URBAN OUTFITTERS, INC.

Fourth Quarter, FY'17 Conference Call
March 7, 2017

Participants

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Margaret Hayne, CCO, URBN & CEO, Free People Brand
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Barbara Rozsas, Chief Sourcing Officer
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David Ziel, Chief Development Officer
Dave Hayne, Chief Digital Officer
Sheila Harrington, President, Free People Brand
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Good afternoon, and welcome to the URBN fourth quarter fiscal 2017 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three and twelve-month period ending January 31, 2017.

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 fourth quarter. 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 will be posted to our corporate website at www.urbn.com. I'll now turn the call over to Frank.

Frank Conforti

Thank you, Oona, and good afternoon everyone.

I will start my prepared commentary discussing our recently completed fiscal year 2017 fourth quarter results versus the prior comparable quarter. Then I will share some of our thoughts concerning the fiscal year 2018 first quarter and full year.

Total Company or URBN sales for the fourth quarter increased 2% to $1.03 billion. This sales increase was driven by a $19 million increase in 'non-comp' sales, including the opening of 2 net new stores in the quarter, and sales from the newly acquired Vetri family restaurants. Retail segment 'comp' sales were flat for the quarter and wholesale sales were down 1%. Please remember, that last year the wholesale segment's fourth quarter benefitted from shipping delays in the third quarter. Additionally, please note that our sales growth during the quarter was negatively impacted by approximately 150 basis points of foreign currency translation.

Within our retail segment 'comp', the direct-to-consumer channel continued to outperform stores, posting a double-digit sales increase, driven by increases in sessions, and conversion rate, which more than offset a decrease in average order value. Negative 'comp' store sales resulted from decreased transactions and average unit selling price, while units per transaction were flat.

By brand, our retail segment 'comp' rate increased by 2% at Urban Outfitters and 1% at Free People while Anthropologie was down 3%. Our URBN Retail Segment 'comp' was the strongest in November, which benefitted from the shift of Cyber Monday, while December and January posted negative 'comps'.

Free People wholesale segment sales were -1% for the quarter. This is primarily due to the prior year fourth quarter benefitting from approximately $9 million in carryover orders that were delayed out of our fulfillment center. Please note that wholesale delivered 13% sales growth over the second half of the year, and we currently believe our growth rate in fiscal 2018 will be approximately 10%.

Total URBN gross profit for the quarter was down 2.5% to the prior comparable quarter at $340 million. Gross profit rate, declined by 142 basis points to 33.0%. The decline in gross profit rate was driven by deleverage in delivery and logistics expense primarily due to the penetration of the direct-to-consumer channel. Additionally, maintained margins deleveraged due to lower initial markups and higher markdowns at both the Anthropologie and Urban Outfitters brands.

Store occupancy as a rate-to-sales was flat for the quarter, which includes approximately $4 million of store impairment charges in the current year and approximately $7 million of store impairment charges in the prior year. The current year impairment charges related to one Urban Outfitters store and two Free People stores.

Total ‘SG&A’ expenses for the quarter were up 3.5% to $241 million. Total ‘SG&A’ as a percentage of sales, deleveraged by 40 basis points to 23.3%. This ‘SG&A’ deleverage was primarily due to an increase in direct store related expenses. These expenses primarily relate to recently opened expanded format Anthropologie and Free People stores. Looking forward into fiscal year 2018, we believe we have the opportunity to reduce our expense structure improving our payroll leverage at the expanded format stores for each of our brands.

Operating income for the quarter decreased by 14.5% to $100 million, with operating profit margin deleveraging by 182 basis points to 9.7%.

Our annual effective tax rate came in at 35.5% vs. 35.9% last year. The fourth quarter rate came in 200 bps lower than last year due to the ratio of certain foreign profits to global taxable profits in the quarter.

Net income for the quarter was $64 million or $0.55 cents per diluted share.

Turning to the balance sheet, inventory increased by 2.5% to $339 million. The increase in inventory relates to inventory to support our ‘non-comp’ stores. Our total URBN square footage is up 4.5% vs. this time last year. Retail segment comp inventory is down 2% on a cost basis and is well controlled at each of our brands.

We ended the quarter with $403 million in cash and marketable securities and have zero drawn down on our asset backed line of credit facility. Capital expenditures came in at $144 million for the year. Our capital spend was primarily used for new, relocated or expanded stores followed by technology related investments.

