URBAN OUTFITTERS, INC.

Third Quarter, FY'15 Conference Call
November 17, 2014

Participants

Richard A. Hayne, Chief Executive Officer
Frank Conforti, Chief Financial Officer
David McCreight, CEO, Anthropologie Group
Margaret Hayne, CCO, URBN & President, Free People Brand
Ted Marlow, CEO, Urban Outfitters Group
Trish Donnelly, President of Urban Outfitters Brand, North America
Glen A. Bodzy, General Counsel
Barbara Rozsas, Chief Sourcing Officer
Calvin Hollinger, Chief Administrative Officer
David Ziel, Chief Development Officer
Dave Hayne, COO, Free People Brand
Oona McCullough, Director of Investor Relations

Good afternoon, and welcome to the URBN third quarter fiscal 2015 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three and nine month period ending October 31, 2014.

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. 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.

I'll now turn the call over to Frank.

Frank

Thank you Oona and good afternoon everyone.

I will start my prepared commentary discussing our fiscal year 2015 third 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 5% to a third quarter record of $814 million. This increase was driven by, a $34 million increase in non-comparable store sales, opening 14 net new stores and a 26% jump in wholesale segment sales. Retail segment ‘comp’ rate was -1% for the quarter.

Within our retail segment ‘comp’ the direct-to-consumer channel continued to outperform stores posting positive gains at all brands. The direct-to-consumer sales growth was driven by increases in average order value and site visitors which includes web, mobile and mobile ‘apps’. Negative store ‘comp’ store sales resulted from decreased transactions and units per transaction which were partially offset by higher average unit selling prices.

By brand, our retail segment ‘comp’ rate increased by 15% and 2% at Free People and Anthropologie Group, respectively, and declined 7% at Urban Outfitters.

Free People Wholesale delivered another strong quarter as sales surged 26% to $63 million. These results came from double-digit sales growth at department stores and specialty stores domestically and strong international growth.

Gross profit for the quarter decreased by 3% as compared to the prior comparable quarter to $284 million. Gross profit rate declined by 295 basis points to 34.8%. The deleverage occurred primarily due to lower initial merchandise markup, followed by higher markdowns at the stores and store occupancy expense deleverage due to negative store ‘comp’ net sales, which were all primarily driven by the poor performance at the Urban Outfitters brand.

Total SG&A expenses for the quarter increased by 11% to $207 million. Total SG&A as a percentage of sales deleveraged by 128 basis points to 25.4%. The SG&A deleverage was primarily due to increased marketing and technology expenses which were used to drive higher direct-to-consumer traffic. SG&A at the Urban Outfitters Brand in North America grew less than 2% during the quarter.

Operating income for the quarter decreased by 27% to $76 million, with operating profit margin deleveraging by 423 basis points to 9.4%.

Net income was $47 million or $0.35 per diluted share.

Turning to the balance sheet, inventory increased by 15% to $467 million. The growth in inventory was primarily related to the acquisition of inventory to stock new and ‘non-comp’ stores as well as the ‘comp’ retail segment. Comparable retail segment inventory increased by 8% at cost while decreasing 7% in units.

We ended the quarter with $358 million in cash and marketable securities. During the quarter, the Company repurchased and retired 184,000 common shares for approximately $7 million. We have 6.1 million shares remaining on our May 27, 2014, Board of Directors authorization to repurchase 10.0 million shares.

As we look forward to the fourth quarter of fiscal year 2015, it may be helpful for you to consider the following:

We are planning to open approximately 35-40 new stores for the year. For the fourth quarter by brand we are planning approximately four new Urban Outfitters stores globally, including one new European store and six new Anthropologie stores globally, including one new European store.

Due to the current store performance at the Urban Outfitters brand, we believe it is likely that fourth quarter gross profit margin will continue to deleverage on a year-over-year basis. The gross margin deleverage could be similar to the first half of the fiscal year 2015. If this deleverage occurs it would be primarily due to lower merchandise margins and store occupancy expense deleverage and could occur despite continued sales and profitability momentum at the Anthropologie and Free People brands.

