

# URBAN OUTFITTERS, INC.

Second Quarter, FY'14 Conference Call  
August 19, 2013

## Participants

Richard A. Hayne, Chief Executive Officer  
Frank Conforti, Chief Financial Officer  
David McCreight, CEO, Anthropologie Group  
Margaret Hayne, President, Free People Brand  
Ted Marlow, CEO, Urban Outfitters Group  
Wendy B. McDevitt, President, Terrain  
Glen A. Bodzy, General Counsel  
Barbara Rozsas, Chief Sourcing Officer  
Calvin Hollinger, Chief Administrative Officer  
Matt Kaness, Chief Strategy Officer  
David Ziel, Chief Development Officer  
Bill Cody, Chief Talent Officer  
Dave Hayne, COO, Free People Brand  
Oona McCullough, Director of Investor Relations

Good afternoon, and welcome to the URBN second quarter fiscal 2014 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three and six month periods ending July 31, 2013.

The following discussions may include forward-looking statements. Please note that actual results may differ materially from those statements. Additional information concerning factors that could cause actual results to differ materially from projected results is contained in the Company's filings with the Securities and Exchange Commission.

We will begin today's call with Frank Conforti, our Chief Financial Officer, who will provide financial highlights for the second quarter. Meg Hayne, Free People Brand President and Dave Hayne, COO Free People will provide a brief update on the Free People Brand. Richard Hayne, our Chief Executive Officer, will then comment on our broader strategic initiatives. Following that, we will be pleased to address your questions.

As usual, the text of today's conference call, along with detailed management commentary, will be posted to our corporate website at [www.urbanoutfittersinc.com](http://www.urbanoutfittersinc.com).

I'll now turn the call over to Frank.

Thank you, Oona, and good afternoon everyone.

I will start my prepared commentary discussing our fiscal year 2014 record second quarter results versus the prior comparable quarter. Then, I will share our thoughts concerning the remainder of the year.

Total Company sales for the quarter increased by 12%, to a second quarter record of \$759 million. This increase was driven by a strong retail segment comp rate of 9%, opening 10 new stores during the quarter, a \$25 million increase in non-comparable sales, and a 17% jump in wholesale segment sales.

The 9% increase in retail segment comp sales was fueled by continued robust direct-to-consumer growth and positive comp store sales. Direct-to-consumer growth resulted from an increase in visitors and improved conversion rate. Positive comp store sales were driven by increased transactions and units per transaction which were partially offset by lower average unit selling prices.

By brand, our retail segment comp rate was 38%, 9% and 5% at Free People, Anthropologie and Urban Outfitters, respectively.

Free People Wholesale delivered another strong quarter as sales rose 17% to \$44 million. These results came from double digit sales growth at specialty stores and department stores.

Gross profit for the quarter increased by 17% to \$298 million. The gross profit rate improved by 169 basis points to 39.3%. The improvement in gross profit rate was primarily due to a reduction in merchandise markdowns mainly driven by improvements at the Anthropologie brand. We also improved our initial merchandise margins and leveraged store occupancy expenses. These gains were partially offset by deleverage in delivery expense primarily related to an increase in penetration of direct-to-consumer sales.

Total selling, general and administrative expenses for the quarter increased by 13% to \$179 million. Total SG&A as percentage of sales, deleveraged by 14 basis points to 23.6%. The SG&A deleverage was primarily due to increased marketing expenses, to support sales growth and customer acquisition initiatives.

Operating income for the quarter increased by 24% to a second quarter record of \$119 million, with operating profit margin improving by 154 basis points to 15.7%.

Net income was \$76 million or \$0.51 per diluted share.

Turning to the balance sheet, inventory increased by 8% to \$347 million. The growth in inventory was primarily related to the acquisition of inventory to stock new and 'non-comp' stores. Comparable retail segment inventory was flat as of the end of the quarter.

Lastly, we ended the quarter with \$741 million in cash and marketable securities.

As we look forward to the remainder of fiscal year 2014, it may be helpful for you to consider the following:

We are planning to open approximately 35 to 40 new stores during the year. By brand we are planning approximately 16 new Urban Outfitters stores globally, including 5 new European stores, 9 new Anthropologie stores globally, including one new European store and 14 new Free People stores in North America.

We are planning for continued year-over-year gross margin growth, with a goal of producing at least 50 basis points of margin improvement for the second half of the current fiscal year. We believe our gross margin growth opportunities will primarily be driven by lower markdown rates and higher initial margins resulting from improved product execution and continued focus on inventory management.

We continue to focus on effectively managing our selling, general and administrative expenses, but remain committed to investing in our business to drive long term sales and margin growth. These investments relate to increased spend in technology systems and talent to boost web and store based initiatives. Additionally we plan on increasing marketing and customer analytics headcount as well as marketing spend to further customer acquisition and retention efforts. Due in part to these investments we expect total SG&A to increase in the mid-teens for the remainder of fiscal 2014.

Capital expenditures for fiscal year 2014 are planned at approximately \$190-\$210 million driven primarily by new stores and the expansion of our home office.

