to $515 million, driven by continued investments in our DTC, footwear and international businesses. Additionally, a meaningful amount of marketing expenses associated with our new training campaign shifted into the second quarter.

First quarter operating loss was $29 million. Excluding the restructuring, adjusted operating income was $16 million. Interest and other expense was $5 million, which was better than expected due primarily to beneficial changes in foreign currency.

Turning to taxes, our effective tax rate for the first quarter was approximately 12%. Excluding restructuring charges, the adjusted tax rate was approximately 93%. As a reminder, the weight of discrete international items recorded in certain foreign markets are particularly impactful to our effective tax rate in periods like the first quarter, which had smaller consolidated pre-tax income or loss levels. Taking this to the bottom line, net loss was $30 million, or a $0.07 loss in diluted earnings per share, for the first quarter.

Excluding restructuring impacts, adjusted net income was approximately $1 million and adjusted diluted EPS broke even. On our balance sheet, cash and cash equivalents were up 65% to $284 million. Total debt was up 1% to $921 million. Capital expenditures were down 46% to $35 million and inventory was up 27% to $1.1 billion.

Relative to accounts receivable, which was up 28%, it is important to note that during the quarter, we adopted ASC 606, a new revenue recognition standard. Due to this change, a large portion of reserves that were previously recorded as offsets to gross accounts receivable are now being classified within other areas of the balance sheet. Without the accounting principles change in 2018, our accounts receivable for the first quarter would have declined 16% on a comparable basis. With respect to full year 2018, we are reiterating the outlook provided on February 13.

Before we turn it over to Q&A, I want to provide some color on the balance of the year. Based on factors previously discussed, we now expect second quarter revenue growth to be similar to the first quarter as we continue to execute against our inventory management initiatives. We expect all of our gross margin improvement to come in the back half of the year, due to anticipated shifts in back half channel mix driven by a lower planned composition of off-price sales and higher DTC mix, coupled with continued product costing improvements.
We expect SG&A to be up at a low double-digit rate in the second quarter, driven by the marketing shift I mentioned earlier, efforts to support our global UA HOVR and training campaigns, and store expenses associated with the expansion of our international DTC. In total, when taken in the context of the first half of 2018, SG&A should grow at a rate slightly higher than the rate of revenue growth.

Second quarter adjusted operating loss is expected to be approximately $30 million and adjusted diluted EPS is expected to be a loss of $0.09 to $0.10.

With respect to inventory, on our last call, we indicated that we thought our first half ending inventory would be consistent with our prior year-end inventory growth of 26%. Given our accelerated actions, we’re now expecting inventory growth at the end of our second quarter to be up less than 20%, so better than our previous expectation, and then should move more in line with revenue growth by the end of the year. And as a reminder, we anticipate the majority of our restructuring charges to be recorded in the first half of 2018.

That concludes our prepared remarks. So with that, I’ll turn it back to the operator for your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from the line of Matt McClintock with Barclays. Your line is now open.

Matthew McClintock
Analyst, Barclays Capital, Inc.

Hi, yes. Thanks, everyone. Good morning.

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

Hey, Matt.

Matthew McClintock
Analyst, Barclays Capital, Inc.

Hey, Kevin, you started the conversation by saying Under Armour is a great brand, but a good company. And I was just wondering. What is your definition today of what a great company is, and how do we get Under Armour to that standard? And maybe help us think about the sequencing of that path over time, given that 2018 is a hybrid year. Thanks.

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

Yeah, I think it’s a two-part answer, which is probably art and science. And so, let me actually let Patrik kick it off and start with some of the science and what we’re doing and then how we put all that together.

Patrik Frisk
President & Chief Operating Officer, Under Armour, Inc.
Yeah, so, hi. I think one of the big changes that I talked about, as I opened my script today, has been around the structure in terms of how we think about category management, streamlining and really optimizing our entire organization to ensure that we're more agile, flexible and actually faster as well.