As we enter the first quarter of fiscal year 2018, it may be helpful for you to consider the following:

We are planning on opening 19 new stores during the year while closing 7 stores due to lease expirations. Urban Outfitters is planning on opening 1 new store in North America while closing 2 stores and is planning on opening 3 new stores in Europe. Anthropologie is planning on opening 4 new stores, including 1 expanded format store and closing 2 stores, all in North America. Free People is planning on opening 10 new stores and closing 3 stores, all also in North America. The food & beverage division will be opening one restaurant adjacent to an expanded format Anthropologie that will be opened later this year.

As we have been discussing for some time now, we believe we are essentially at our total store count in North America for both Urban Outfitters, currently at 199 stores, and Anthropologie, currently at 210 stores, and nearing our North American total for Free People brand, currently at 127 stores. As existing leases come up for renewal, we will review each location for brand appropriateness and with strong financial discipline. Where the location economics or demographics do not meet our strict criteria, we will continue to close those existing doors. We believe North America remains over stored, and we believe we are fortunate to have remained disciplined in our store growth throughout the years.

We are planning our new store growth to come from international expansion. We will continue to expand the Urban Outfitters and Anthropologie brands in Europe and have begun to look for our first Free People store location in Europe. We are also exploring partnerships in the Middle East and working through our Asian growth strategy for each of our brands.

For the fiscal 2018 first quarter, we are planning five new Free People stores in North America and one Free People closing. Additionally, Anthropologie is planning on opening one new expanded format Anthropologie store, which will have a café adjacent to it, and one store closing.

Now moving on to gross margin. We believe URBN's gross margin rate for the first quarter could decline versus the prior year. This deleverage could be due to increased delivery and logistics expenses related to the increased penetration of the direct-to-consumer channel. There is also a chance that markdown rate could be higher on a year-over-year basis in order to keep inventory clean at Anthropologie and Urban Outfitters.

Based on our current plan, we believe 'SG&A' could grow at approximately 5% for the first quarter and for the fiscal year 2018. The growth planned for the first quarter is primarily from direct store related expenses to support our 'non-comp' store growth, largely due to our expanded formats at Anthropologie and Free People.

Our planned annual SG&A growth rate primarily relates to marketing and direct-to-consumer technology investments to continue to support our strong direct-to-consumer channel sales growth.

Capital expenditures for fiscal 2018 are planned at approximately $90 million. The spend for fiscal 2018 is primarily driven by new, relocated and expanded stores, followed by investments in direct-to-consumer related technology.

Finally, our fiscal year 2018 annual effective tax rate is planned to be approximately 37%. The planned increase in the tax rate versus the prior year is primarily due to the new accounting standards related to stock compensation accounting. This new guidance requires all tax effects related to share-based payments to be recorded through the income statement as discrete adjustments versus additional paid-in capital on the balance sheet under the previous rules. Although this change has no effect on cash taxes paid, it will increase the volatility of our reported income tax expense, resulting in either net benefits or detriments in any given reporting period.

Similar to fiscal year 2017, we believe our fiscal year 2018 quarterly effective tax rate will be higher in the first half of the year and lower in the second half of the year due to the ratio of certain foreign profits and losses to global tax profits in the period.

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 it is my pleasure to pass the call over to Dick Hayne, Chairman and Chief Executive Officer for URBN.

Dick Hayne

Thanks Frank, and good afternoon everyone.

Today I'll speak to our fourth quarter results, talk about the macro business environment and then finish with how we plan to navigate in this climate. Let me begin with a fourth quarter overview.

I would characterize results during this year's fourth quarter, especially the Holiday season, as both disappointing and highly unusual. Total Company comparable sales were flat for the quarter, but within the quarter two distinct periods appeared. 'Comps' were up nicely in the month of November. All three brands enjoyed a fantastic start to the Holiday season by driving double-digit 'comp' sales gains on both Black Friday and Cyber Monday. Things were looking very good.

Then came December…

Store traffic and overall demand in North America at all three brands evaporated for several weeks at the beginning of December. More normal demand returned only as Christmas and Chanukah drew near. Demand remained normal immediately after the Holidays, but fell back again once the new year began. I can't recall having ever seen a quarter with such wild and wide fluctuations. And while all three brands experienced the same sales curve, the amplitudes were different. I'll provide some color on those differences starting with the Urban Outfitters brand.