We are planning for SG&A to grow at a low, double-digit rate for the final quarter of the year. This increase would be driven by increases related to direct and selling support expenses to support our new store growth and continued investments in technology and marketing expenditures utilized to further customer acquisition and retention efforts.

Capital expenditures for fiscal year 2015 are planned at approximately $215-$235 million, driven primarily by a new fulfillment center in Gap, Pennsylvania, the expansion of our home office and new stores.

Our fiscal year 2015 annual effective tax rate is planned to be approximately 36.5%.

As we look forward to fiscal year 2016, we are excited about many of our ongoing and new initiatives. We will continue to invest in technology, specifically around web, mobile and ‘omni’ capabilities and the opening of our new fulfillment center in Gap, PA. Within the brands, we will continue to invest in product category growth such as: shoes at Free People, home at Anthropologie and beauty at Urban Outfitters. We will also continue to enhance our marketing and imagery capabilities across all of our brands. We look forward to opening our first large format Anthropologie and our first Free People store in Europe. We are excited about the many opportunities for Free People to continue their strong international growth. We are planning to moderate our Urban brand store growth in North America and Europe. In order to increase the Urban Outfitters Brand profitability, we are taking steps to reduce their base SG&A spend and improve their product margins. The fiscal year 2016 plans are not finalized yet, and we will have more commentary on our plans on our next call in March.

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 our Chief Executive Officer, Dick Hayne.

Dick

Thank you, Frank and good afternoon everyone.

Let me say at the outset that URBN's overall performance in this year's third quarter was sub-par. Disappointing results at the Company's namesake brand, Urban Outfitters, deflated what otherwise would have been a powerful Company performance. And while we had many successes in the quarter, total performance – namely, a 9.4% operating profit – is well below our historic norm and certainly less than what we know our brands are capable of producing.
It is obvious that the environment surrounding apparel retailing over the past year has been challenging. Many brands have struggled, a few have delivered fair results and very, very few have showed strength. We are pleased that two of our brands, Anthropologie and Free People, continue to be among the strongest performers in the market.

So let me begin with an overview of the total company in the third quarter. Frank has already given most of our total URBN 'stats' so I won't repeat them but I would like to elaborate on our results by channel. I think it is important to note the significant divergence across our channels and speculate on what this means. In general, direct-to-consumer performed very well, while stores fared more poorly. The Free People wholesale channel continued to produce amazing sales gains.

First, let me discuss the stores. Total store 'comps' in the quarter were negative. This was driven by lighter store traffic which resulted in fewer transactions. AUR was positive while the units per transaction were down. For some reason, which we can't explain, September was a particularly poor month but, happily, October improved from the September level.

Total 'comp' store sales and transactions were down in both North America and Europe. In North America, the west coast stores performed better than those in the east. And in total, we were slightly more promotional in the stores this year than in last year's third quarter. This increase was driven entirely by store promotions at the Urban brand.

As Frank pointed out, negative 'comps' caused total occupancy costs to deleverage and store expenses as a percent of sales to increase. Inventories at the end of the period were heavier than we would like at the Urban brand but were well controlled at the other two brands.

In contrast to store performance, the direct-to-consumer businesses in Q3 delivered strong double-digit sales increases and robust traffic gains. DTC transactions increased and produced excellent full-price sell-throughs across all brands and product categories. Compared to the same period last year, DTC required fewer promotions to drive these sales gains.

The on-going customer shift from desktop to mobile continued during the quarter with total mobile sessions increasing by 38% over Q3 last year. Even though mobile sessions tend to convert at a lower rate than desktop sessions, our overall DTC conversion rate rose slightly. This is largely due to the growing popularity of our brands' mobile apps which tend to convert at roughly twice the rate of other mobile sessions.

Total retail segment sales increased by 4% in the third quarter while the Free People wholesale segment continued its stellar growth with Q3 sales jumping 26% above last year's level. Wholesale produced strong gains both domestically and internationally with specialty, department and e-commerce stores all showing significant increases.

