

# URBAN OUTFITTERS, INC.

Third Quarter, FY' 14 Conference Call  
November 18, 2013

## Participants

Richard A. Hayne, Chief Executive Officer  
Frank Conforti, Chief Financial Officer  
David McCreight, CEO, Anthropologie Group  
Margaret Hayne, President, Free People Brand and Chief Creative Officer  
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  
Oona McCullough, Director of Investor Relations

Good afternoon, and welcome to the URBN third quarter fiscal 2014 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three and nine month periods ending October 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 third quarter. Ted Marlow, CEO Urban Outfitters Brand will provide a brief update on the Urban Outfitters 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.

Please note new to this quarter's call, is a slideshow presentation to accompany Dick's commentary which is available via the webcast link on our investor relations website along with the text of today's conference call, and detailed management commentary. Each of the previous items is posted to our corporate website at [www.urbanoutfittersinc.com](http://www.urbanoutfittersinc.com).

I'll now turn the call over to Frank.

## **Frank**

Thank you Oona and good afternoon everyone.

I will begin my prepared commentary discussing our fiscal year 2014 third quarter record results versus the prior comparable quarter. Then I will share our thoughts concerning the fourth quarter.

Total Company sales for the quarter increased by 12% to a third quarter record of \$774 million. This increase was driven by a strong retail segment comp rate of 7%, the opening of 9 new stores during the quarter, a \$29 million increase in non-comparable sales, and a 21% jump in wholesale segment sales.

The 7% 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 improved conversion rate, higher average order value and an increase in visitors. Positive comp store sales were driven by increased units per transaction, which were partially offset by lower average unit selling prices while transactions remained flat.

By brand, our retail segment comp rates increased 30% at Free People and 13% at Anthropologie and decreased 1% at Urban Outfitters.

Free People Wholesale delivered another strong quarter as sales rose 21% to \$50 million. These results came from double-digit sales growth at specialty stores and department stores.

Gross profit for the quarter increased by 12% to \$292 million, while the gross profit rate improved by 11 basis points to 37.7%. The improvement in gross profit rate was primarily due to a reduction in merchandise markdowns and improved initial merchandise margins at the Anthropologie and Free People brands. These improvements were partially offset by an increase in merchandise markdowns at the Urban Outfitters brand in North America. The increased penetration of our direct-to-consumer channel continued to drive occupancy leverage while also driving delivery expense deleverage.

Total selling, general and administrative expenses for the quarter increased by 12% to \$187 million. Total SG&A as percentage of sales, remained flat at 24.1%. The increase in SG&A expense was primarily due to increased variable expenses to support new store growth, and increased spend in web marketing and technology investments to support direct-to-consumer growth.

Operating income for the quarter increased by 13% to a third quarter record of \$105 million, while operating profit rate improved by 12 basis points to 13.6%.

Net income was \$70 million or \$0.47 per diluted share.

Turning to the balance sheet, inventory increased by 3% to \$407 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.

In August 2013, our Board of Directors authorized the repurchase of 10 million common shares under a share repurchase program. During the quarter we repurchased and retired 300,000 common shares for \$11 million, leaving 9.7 million shares available for repurchase under the current authorization.

Lastly, we ended the quarter with \$726 million in cash and marketable securities.

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

We are planning to open approximately 10 new stores during the final quarter of the year; 2 Anthropologie stores, 4 Free People Stores and 4 Urban Outfitters stores globally, with 2 in Europe. By brand, this will bring our fiscal year 2014 new store count to 15 new Urban Outfitters stores globally, including 5 new European stores, 8 new Anthropologie stores globally, including 1 new European store and 13 new Free People stores in North America.

Due to what we believe could be an increasingly promotional holiday environment, we are planning inventory conservatively. This promotional environment could negatively impact our gross profit margins for the fourth quarter.

We believe that SG&A could grow at a low to mid-teens rate for the final quarter of the year. This increase would be driven by continued investments in technology systems and talent to support web and store based initiatives and marketing and customer analytics to further customer acquisition and retention efforts.