The process that we've put in place as it relates to go-to-market has been dramatic for the company. You've seen some of that starting to come through in the HOVR campaign and our current training campaign, which we're very, very satisfied with, how we're driving our S&OP to support our go-to-market, and also now through our innovation funnel that's tying into the go-to-market funnel, so driving more upstream in terms of future innovations that we're very, very excited about.

And then, of course, being consumer-led, we've done a lot of work around the consumer, understanding the consumer from a global perspective, both the space that we're competing in but also the consumer through our massive global consumer segmentation study of over 22,000 people around the world. And then editing and really amplifying, prioritizing, reallocating resources to the categories that we want to drive the most and then just making sure that we're segmenting our product much better as well as we do that.

And driving stronger financial discipline in everything that we do, thinking more around ROIC, making sure we're prioritizing investments, as I said, and becoming more EPS-driven as we go forward. All these things together really driving a more holistic approach through the entire organization is what we believe is going to make us really great.

I don't know if you want to add something to that, Kevin.

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

Yeah, I think as I closed my script, I used the words that we're playing the long game. And what's really important I think is for everyone to understand what it means. It's 23 years in business, 13 as a public company, and sort of the moment where we are today. There's a reason why in our industry there's only a couple or a few companies that have made it through this $5 billion level. It's because the force of nature or force of will that sort of gets you to this moment means that process and structure and systems are what must become a part of the way that we operate and how we do business, and that's why I wanted Patrik to kick that answer off.

But I want you to know is that the DNA that got this brand to where it is today is something that's still very much a part of what and who we are. So when we say Under Armour is a great brand and a good company, it means that we just have so much runway of opportunity to be a much better company. And that's what we're focused on now. That's what 2017 was about, and that's what 2018 is about as well.

We mentioned what we've brought to bear with the changes made in 2017 of standing up our category management structure that we have, which is a huge undertaking, implementing our new systems with SAP, and then also what we've done with the addition of Patrik coming and helping us to really work out and work through our go-to-market process. And so we're putting those pieces in place.

As far as it relates to what the company is doing, where I'm focused as the CEO of the brand is something that the four pillars that really founded this company, product, story, service and team, they highlight and they lay out and architect really the structure that we're going to use to go forward for our strategy as a brand and as a company.
We need to make better product. We just need to make the best product. That's what put Under Armour on the map, and that's what we do today. But we need to make sure that it comes through at every touch point in places where we can be better like footwear. We see a massive opportunity there. And the good news that is we've put the pieces in place. And the best news is that we have the team to execute on it.

Our story is great simple stories that comes across explaining our product. Service is something that – it was a push for us in 2017 because we reached a breaking point with our systems that we had to implement a new ERP system. And those are the kind of things which are Herculean in nature to take on. But once you have them in, you start seeing the progress. And you see yourself getting better, which is why I say returning to making service a center of excellence for this company; as then, of course, as I just mentioned, the idea of team.

These four things really define the strategy, literally define the strategy that we've laid out for our total company. And when I look and think how am I going to spend my time, and this is a long answer for what you asked, Matt, but I think it unlocks a bit of what we want to say, is number one, raising the product bar, making the best product in the world. That's what Under Armour is, and that unique positioning of that every product does something is what gave us permission to be to begin with.

Second, is amplifying the brand, as we talked about, being a loud brand and a quiet company. We want to amplify the story of this brand and make sure people that heard us. And we don't think we were very loud in 2017. And so you will hear us tell our stories.

And then, finally, where I focus is on, A, the team, the team, the team. And the best thing that I can do to build that team is ensure that we have the right culture here. So what you're seeing is this entire rebuild in this company of taking the best aspects that we had that allowed us to get to where we are today and amplifying those to the company that we intend to be. And I'm really proud of the team and what they've done, and I think this quarter's a great sentiment of us putting our heads down, chopping wood, and going to work. And you'll continue to see and feel that from us.
So when you get these wins, how are you trying to figure out ways to amplify the supply chain and manufacturing capabilities to kind of get those products in a bigger scale out in the marketplace? Thanks.