So what have we learned? Clearly, the consumer's growing affinity for direct-to-consumer shopping has somewhat tempered her need to shop in stores. Physical shopping trips, particularly to undifferentiated malls, are becoming less frequent. DTC is more efficient. It allows her to browse more products from many different sources faster, see outfits and styling more clearly and engage others as part of a 'social network'. She is willing to pay for these advantages but expects consistent quality and prompt service.

What does this mean for stores? Obviously, it raises the bar for bricks and mortar stores. It's no longer sufficient to build a store, stock it with tables and racks of wares and open for business. The store experience must become a performance with the energy and precision of a Broadway play. We must permeate the stores with creativity and offer service when and to the degree the customer wants it. Of course, it means offering all of the 'omni' bells and whistles they want like in-store pick-up, same day delivery and mobile point-of-sale. And all of this must be done every hour of every day the store is open.

I see this as an exciting opportunity to reinvent the store and the store experience to compliment the on-line experience, not compete with it. As a company, this is exactly what we are working on. For those of you who attended our Investor Day in September, you were able to see and experience our ideas for a larger and more compelling Anthropologie store.

Now returning to our third quarter results, let me give you some color by brand.

First is Anthropologie. The Anthropologie brand delivered solid retail segment 'comp' growth which along with 'non-comp' sales resulted in record third quarter revenues. The quality of the sales was excellent as the brand set a new record for merchandise margins in the quarter. This is on top of record merchandise margins achieved in Q3 of the previous year, as well.

The Anthropologie brand continues to succeed in emotionally engaging its customers while delivering strong financial results. During the quarter the brand also made progress on many of their strategic growth initiatives.

- They successfully launched the Anthro gift registry with over 3,000 customers registering in a little over a month with a total registry value in excess of $5M. As expected weddings drove the majority of registries but almost 20% of those signing up were for non-wedding events.

- They also mailed a home journal which introduced the customer to an expanded Anthropologie home assortment. Response to the journal was overwhelmingly positive and many items sold out within days. The results definitely strengthen our confidence in the strategy of category expansion that David unveiled during our recent Investor Day.

- The brand successfully opened six new stores during the quarter – five in North America and one in the UK. In addition, Anthropologie opened its first concession in Paris in the Galleries Lafayette department store. This marks the brand's first foray into continental Europe. Early results have been encouraging and leave us excited about the potential for additional concessions in France and other countries.

- And finally, they began the integration of Terrain into the Anthropologie group. As a way of introducing the Anthro customer to the Terrain brand, the upcoming Anthropologie Holiday gift catalog will feature a full page of Terrain products.

I want to thank David and his team for delivering another strong quarter and making wonderful progress on Anthropologie's strategic growth initiatives. I also want to congratulate the Anthro team on winning the Ragan's 2014, Grand Prize for Best Content Marketing Strategy. As the publisher said, "Overall, we haven't seen many content marketing strategies that hit all the right notes, are planned so meticulously, and are executed with such class and style." Those are very nice words indeed, coming from a recognized marketing expert.

Now Anthropologie was not alone with successes in the quarter. The Free People brand produced yet another outstanding quarterly performance with both sales and operating profits reaching new highs. This feat is more impressive given the extremely difficult comparisons established over the prior two years.

All channels excelled in the quarter. The retail segment produced a 'comp' increase of 15% and wholesale grew by 26%. During the quarter the brand celebrated the opening of its 100th Free People store. And total revenue growth at the brand exceeded 25% for the 10th consecutive quarter.

Free People has done an outstanding job of executing its strategy of expanding product categories. Footwear continued to gain momentum across all channels and is performing well above plan. And the 'intimates' category drove especially strong revenue growth during the quarter.

However, of all of the Free People initiatives, international expansion is delivering the fastest growth. During the quarter revenues from Asia increased by more than 100% driven by strong sales in Japan, Hong Kong and now China. In October, Free People wholesale in partnership with the Hong Kong based I.T. group launched the first Free People shop-in-shop inside mainland China. Plans are to open four more shop-in-shops with the I.T. group next year: two in Mainland China and two in Hong Kong.