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 35.50%.

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 Ted Marlow, our Urban Outfitters Brand CEO.

**Ted**

Good Afternoon.

It is my pleasure to speak to you today regarding the quarter just completed for the Urban Outfitters brand and our thoughts on the road ahead for the brand. While the third quarter proved to be a challenging moment in time for our brand, it was filled with learning's that are driving progress on the execution of our brand strategy.

Our most significant challenge in the quarter came from North America. I attribute the short fall in the North American market to missed fashion calls, off-pitch marketing, and poor creative execution. Magnifying these issues, without doubt, was the extreme promotional environment which exists in the young adult market today. This type of operating environment demands that we execute our best work in product offer and experience. In a word we came up short.

First, let me say a few words about the environment. The hyper-competitive space that is the young-adult market is not new to us. The foundation of our model is built on pleasing the customer through a differentiated, creative experience combined with a compelling product offering. That offering must be eclectic, broad and of the moment. We have proven over many years to be experts at executing these two factors. During the quarter we did not execute either factor as well as the previous year. Our women's fashion offer didn't strike a strong enough note to better last year's performance and was too narrow, too one-note. Our men's apparel also had difficulty driving needed volume.

However, there were bright spots in the North American business; a number of women's and men's categories did produce excellent regular price sell-throughs. In addition, the home business posted another positive quarter of sales growth driven by strong sales in the entertainment component of the business. At present, we feel we have a good understanding of where the opportunities exist, and we are working to realize them. We recognize this is not something that can be corrected overnight; therefore, we remain very cautious about Q4 and have positioned our inventory accordingly.

As for the experience, our business and brand position are built on the strength of our brand experience as our point of differentiation vs. our competitors. Our brand experience is driven by the culture of our core customer. When we do our best work we get rewarded; when we do not it follows that we fine tune, adjust and move forward to improve. Our focus must always be on our customer and developing a brand community that appropriately serves them. We are acutely focused on improving our execution as it relates to this experience and serving our community, this goes for our stores and on-line.

In line with this thinking, during the quarter, the North American E-commerce team launched generation 5 of our iPhone app, URBANON. URBANON allows us to evolve with our customers by focusing on elements that are important to them, exclusive access to rewards and events and the utilization of social media to facilitate their interaction with the UO brand community. Over the past few weeks 370,000 customers have downloaded the new app.

Additionally, at the end of October we launched the first phase of our Urban Outfitters site re-design with an emphasis on improved presentation of our product narratives. This initial phase focused on the elements of our experience that are most visible to our customers including how stories are presented on our homepage, our gateway pages and how our site scales across different screen sizes. Although the majority of this work is focused on the adoption of new technical features, it as well positions us to craft more immersive experiences for our customers through the creative voice of our brand.

Turning my attention now to Europe, I want to congratulate our European crew on their performance during the quarter. Sales in the quarter grew nicely versus last year, with healthy margin contribution driven by excellent inventory control which dramatically reduced markdown expense. The European team executed two standout openings during the quarter, Galeries Lafayette in Paris and Kalverstraat in Amsterdam. In early September, we opened a pop-up space in Galeries Lafayette on Boulevard Haussman in Paris. This space provided us with a gauge for our brands acceptance in a physical retail location in France and a feel for conveying our brand in a smaller pop-up size environment. The results of the test have been quite encouraging and thus fuel our thoughts regarding further brand opportunity both in France, and, in regard to small format possibilities.

Regarding Amsterdam, in October we opened on Kalverstraat, a destination shopping street for our customer in Amsterdam. We have been looking for an appropriate space on Kalverstraat for the better part of 10 years. Our patience has been rewarded with a beautiful addition to our European retail store strategy. Our team did excellent work on store design, product assortment, merchandising, marketing and engaging with the local community. Sales have exceeded our expectations since opening.