The Urban brand reported a +2% 'comp' with both the North American and European groups reporting positive 'comps'. In North America, sales benefitted from strong improvement in the men's apparel and accessories categories, continued strength in intimates and beauty, and slightly positive 'comps' in the women's apparel offering. Partially offsetting those gains were weak sales in the women's accessory and home categories. Accessories suffered from underperformance in cold weather related products and the home category was impacted by lower demand for electronics, vinyl and books. Meanwhile, the European group produced outstanding 'comp" increases in their women's apparel category with own brand product driving all of the gain and mostly through regular price sales. Thus, we know there is an abundance of women's fashion available to drive sales.

Although 'comps' were positive, the brand saw a decline in merchandise margins. IMU declined by 55 bps versus the prior year due to a shift in sales by category and the outperformance of branded apparel product which typically carries a lower initial markup. The shift in mix was also largely responsible for a 5% decrease in AUS at the brand. We believe these factors may continue to be a drag on sales and merchandise margins through at least the first half of fiscal 2018. Additionally, sales trends decelerated toward the end of the quarter resulting in markdowns that were slightly higher by rate than planned. We believe the sales deceleration in the final 30 days of the quarter was caused, in part, by fewer fresh receipts. January is no longer a clearance month; she wants new fashion and the brand did not offer her enough of it.

One of the Urban brand's big wins in the quarter and the year came from its marketing efforts. During the quarter, marketing activity on a year-over-year basis drove 23% more sales and generated 56% more incremental margin. Digital communities and social media are replacing storefronts and traditional advertising as the preferred means by which brands and customers are connecting. I believe the Urban brand's use of social media platforms and the customer connections they are building are among the best in the industry. Currently the Urban brand enjoys almost 7 million Instagram followers, a 52% increase versus the prior year and well surpassing most of its peers.

Now, let me turn your attention to the Anthropologie group. The brand's fourth quarter performance in North America was less than stellar and results were largely a repeat of the previous three quarters. The growth experienced in the home, beauty, Bhldn and Terrain categories and concepts continued to be overshadowed by challenges in the apparel and accessory offerings. As a result, total brand comparable sales in the quarter dropped by 3%.

During the quarter, the expanded home category continued to enjoy positive momentum. This category posted strong 'comp' sales with improved IMU and lower markdowns on a year-over-year basis. We believe this momentum should continue as the team evolves its aesthetic, broadens the offering and refines its marketing.

The beauty category posted double-digit 'comps' in Q4 and the brand team believes there is significant opportunity in FY18 to build this category out further. Both the Bhldn and Terrain concepts also delivered strong, double-digit 'comps', and both continued to benefit from inclusion into the Anthropologie Group where they can leverage the Anthropologie customer base.

Terrain product proved to be very popular in the two shop-in-shops opened inside the new Anthropologie large format stores in California. Because of this success, additional Terrain shops are planned for future large format Anthropologie stores. In addition, Terrain plans to expand the number of garden center locations it operates independently.

Customer excitement around all of the expansion categories confirms our belief that the Anthropologie brand resonates deeply with its customer. However, the customer is also telling us in no uncertain terms the apparel and accessory offerings are currently 'off-pitch'. We believe strongly that with a better product offering, both categories would be enjoying the same positive 'comps' as the other Anthro products. Indeed, the brand in Europe, where approximately 40% of the product in those two categories is now sourced locally, succeeded in producing positive apparel and accessory 'comps' in the fourth quarter.

We are aggressively addressing this issue and have begun the process of strengthening the North American design and merchant teams in these two categories. The brand has now been reorganized and product responsibility has been divided between soft and hard goods. Hillary Super has joined the Anthropologie Group as President of Women's. She will oversee and be responsible for all apparel, accessories, and beauty products plus the Bhldn business. At the same time, Andrew Carnie has been promoted to the position of President of Home. In that position, he will oversee and be responsible for gift, décor, and furniture products, plus the Terrain business. We have also added a new merchandise manager and three new classification design directors to the women's apparel team. We're determined to fix the fashion issue and are planning for better results as FY18 progresses.

Moving to the Free People brand, the positive momentum derived from better fashion apparel that began in Q3 continued into the fourth quarter and the brand was able to deliver a 1% positive retail segment 'comp' in this year's Holiday quarter. Positive 'comps' across the apparel assortment, including Movement, was partially offset by weakness in footwear and cold weather related accessories.