In Europe, Free People's third quarter revenues grew by more than 200% driven by successes in the UK and Germany. As is true in Asia, the European customer is just beginning to become familiar with the Free People brand and the lifestyle it represents. We believe, as brand awareness and product demand multiply, as they did in the third quarter, Free People will become a premiere global lifestyle brand enabling it to expand all of its channels of distribution around the world.

I extend my congratulations to Meg and her team for delivering another terrific quarter. Additionally, I would like to congratulate the Free People store design and merchandising team that recently won the coveted VMSD Excellence in Visual Merchandising Award for 2014.

Now finally let me discuss results at the Urban Outfitters brand. As I mentioned earlier, the Urban brand contributed far less to our overall profitability than we have come to expect given its historic performance levels. Some of this shortfall I attribute to market conditions, some to the fashion cycle, but some is definitely a result of poor execution. Let me explain.

Urban's total retail segment 'comp' sales decreased by 7% in the quarter. On a total retail basis, average selling price was up, units per transaction were down slightly but total transactions were down. Looking deeper, once again we see that it was a tale of two channels.

The Urban customer shopping electronically responded very nicely to Urban's fashion offerings and price points. The brand's on-line marketing was far superior relative to last year. Traffic was up as was the average order value. Urban's mobile app, called Urban On, grew its number of users by more than 150% in the third quarter over the corresponding quarter last year. Most importantly, full price sales, including full price apparel, were strongly positive. This isn't business that Urban bought through mark-downs and promotions. As a matter of fact, mark-downs in the DTC channel were actually lower in the third quarter, and we saw no price resistance to higher priced merchandise.

The story in the stores couldn't have been more different. Traffic was down and transactions were down. The sales penetration of accessories, intimates and home products grew while apparel shrank. This change in mix is partly responsible for an overall drop in merchandise margins. That, combined with lower IMU's, higher mark-downs and occupancy deleverage caused by negative 'comp' store sales, caused significant deterioration in gross margins in the quarter.

A number of these store issues were self-inflicted. Obviously the Urban team controls IMU and they are making adjustments going forward to bring it back to historic levels. The team did a poor job of designing the architecture of the store buy and creating different assortments for different type stores. In the women's apparel area, there were too many redundant styles and the buy was not properly distorted. The result was that many of our stores were needlessly over-assorted and 'piecy', which made the shopping experience more difficult and less appealing. The merchant and planning teams are working diligently to resolve these problems.

Clearly, the teams still have work to do and it may take more quarters to fix, but they have also made significant progress. The fashion offering and the imagery and marketing are much better than last year. For this reason, even though I'm disappointed in many aspects of the team's execution, I'm actually much more confident in the brand's position today than last year at this time. The most positive sign in my opinion is that the Urban customer is back. She's definitely on-line and she's buying, but she's also coming back into the stores – perhaps with a little less regularity than in prior years but unlike last year, our 'hip', young adult customer is shopping in the stores once again. The teams now need to execute and align the stores so they are telling the same compelling stories as Direct and telling them with clarity, conviction and creativity.

I want to thank Ted and Meg and their teams for the many, many extra hours they have worked to get this turnaround underway. Repositioning a brand is never easy and rarely without pain. I believe the Urban brand is making the necessary changes that will allow it to more fully engage its traditional customer and return to solid profitability.

Now before I turn the call over for questions, I would like to announce the retirement of a senior member of our executive team and a good friend of mine, Glen Bodzy. Glen who currently serves as the Company's General Counsel and Secretary plans to retire effective June 15, 2015. Mr. Bodzy, 62, has overseen leasing and general corporate matters since joining the Company in 1997. He is credited with making many contributions to the success and growth of the Company during his 17-year tenure and has been an invaluable adviser to me. Thank you, Glen. I wish you and Linda the very best in your retirement years.

In addition, I want to recognize and thank our 22,000 associates worldwide including all of our teams in Europe and our shared service teams. I thank our wholesale partners – domestic and abroad, and our many vendors and suppliers.

Lastly, I extend my thanks to our many shareholders for their continued support. I am grateful for the opportunity to lead the URBN community. Thank you.