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

Yeah, Randy. This is Dave. Relative to inventory, we're not actually going to give the composition, but we talked a lot about the overhang that we had from late 2017. And we're clearly actively moving against that, especially in the first half of this year, and we're making a lot of progress there. We've got great partners that we work with on the off-price channel. And it's not just in North America. We're doing some things around the world, too, to make sure we spread it out in a brand-right way and really get after it and move forward to get cleaner towards the back half of the year.

So you will see our inventory growth rates get more in check. We're doing more relative to how we're going to land Q2 on inventory growth. And, again, I think as we get towards the back half and towards the end of the year, much more in line with revenue growth. So we would not expect to carry a lot of inventory or challenged inventory into 2019 at all. And that's really one of our goals in 2018.

Relative to SKU count, I'm going to let Patrik touch on that a little bit more, but, obviously, every time that there's less SKUs, that's less locations in our DH. It's less product we have to order. So there's a lot of different puts and takes there. But generally, that's going to be a big benefit as well.

Patrik Frisk  
President & Chief Operating Officer, Under Armour, Inc.

Yeah, hi, Randy. This is Patrik. So I think the SKU count is, of course, really important to us. We talk a lot about SKU count, but the reality is, of course, we're not just managing our SKU count down. We're also doing the same thing as it relates to materials, trims, and all the other things that come with it. What it's actually enabling us to do is also be more specific about our segmentation. So it's actually helping our segmentation because we're now and through our go-to-market, building into the line versus creating product and then trying to assort it through the line, so we're being much more specific about the intent of every product that we have.

We're also being much more specific about the amount of product that we're making. So your call-out on HOVR being sold out, it's not necessarily a bad problem to have, right. And it's maybe not one that we've had so much of lately. But I think as we think about the future and future releases, the way that we dealt with the HOVR campaign, first of all, it was our first totally digital campaign from a 360-degree perspective. It was global. And what's so encouraging for us is that the sell-throughs were similar across the world. In other words, it was a success wherever we launched the product.

We're now building off that methodology and also that platform, to some extent, as it relates to HOVR, but we've also got other things coming down the pipeline. And that's now a new methodology for us also in terms of how we think about segmentation, segmenting the right product, the right channel and actually making the right amount of product for each product.

So, of course, the intent is not to always be sold out, but it's certainly part of the game here. And the game plan, the long game is to really make sure that we're managing our franchisees going forward as it relates not just to apparel, which we have traditionally done fairly well, but also in footwear. And that's kind of new muscle for us, but we're learning fast. And we're getting faster, better, much faster than we thought we would. And like Kevin usually says, we're the best at getting better. And we're going to be proving that out in terms of our footwear and apparel as it relates to the SKU maximization and efficiencies that we're building.
Randal J. Konik  
*Analyst, Jefferies LLC*

And does SKU count have to come down equally between footwear and apparel or is one category being more distorted versus the other in terms of getting more focused on the SKU count side? And can HOVR be more or less like the Company's [ph] Boost moment, (33:27) if you will? Like, do you see this technology and the style that you're seeing resonating with the consumer as an opportunity to kind of scale it out more to more kind of lines with the technology and utilizing the design that's been, I guess, a success in the marketplace to kind of go forward with the footwear franchise? Thanks.

Patrik Frisk  
*President & Chief Operating Officer, Under Armour, Inc.*

Yeah, we think HOVR is definitely a really important platform for us. We also have Charged and Micro G, two other platforms. We now have three strong platforms, we believe, in our tool bag, in our toolkit. We believe we can continue to build on HOVR.

You've just seen the first iterations of HOVR. We have some really exciting stuff coming down the pipeline. But we're being very, very careful and deliberate in terms of how we think about that going forward.