Finally, our fiscal year 2014 annual effective tax rate is planned to be approximately 36.5%.

As a reminder, the forgoing does not constitute a forecast, but is simply a reflection of our current views. The Company disclaims any obligation to update forward looking statements.

Now I will pass the call over to Meg Hayne, our Free People Brand President.

Thank you, Frank.

When we last spoke in November, I expressed my excitement about our past performance and what lay ahead for Free People. Since then, our business has outperformed our goals, and we have just completed a record second quarter with each of our three channels of distribution delivering record sales and profits.

Product is at the heart of our brand, and our second quarter offering of clothing and accessories resonated deeply with our customer. It included outfits with many different looks and moods, all of which fit the Free People lifestyle.

The brand, however, has become more than product. In stores and on web, it has become a community of women who share our passion for the Free People lifestyle. In addition to product, we offer information, entertainment and engagement. We inspire and inform her

through our blog, catalogs, website, events, videos and social media channels. The success we have seen with women world-wide, participating in and embracing our community is powerful.

I would like to thank the entire Free People team for delivering a strong quarter; and our many wholesale partners for their continued support. Our Free People COO, Dave Hayne, will now share some of our second quarter successes...Dave

Thank you, Meg.

Let me begin with our wholesale channel; it remains the largest of our three channels, and Q2 sales set a new record. Quarterly wholesale sales surpassed last year by nearly 17%, driven by strength across both our specialty and department store accounts. Our ecommerce customers showed particular strength.

Following the success of our first branded shop in Nordstrom's downtown Seattle location last year, we've opened nine additional department store shops so far this year. These shops carry extended product assortments in a branded environment, and are sold by Free People-trained sales associates. We're very pleased with the productivity increases we've seen in these locations and anticipate several more openings later this year.

Significant growth opportunities await us overseas, particularly in Europe, where in June, we opened our first wholesale showroom in London. Set on a quaint cobblestone street in Marylebone, with designs and display showing the essence of our brand, this new showroom is the perfect way to introduce ourselves and our product to the European market. We've signed several new key accounts, and we recently piloted a popup shop in Selfridges' London flagship, where the initial customer reaction has been excellent.

In Asia, our partnership with World Co. Ltd. in Japan has been progressing well; we continue to be pleased with their team's capabilities and collaboration. Following two strong pop-up shop tests, plans are now underway to open the first two permanent locations in late October: a street-level shop at the Shinjuku station building, as well as a 2,300 square foot, stand-alone store in Harajuku. We believe this Harajuku space will be an excellent brand introduction for the Japanese market, complete with an impactful ground floor for product presentations. Adjacent to the store will be a new wholesale showroom enabling us to reach more wholesale customers.

Moving to the retail segment, we're presently on pace to open 14 new stores this year. The second quarter saw three new store openings, including Sherman Oaks, CA, our largest mall store to date, and a relocation of our Bellevue, WA store that more than doubled the selling square footage. Early indications point to an excellent customer response; they can now shop wider assortments of our apparel, accessories and intimates, and our display and merchandising teams are empowered with more space to reinforce the brand aesthetic, both of which, we believe, lead to a more compelling overall experience for customers. In total, Free People now directly operates 83 stores, and we anticipate ending the year with approximately 90 stores in North America.

Our direct-to-consumer channel enjoyed a robust Q2, delivering one of our largest ever quarterly increases. All contributors to our ecommerce channel are delivering innovative and compelling solutions that are satisfying our customers. True to our “web-as-alpha” strategy, we have widened and deepened our web assortment, which has made it stronger. We have invested in merchandising, image and graphic design, which have added to the rich story-telling and visual appeal of our digital storefronts. Our PR, CRM and digital marketing efforts have been successful in finding the Free People woman and attracting her back to our website and stores to shop and explore, to learn and be inspired; and our blog is enjoying its largest readership ever.

In June, our ecommerce team successfully launched our iPhone app. Since then, more than 80K customers have downloaded it, and the app is now driving robust sales volume. Perhaps just as importantly, our customers immediately engaged with the app’s FP Me integrations; we experienced a doubling of daily FP Me pic uploads and product hearts, an increased customer registration rate and a significantly higher conversion rate than our mobile website.

We understand that Free People must pursue more than just transactions...we must offer our customers ways to engage with the full Free People lifestyle experience. More of these engagement points are migrating online, which is why we have plans to further increase our mobile and FP Me investments.

Last but not least, we are excited to share that Roshambo, Free People’s first fashion film, won three awards at the La Jolla Fashion Film Festival this summer. The awards were for Best Actress, Best Direction, and Best Picture. The success of this film series, and the buzz it has created for Free People, has encouraged us to experiment with other creative and compelling ways to engage and delight our customers. Elevating the Free People brand and building our community is our constant goal. If you would like to view the Roshambo video, it can be viewed on our YouTube page.

Thank you very much, I will now hand the call to our CEO, Dick Hayne.

Thank you, Dave, and good afternoon, everyone.

First, congratulations to our brand leaders and shared service heads for delivering another record-breaking quarter. This year’s second quarter sales and profits were the highest in the Company’s history.