In closing, I am confident in our brand's long-term potential. Continuing to grow our business is an iterative process calling upon passion, vision, creativity and an ability to execute successfully. I am confident in our ability to execute and believe we are better prepared for the future we envision for UO.

Thank you. I now turn the call over to Dick for his closing commentary.

## Dick

Thank you, Ted, and good afternoon, everyone.

First, congratulations to our brand leaders and shared service heads for delivering another record quarter. Our results are especially gratifying given the difficult retail environment we face. Even though, as Ted said in his comments, the Urban brand fell short of their internal goals, all brands delivered record sales for the quarter and the Anthropologie and Free People brands produced record merchandise margins, as well. Overall, URBN produced record third quarter revenues and operating profits. This demonstrates the strength of our model in two different ways. First, when one of our brands offers compelling products and a brand-enhancing, creative experience, customers will respond regardless of the retail environment. Secondly, because URBN operates a portfolio of brands, if one brand has a disappointing quarter, the overall company can still achieve strong results.

Speaking of strong results, the Anthropologie team produced an extremely strong quarter. David and his team continue to make significant improvements to all aspects of their business. The current product is more trend-right and differentiated, and the marketing and creative efforts are improved, as well. Together, these improvements created a more compelling shopping experience and based on our third quarter results, she responded. During the quarter, for instance, the Anthropologie team launched a refresh of the website with dramatically improved visuals which helped to drive strong direct-to-consumer sales gains. Inventory control at the Anthropologie brand was outstanding. This, along with better product, led to minimal markdowns, high teen regular price 'comp' sales and record merchandise margins and operating profits.

Not to be outdone, the Free People team continued to deliver an exceptional performance they established in the first half of the year. All channels of distribution produced solid, double-digit sales gains. Regular price 'comp' sales outpaced total sales growth in both the store and direct channels. Wholesale revenues increased by 21% driven by domestic and international expansion of the Free People shop-in-shop concept. Like the Anthropologie brand, Free People also delivered its best-ever third quarter in terms of merchandise margins and operating profits. Free People continues to be an industry leader in terms of creative marketing, customer engagement and product development.

Now let me discuss the progress we made in the third quarter, delivering on our growth initiatives. To refresh your memory, those initiatives are as follows:

- expand our retail square footage by continuing to open new doors in North America,
- grow the direct-to-consumer channel,
- increase the penetration of our brands outside of North America, and
- expand our product and category offerings.

I'll begin with North American store expansion.

During the quarter, we opened 7 new stores in North America, bringing the year-to-date total to 22. Of those, Anthropologie opened 5 Urban Outfitters opened 8, and Free People opened 9. We expect to open approximately 8 additional North American stores in the current quarter.

Turning to direct-to-consumer, this channel continued to experience strong growth and increased its penetration to total sales by more than 200 basis points in the quarter. Each brand produced double-digit direct-to-consumer revenue growth. Driving this growth was a 7% increase in traffic to our websites, a 34 basis point improvement in conversion rate and an increase in average order value. Within the direct-to-consumer channel, mobile devices accounted for the largest percentage increase in transactions. Mobile, which includes smart phones and tablets, is quickly becoming the preferred method of virtual shopping for our customers and our brands are focusing much of their attention on becoming more 'mobile friendly'. During the quarter, the Urban brand launched its mobile app, called URBANON, and the Anthropologie brand introduced responsive design into their web platform. This feature optimizes the image the customer sees based on the device the customer is using. And finally, Free People's, FP Me app is continuing to gain momentum already attracting more than 165,000 members since the site was launched in June of this year.

Now I'll discuss our international expansion beginning with the Free People brand.

I am happy to report that during the quarter, the Free People wholesale team in conjunction with World Co., Ltd. of Japan opened the first two Free People stores in Japan. The flagship store is a 2,300 square foot, free-standing space in the Harajuku section of Tokyo; the other is a 600 square foot shop in the Lumine est station building in Shinjuku, which is the busiest transport hub in the world. The Free People team also helped to open a two-story wholesale showroom in Tokyo next door to the Harajuku store. We are delighted with the initial customer response to the brand and look forward to helping World open additional locations across Japan.