So, yes, we believe it's a strong platform. It's resonating with the consumer. Functionally, performance-wise, it's outstanding. We'll continue to build on it. And we believe it has lots of runway and lots of legs in terms of what we can do with it. So it's certainly one of the platforms.

I also talked about the innovation pipeline. We have very exciting things coming down the line also to complement HOVR going forward, so we're very exciting, but that, I guess, is one way to look at it, it's one of the new strong platforms in footwear for Under Armour going forward.

Randal J. Konik  
*Analyst, Jefferies LLC*

Thank you.

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

Thanks, Randy.

Operator: Thank you. And the next question will come from the line of Omar Saad with Evercore ISI. Your line is now open.

Omar Saad  
*Analyst, Evercore ISI*

Thank you. Good progress, guys. Thanks for the update. Kevin, I was hoping you could maybe talk a little bit about the evolution of the brand and how consumers perceive it and the strategy around the brand positioning, especially as you kind of go through the transition on the business side, maybe where the brand's coming from and where you'd like it to go in the marketplace, keeping in mind maybe address style versus performance, fashion versus performance, as you think about the strategy for the brand specifically; and, Patrik, maybe you having to add, as well. Thanks, guys.
Kevin A. Plank  
Chairman & Chief Executive Officer, Under Armour, Inc.

Yeah, thanks, Omar, and good to catch up. And I really enjoy this opportunity to just explain to people sort of where we are. When you look at the continuum of the journey of this company, we're really fortunate about our moment in time because every company has to evolve to saying you're a small company, you're a mid-sized company, becoming a large business.

And we spent a long time as a small company that could compete and use that as an advantage. And then, we became a big company, that net-net with others in our industry, [ph] are a smaller big (36:16) company. So we have to create the centers of excellence that give us the ability to compete in a different way. And that means everything from our global scale to our product engine, to creating go-to-market process, to, frankly, the partners that we do business with.

And where you find us right now when you talk about the evolution from performance of what it means to be where the market is today, where it is much more broader and open as to the sports-style aptitude the consumer is looking for, we can answer that. Sports style isn't a place or lifestyle isn't a place. It's just everything that you do.

And so the evolution for our company isn't one thing that anyone would want us to point at, it's just everything of who we are and how we create product. When I think of where we're going now, we've heard a lot of conversation around our product pipeline and our innovation pipeline. I just want to be clear, is that innovation is like the core of this company.

When I talked about the two components of what gives Under Armour the reason to be, I said number one, is that every product that we make does something. That's a unique positioning. That's very different than other brands. When you pick it up, if it's Under Armour, it better be special. What makes it Under Armour, is not just the logo on it. It's the fact that the consumer will ask the question, if it's Under Armour, well, what's it do?

The second thing is that when you look in our category, is that our competitors have done a really good job. And they have captured hearts and minds of consumers globally. And there's just not a lot of brands that are positioned to do that. And so, take the first point of everything doing something and take the second point of the fact that we can do it from a credible basis of the fact that we are authentic.

Our brand was born on field. We understand the athlete. And what you're hearing from us say today is our focus with what we're doing with the demand-centric growth and really dialing ourselves into living at the hearts and souls and minds of every consumer that we want to do business with.

That was our switch to category management, of now having nine distinct leaders that are focused on these categories will make a difference of staying as close to the consumer as possible, so building ourselves with that. And then, building product that is relevant and makes sense for them is something that we are highly, highly motivated to doing. And then, watching it come out and watching the go-to-market calendar come together and watching all these touch points be able to express themselves is an incredibly powerful, powerful place for this brand to be. So we're fortunate to have the size and scale of a $5 billion business that, as you can see, is stabilized.

And what we're doing now is, now we're getting really good. We're going to build muscle. We're going to get strong. And you're going to watch us grow. And the way that we're going to define growth in the short term is going to be growth in the bottom line. And how we're focused on becoming a really good business is that we are
not concerned with how do we grow the top line today. We're focused on how do we become an incredibly profitable company that is delivering the best products to our consumer, delivering them great value at the same time. So we are hyper-focused on that. And as we get strong, you'll continue to watch us march forward. And the good news we're doing this in a way that's pretty balanced.