In addition to producing positive retail segment 'comps', the brand also controlled its inventory effectively with ending levels, on a 'comp', year-over-year basis, down 18%. This resulted in double-digit decreases in markdown 'comp' sales while regular price sales rose nicely. IMU improved, as well. Combining all of these factors, merchandise margins improved by more than 200 bps in this year's quarter versus the same period last year.

In Q4, the wholesale channel recorded revenues down 1% but this drop was entirely due to timing shifts resulting from last year's late shipments. In order to capture a more accurate picture of the wholesale business, we look at the combined quarters. For the six-month period ending January 31, total wholesale revenues increased by 13%. Revenue growth during that combined period was driven by year-over-year gains at ecommerce accounts, especially those at department stores, European accounts and growth in new specialty accounts related to expansion categories such as Movement.

Revenue generated from Movement product grew by 71% versus the same period last year. Movement product is now sold through 102 Movement accounts such as spas, yoga studios, gyms and fitness centers, in addition to existing Free People department and specialty store accounts. We believe the Movement brand has very exciting opportunities and could drive substantial future revenue growth.

Finally, current quarter wholesale shipments and bookings remain strong, and we believe the wholesale business may be able to achieve double-digit growth once again in FY18.

Now, let me say a few words about the macro-environment. Without doubt retailers in general, and URBN specifically, face a number of challenges, the most obvious of which is the disruption created by the digital revolution. Once again, sales from the DTC channel grew much faster than the store channel. DTC session traffic is up strongly while store traffic is weak. The shift in consumer preference is both obvious and growing. Total company penetration of our direct channel across all brands increased by roughly 400 basis points during the holiday season. I predict within the next three years, total URBN retail segment sales by channel will be almost equal.

This would be fine if the increase in DTC sales were wholly additive, but they're not. Digital shopping is partially replacing store shopping and thus, is negatively impacting store traffic and store generated sales. Flat to negative store 'comps' are causing occupancy deleverage and eroding four-wall margins.

Add to that the fact that the US market is oversaturated with retail space and far too much of that space is occupied by stores selling apparel. Retail square feet per capita in the United States is more than six times that of Europe or Japan. And this doesn't count digital commerce.

Our industry, not unlike the housing industry, saw too much square footage capacity added in the 90's and early 2000's. Thousands of new doors opened and rents soared; this created a bubble, and like housing, that bubble has now burst. We are seeing the results; doors shuttering and rents retreating.

This trend will continue for the foreseeable future and may even accelerate. Another consequence of overcapacity is discounting and endless promotions as retailers try to drive demand through lower prices. This causes AUR deflation and erodes merchandise margins.

Given an uncertain environment where occupancy costs are deleveraging and merchandise margins are pressured, how does URBN, with our current portfolio of strong, omni-channel, lifestyle brands, adapt, grow and remain solidly profitable? The answer: we plan to do what any good portfolio manager would – invest resources in the most promising opportunities, diversify to lower risk, and increase liquidity. Fortunately for us, we are already reasonably diversified. Three years ago, we set out to strengthen and grow our non-apparel categories and have done so with considerable success. We now see many additional opportunities to grow by channel, category and geography.

Over the past five years, if we look at URBN growth rates by channel, the direct-to-consumer and wholesale channels grew the fastest. Both produced CAGRs in the high teens. Stores, on the other hand, produced a CAGR in the low single digits. With no compelling reason to believe those trends will change abruptly, we plan to distort our efforts and spend accordingly.

Our highest priority is where we've had the most recent success – digital. Last year, we made many improvements to our capabilities in this channel. We developed a single platform for all brands. This enables URBN to be more scalable and efficient in developing and rolling out front end enhancements across all brands, both on mobile, and all websites. We have improved our functionality around check out, payments, search, inventory visibility, in store pick-up, ship to store, mobile capabilities and speed on all web platforms.

This year, in order to maintain that strong digital growth, we plan to:

- Complete the single platform rollout to all brands,
- Make additional improvements to our site functionality,
- Invest more in data analytics so we can know our customers better and give that customer personalized experiences,

- Improve our service levels, including faster and more reliable shipping and enhanced customer communications,
- Give the customer more product choices in all categories, and
- Speak to her on the devices and through the social sites she prefers.