During the quarter, the Free People wholesale team also opened a shop-in-shop in Hong Kong. These forays into Asian markets compliment Free People's entrance into the European market earlier this year. If you recall, Free People opened a wholesale showroom in London and a shop-in-shop in Selfridges department store on London's Oxford Street. In all, international growth in the third quarter helped to increase Free People wholesale revenues by 21% on a year-over-year basis. We expect international expansion to continue to be a significant growth vehicle for the Free People wholesale channel.

The Urban Outfitters brand also expanded its international presence during the quarter. As Ted mentioned, Urban added two exceptional locations to their European portfolio. The recently-opened Amsterdam store is located on Kalverstraat, the busiest street in that city. This store had a fantastic opening, recording the second highest opening day sales of any of our European stores. Better yet, since opening, sales have remained significantly above our projections.

Additionally, the Urban brand opened a pop up shop in the Galeries Lafayette department store in Paris. This location has given us a wonderful platform to communicate our brand to the French customer and has helped to drive more traffic to our '.fr' website. Total Urban brand sales from France have exceeded our expectations and we intend to make additional investments designed to further penetrate that market.

During the quarter, the Anthropologie brand opened its fourth UK store. It consists of approximately 7,000 square feet of selling space on two floors and is located on the High Street in Guildford, an affluent suburban town located thirty miles outside of London. This is Anthropologie's first suburban store in Europe and judging by the strong customer reaction and sales to date, the results suggest that there could be many similar opportunities across UK and Europe.

Finally, let me turn to product and category expansion.

Free People continued to expand its successful line of lingerie called Intimately Free. The line is now carried in 35 Free People stores and is sold through the wholesale channel to many retailers across the country including Nordstrom's and Bloomingdales. This year, the line was expanded to include more structured and underwire bras which have been very well received by the customer.

In the third quarter, Free People also expanded its shoe offering with a greater penetration of Free People branded shoes. During the quarter, these own-brand shoes accounted for over 50% of the offering within Free People stores. The own-brand product performed better than third-party branded shoes. Free People plans to add its line of shoes to the wholesale offer in 2014 and believes that the shoe category will be an important growth vehicle for all of its channels of distribution.

The Urban brand is expanding its product offering, as well. One successful expansion category is home goods. During the third quarter, a number of larger Urban brand stores in the U.S. and on-line channel received an expanded home goods assortment. Based on the strong customer reaction, we believe there is opportunity to expand this assortment even further.

Another category the Urban brand identified as a growth opportunity is beauty. Throughout the year, the brand has expanded its selection of nail and hair products and believes this assortment can be expanded to include color, face and other beauty products. In order to realize this opportunity the Urban brand recently hired a veteran of the beauty industry to oversee the growth and development of this category both in-stores and on-line. Among other initiatives, the brand expects to launch a beauty shop in the Herald Square store, which is scheduled to open next year.

The Anthropologie brand continues to expand its collection of petite apparel which is now offered in eight Anthropologie stores and on-line. During the quarter, the petite business more than doubled on a year-over-year basis.

Now, before I turn the call over for questions, I have the pleasure of announcing that Meg Hayne, has taken on a new role in addition to her role as President of Free People – she now is also Chief Creative Officer of URBN. As CCO, Meg will work with all URBN brand leaders, as well as, designated individuals and teams to help refine and develop each Brand’s creative vision. She will also help attract, train and develop the Company’s creative talent and help implement structures and procedures that will allow that creative talent to be more effective and productive. I believe that Meg’s creative and visual abilities are among the best in the industry, and I’m confident that her involvement will benefit each brand.

Finally, I would like to recognize and thank our 20,000 associates worldwide and our many business partners around the globe. Your enthusiasm and creativity are a constant source of inspiration to me.

I also want to extend my thanks to our many shareholders for your 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.