Patrik Frisk  
President & Chief Operating Officer, Under Armour, Inc.

Yeah, I think something that should give you some confidence, I guess, Omar, is if you think about the HOVR campaign that we just launched a few months ago, that was launched without any specific asset or athlete, per se, or persona, right? It was launched in digital. It was launched endemic. It was launched as a performance product, targeted at a specific end consumer and with a tone of voice at every touch point with a great buildup and when we did release it, it sold through.

So, yes, of course, we have been too quiet. We believe we're now ramping up, becoming a louder brand and a more quiet company. And in doing so, when we do have the right product, the right style and when we communicate it with the right story, the consumer is there for us.

I see it also with the Project Rock that we have just launched recently, that's basically sold out across the world. In that case, we're also able to do it with the right asset, or with Curry. That's really working well for us, both the Curry 4, the Curry 5 that we're releasing, as well as looking forward into this year, later in this year, with Curry 6. So we're able to do both.

So we built this new muscle now in the company that we're starting to really be able to drive harder. And like Kevin says, the performance aspect of this brand, which might be looked upon as a bit of a weakness for us at this point in time in the marketplace, we believe is going to be our longest-term strength, if you like.

Omar Saad  
Analyst, Evercore ISI

Perfect. Thanks, guys.

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

Thanks, Omar.

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

Edward J. Yruma  
Analyst, KeyBanc Capital Markets, Inc.

Hi. Good morning. Thanks for taking my question. Kevin, you talked a lot about becoming a louder brand. I guess, how should we expect you to kind of articulate the stories of Under Armour? Should we expect this loudness to kind of be in tandem with innovation that you launch? And I guess, are there particular channels that you think are most effective in this environment? And then maybe one other follow up, there's on the balance sheet, a customer refund liability. Is that tied to the accounting change? Thanks.
Kevin A. Plank  
Chairman & Chief Executive Officer, Under Armour, Inc.

Yeah, I think being a loud brand, it's not about a big campaign. It's not about [ph] a signing. (41:50) It's about great product. Everything that we do, when we make great product, we win. When we get behind something, we win. So what you saw — and I don't want to run it ad nauseam, but you've heard us talk about HOVR and the success that we've seen there. Now, that's a first step. But that first step began with it's a terrific product that, at first glance, it is something that the consumer wants to buy and wants to wear and put on their foot.

The good news is that it also engages. It's got a terrific fit to it, as well as it's got incredible performance from the step-in cushion, comfort and feel that you feel in the shoe, and also the fact that it's connected and a part of our 230 million person ecosystem that we have with Connected Fitness. So it's really the trifecta of style, performance and fit that come together that allow us to become a louder brand when that happens.

At the same time, we want to continue to press on that pipeline of innovation. We want to make sure that our customers are winning with unique and segmented product. And if there's anything I want you to take off of this call is our focus on segmenting our line to ensure that each and every distribution partner or channel that we're in is something that's unique and positioned with the right product, at the right price, at the right time for the consumer.

So we feel like we've made great strides in making that happen beyond just being – launching product into the market in the spring and in the fall, but truly becoming a company that is channel-specific and, more importantly, customer-specific with differentiated product.

Now, again, we've heard a lot of – I just want to be clear. And this is an opportunity for us to get to speak a little bit about what we see out there. So from our product pipeline, we are incredibly intrigued and enthused about the products we have coming down, like the expansion you'll see and feel with HOVR. We're also very excited about the partners we're doing business with today.

Our goal is never to trade distribution or to trade partners. We want everybody to grow. And that means creating platforms, as Patrik said, like HOVR, like Charged, like Micro G that we have, of differentiating our partners by the end use as well as what the correct and proper price point is.

And so, we're very proud of the partnerships we have in place. We have the right amount of distribution. And we intend and expect to amplify each and every one of those customers to make them great.