While doing all of this, we have to ensure that these initiatives are done in a voice that is both brand appropriate and aspirational.

To accomplish many of these digital initiatives, we recently reorganized the digital teams and created a new role of Chief Digital Officer. Dave Hayne, our CDO and his team, working in conjunction with the brands and the IT group, should help to facilitate investments in the digital channel by identifying and force ranking opportunities, and should allow us to implement those investments faster and more effectively.

Moving on to the wholesale channel, we plan to grow revenues through category and geographic expansion and diversification.

The FP Movement brand is an excellent example. The concept is built around exercise and wellness for women and it affords the wholesale channel, for the first time, access to the 200 billion dollar per year action sports market while still permitting crossover into the casual fashion world, too. Movement product exists at the intersection of active functionality and feminine fashion. It is infused with Free People's signature fashion sensibility which differentiates it from most competitors in the space. We are excited by the opportunity this concept possesses and are continuing to invest in its future by committing more resources to product design, expanding the breath of the offering, building out a dedicated, national sales team, attending more action sport-centered trade shows, and developing and executing a strategic marketing plan.

The core Free People fashion product also holds opportunities to grow and diversify, in this case, by geography. Currently over ninety percent of the core product is distributed into North America. Certainly the brand has the capacity to expand internationally. To that end, Free People has recently hired a senior sales manager, based in London, to manage the sales team and grow the European account base. The brand is attending more fashion trade shows across Europe and to support the growth, Free People intends to begin utilizing the current URBN distribution facilities in Rushden, UK, to stock and ship the wholesale product to European accounts.

I certainly don't want to give the impression that we are abandoning the store channel because we're not. I envision our brick and mortar store fleet as an equal partner with the virtual store in the new omni-channel retail world. We will continue to invest in this channel, but relative to historic levels, store investment is trending downward. This is largely because both larger brands have now reached what we believe, and have always said, is full penetration in North America – a fleet between 200 to 250 stores. Furthermore, it makes little sense to enter into many new, long-term leases at this time when all signs indicate that a similar lease will be less expensive in the near future.

This year URBN plans to open 15 new stores in North America versus 26 and 29 over the two previous years, respectively. To date we have signed only eight leases for new stores to be opened in North America in FY19. We do, however, continue to believe strongly in the Anthropologie large format concept and will continue to invest in opening more of them, but these new stores will be primarily expansions or relocations of current stores rather than geographic expansion. URBN will also continue to make omni-channel investments like in-store pick-up and inventory visibility by store.

All three brands do have an exciting opportunity to expand their store base internationally. There are many robust markets where our brands have limited to no distribution. This year we plan to open two to three new stores in Europe and over the next five years, besides more European stores, we plan to open stores in Asia and the Middle East, as well. A number of these might be through franchising or joint venture arrangements.

Lastly, allow me to say a few words about liquidity. Fashion brands always deal with significant product uncertainty and risk. I think of designers and merchants like weather forecasters as they try to accurately predict the future. Today, added to this underlying uncertainty is the risk brought on by digital disruption and deflationary pricing pressures. This creates a new level of risk.

Besides diversification, the best way for us to deal with increased risk is to stay liquid. It's important to keep inventories very lean and have as much flexibility as possible to move in or out of certain products quickly. One of our primary goals for each brand this year is to lower initial order quantities and introduce more new products while maintaining lower overall weeks of supply. This means working closely with suppliers and our production and logistics teams to speed up our supply chain capabilities. Risk mitigation and bringing more newness into our product assortments is more important than ever.

So in conclusion, our plan going forward includes:

- Shifting our resources to better align with today's opportunities as we see them,
- Continuing to diversify our businesses around channel, category and geography, and
- Placing smaller, more frequent inventory bets and staying as liquid and nimble as possible.

If we succeed in accomplishing these goals, and I believe we will, I'm confident URBN will successfully navigate the current choppy environment and deliver solid profitability and growth.

Finally, in closing, I thank our brand leaders, David, Trish, and Sheila and their teams, Meg and her creative teams, and our shared service teams for building and maintaining the infrastructure that allows the brands to succeed. I thank our 24,000 associates world-wide for their inspiring dedication, drive and creativity. I also recognize and thank our many partners around the world, and finally, I thank our shareholders for their continued support.

That concludes my prepared remarks. I now turn the call over for your questions.