Record sales were driven largely by a strong, retail segment ‘comp’ increase. In the second quarter both retail channels showed positive ‘comp’ sales growth with the direct-to-consumer channel continuing to grow at a much faster rate than the store channel. This pushed DTC penetration to total sales up by more than 350 basis points. Each brand posted a strong double-digit gain in direct-to-consumer sales. Total DTC traffic grew by 16% and conversion improved by 51 basis points driving the total number of Direct orders up by 40%. The increased penetration of Direct-to-consumer sales enabled us to lever store occupancy and store controllable expenses. Offsetting those savings was an increase in marketing and net delivery expenses each of which were used to help grow the direct sales.

Turning to profits, higher sales, better initial margins, more compelling product and effective expense control all combined to create record earnings. The improvements in product led to higher full-price sell-throughs and lower merchandise mark-downs. In total, gross margins improved an inspiring 169 basis points over the same period last year, and operating profit jumped to just under 16% of sales. This is especially noteworthy since nine quarters have passed since we delivered a profit rate this strong.

In total, all metrics suggest that URBN's second quarter performance was very successful.

At the brand level, Meg and her Free People team produced a truly outstanding quarter. In my 40 plus years in this business, I cannot remember any URBN brand delivering a more successful, all around quarter. All three of Free People's channels of distribution achieved strong, double-digit sales growth, the product offering was exceptional, inventories and expenses were well managed and the creative marketing was, in my opinion, best in class in the industry.

The Anthropologie brand produced excellent second quarter results, as well. David and his team continued to make significant improvements to the product, the product assortments and the marketing. I believe the Anthropologie stores looked better than I have seen them look in many years. It seems as though their customers agreed because regular price selling saw strong, double-digit growth while promotional activity decreased significantly. Finally, inventory and expense control at the Anthropologie brand were outstanding in the quarter.

The Urban Outfitters brand delivered good, but not exceptional, quarterly results. Ted and his team faced difficult comparisons because their second quarter results last year were especially strong. This quarter they did post top line growth with significant gains in the direct-to-consumer channel, but bottom line contribution reflected the effects of increased promotional activity during the quarter.

Turning to international expansion, during the quarter we opened one new Urban Outfitters store in the UK and plan to open three more Urban stores in Europe this year. Anthropologie will open one store in Europe during the third quarter. This opening demonstrates our confidence that the Anthropologie brand is ready for continued global expansion.

Dave has already discussed Free People's international growth, but to summarize, the brand opened a pop-up shop in Selfridges and a European wholesale showroom in London. European interest in the Free People brand is currently strong and we expect to open shops in a number of additional 'doors' in Europe next year.

In Asia, Free People along with World Co. Ltd. of Japan will launch a shop in Shinjuku and a free-standing store and wholesale showroom in Harajuku. Both projects are scheduled to open this October. The results will help inform us about further expansion in Japan and about entering other Asian markets, as well.

In the direct-to-consumer channel, we continue to look at the entire world as an expansion opportunity for all of our brands. The Urban brand is leading this effort. They now ship to over 120 countries from our fulfillment centers in the US and UK. We believe we are in the very early

stages of realizing the world-wide potential that each brand possesses, and we are dedicating more resources to unlock this significant growth opportunity.

Now let me give you an update concerning one of our strategic initiatives. We have said that driving top line growth in ways that are accretive to the bottom line is our number one financial objective. You may recall us discussing the initiatives we envision to achieve this top line growth – opening new stores, growing the direct-to-consumer business, expanding internationally and finally, product expansion within existing brands.

I will elaborate on this last initiative. We have discussed our intention to continue to expand product choices and categories and to enter adjacent businesses. By doing so, we look to attract new customers and expand the share of wallet each brand captures with existing customers. We will accomplish this expansion through a combination of internal development and external relationships. These external relationships may include licensing, partnerships, joint ventures and acquisitions.

We have successfully expanded product choices and categories through internal development with initiatives like the Free People intimates offering, the petite selection at Anthropologie and the growth of style and size offerings at all three brand web-sites. We have also launched the BHLDN and Terrain brands which are both adjacent categories to the Anthropologie brand. To date, we have not used external relationships to accomplish this goal. We now intend to pursue this method more aggressively and are currently in discussions with several companies about a possible relationship.

The partnerships and acquisitions we believe present the most potential are those that have a similar customer profile to one of our existing brands, have a management team that will augment or complement our existing expertise and those that offer strong growth opportunities. We look forward to making further progress on this initiative.

Now, before I turn the call over for questions, I would like to recognize and thank our 20,000 associates worldwide and our many business partners around the globe. Our industry is in the midst of radical changes. These present us with unparalleled opportunities for growth. We have the capital necessary to invest for growth, the strategy that maps how that growth can occur, and most importantly, the people with the creative energy to produce that growth. This should allow us to meet the challenges of change and keep winning, and I am confident we will do so. I also want to extend my thanks to our many shareholders for their continued support. I am profoundly grateful for the opportunity to lead the URBN community. Thank you.

At this time I will open the call to your questions.