DICK'S Sporting Goods is going to be great with Under Armour in their stores and will be stronger with it. And we've got a number of other partners, and the same thing that we look to do in the mall channel, the same thing in every channel we're doing business. So we're not adding any new channels at this time.

We just look to make everywhere we're doing business now, we want to amplify it. We want to amplify the story. And the way we're going to do that with terrific product at a fair and reasonable price for the consumer that gives them something that they never thought – they never knew they needed, and then once they have it, wonder how they ever lived without it.

David E. Bergman  
Chief Financial Officer, Under Armour, Inc.
And, Edward, this is Dave. On the second part of your question relative to the customer refund liability, you are correct. That's just an accounting standard change that we had to implement in Q1 of 2018 that's ASC 606, so not really any business change of any kind there. It's just a reclassification in 2018 and going forward.

So we adopted that prospectively, so that used to be an amount relative to returns reserve, et cetera, that used to net down gross accounts receivable. And so, you wouldn't actually see that individual amount. It will be in the net A/R in 2017. And then prospectively with the new accounting rule change, we're showing that separately in 2018 and going forward.

Edward J. Yruma  
*Analyst, KeyBanc Capital Markets, Inc.*

Great. Thanks so much, guys.

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

Thank you.

**Operator:** Thank you. And the next question comes from the line of Jim Duffy with Stifel. Your line is now open.

James Vincent Duffy  
*Analyst, Stifel, Nicolaus & Co., Inc.*

Thank you. Good morning.

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

Hi, Jim.

James Vincent Duffy  
*Analyst, Stifel, Nicolaus & Co., Inc.*

The commentary around the inventory expectations is encouraging. If we look at the composition of the gross margin compression we've seen over the last few years and year-to-date, for that matter, it's been a function of liquidation. As inventories better match with demand, how do you guys see the prospects for gross margin recapture? Is it unreasonable to think that gross margin could get back into the high 40s as supply is better matched with demand?

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

Jim, this is Dave. It's a good call-out. And I think you'll see just as you play out our gross margin outlook for this year, you know, obviously in Q1, it was more pressured as we're moving forward on dealing with some of that overhang inventory, and we're going to be doing some of that again in Q2.

And then, in the back half of the year is where you see our gross margin improvements because you're not going to see as much of a large year-over-year composition of the off-price channel as we get healthier there. And then, obviously, the plan would be that as we move into 2019 and beyond, we're going to be healthier from an inventory perspective and from an excess creation perspective relative to all the go-to-market and supply chain initiatives that we're working on that Patrik mentioned and the supply chain team is working on as well.
So we are excited about 2019 and beyond. We're not going to get into that level of detail right now. But between supply chain changes and how we're getting tighter on the buys, coupled with continued costing improvements that the supply chain is driving through with our vendor base, we're definitely excited about 2019 and beyond. And we'll look forward to speaking to that more at Investor Day towards the end of the year.

James Vincent Duffy  
**Analyst, Stifel, Nicolaus & Co., Inc.**

Great. And then, a follow up on that, with the SKU management and the tightening of lead times, that also suggests working capital as a source of cash. Dave, any thoughts on cash flow opportunity from tightening the working capital management?

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

Yeah. Great question and definitely one that we are much more focused on now and going forward. This year, 2018, is still going to be a little bit of a fight, as we're dealing through the restructuring charges and the fact that probably about 80% of these restructuring charges are cash-related. But as we get into 2019 and beyond, when you do think about tighter inventory management and you think about not having the cash impact of restructuring charges in addition to a heightened focus across the company on working capital management and CapEx prioritization, you should see meaningful improvements there. And we're driving it through from a longer-term free cash flow improvement, but also longer-term and even more focused on ROIC improvement.

James Vincent Duffy  
**Analyst, Stifel, Nicolaus & Co., Inc.**

Great to hear. Nice to see the progress, guys.

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

Thanks a lot, Jim.

Operator: Thank you. And our next question will come from the line of Jonathan Komp with Baird. Your line is now open.

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

Yeah, hi, thanks. Thanks. Dave, first, I want to just clarify a couple things on the guidance. Q2 for gross margin, I know Q1 was down just under 60 basis points year-over-year. How do you expect Q2 to trend relative to that? Will it be down that much or any thoughts there? And then, I know previously you talked about SG&A growth being front half-weighted for the year. Assuming that's still the case, could you just walk through some of the puts and takes first half versus second half?

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

Yeah, I mean, on gross margin, we didn't give specific guidance to Q2. There'll still be some pressures in Q2 as we continue to deal with the inventory management initiatives to get us cleaner going into the back half of the year. So you'll still see some of that pressure in Q2.
And then, when you think about the back half of the year, we're definitely going to have the lower year-over-year North America off-price sales in back half, which is going to help year-over-year margin in back half.

Also, the improved costing is really going to be kicking in. So we talked about that a little bit on the last call and also a little bit towards the end of last year. But a lot of the initiatives that the supply chain is driving through and working with our vendors, consolidating vendors, increasing volume, working on better costing transparency with our vendors, a lot of those initiatives you're going to start to see those come to light in the actual inventory being received in those purchase orders for the back half of this year. So that's going to help a little bit as a tailwind in back half of this year.

And then, you'll see some smaller benefits relative to regional mix with North America and Asia-Pac and then also DTC mix will be a little higher back half of this year versus 2017 as well. So couple different things going in our favor in the back half that are going to help out and lift that gross margin.

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

And maybe just to clarify that point, Dave, I know if you assume revenue growth close to Q1, SG&A up low double digits, it's hard to embed a lot greater pressure on gross margin than you saw in Q1 and maybe even less. So I just wanted to make sure the arithmetic around that was clear.

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

Yeah, Jonathan, that's fair. You probably won't see as much pressure on gross margin in Q2 as you did see in Q1, so that's fair.

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

Okay, great. And then, just a broader question as you talk about shifting the focus near term to improving the bottom line, I know previously you talked about getting SG&A below 40% from a percentage of sales basis. And that would get you back at least to a mid-single-digit operating margin, if you can achieve that piece. But how do you think aspirationally over time what type of margin is fair for this business? You don't have to commit to a timeline, but just curious how you think about the overall opportunity.

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

Yeah, I mean, I think we're going to be looking at it more as a longer-term play from a CAGR perspective. We are going to be looking to continue to find ways to leverage SG&A and take advantage of a lot of the restructuring benefits from the 2017 and 2018 plans that we'll see in 2019 and beyond.

So we're not ready to really discuss details on that or timeline on that, but we are excited to be able to talk about that at Investor Day later in the year.

But, again, when you think about the combined impact of what Patrik's driving from a [ph] GTM (51:40) perspective and, therefore, an effectiveness perspective, and you couple that with the benefits of the restructuring activities in digging deep and trying to reset the cost structure, we're going to be pretty excited about what we can share towards the end of the year.
Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.
Okay. Thank you.

Operator: Thank you. This does conclude the question-and-answer session. I would now like to turn the call back over to Mr. Kevin Plank for any closing remarks.

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

Yeah, thank you, Operator. We spent a long time defining ourselves as a growth company, and I want to be clear that that definition is not different today. I explained that we want growth in the bottom line, so we can show you and demonstrate how great of a company that we can be. But it doesn't take anything away from the opportunity and the runway we see in front of ourselves as we do play the long game with what's in front of us.

I just want to take a minute, and I want to thank our team that has demonstrated such incredible strength and resilience going back now nearly 18 months. So we've been in this thing and we've been in the fight, and I'm incredibly proud of the hard work and the effort that they put through. And I think you're seeing it come out in days like today, where we get to have a very proud explanation of where our company is and, more importantly, where we're going. So we're in this fight. We look forward to it, and we appreciate your support. Thanks very much.

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