

# URBAN OUTFITTERS, INC.

Second Quarter, FY'19 Conference Call  
August 21, 2018

## Participants

Richard A. Hayne, Chief Executive Officer  
Frank Conforti, Chief Financial Officer  
Margaret Hayne, CCO, URBN & CEO, Free People Brand  
Trish Donnelly, Global CEO, Urban Outfitters Brand  
Hillary Super, President, Apparel and Accessories, Anthropologie Group  
Andrew Carnie, President, Home, Garden and International, Anthropologie Group  
Azeez Hayne, General Counsel  
Barbara Rozsas, Chief Sourcing Officer  
Calvin Hollinger, Chief Operating Officer  
David Ziel, Chief Development Officer  
Dave Hayne, Chief Digital Officer  
Sheila Harrington, President, Free People Brand  
Oona McCullough, Director of Investor Relations

Good afternoon, and welcome to the URBN second quarter fiscal 2019 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three and six-month period ending July 31, 2018.

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 quarter. Trish Donnelly, Global CEO Urban Outfitters, will provide an update on the Urban Outfitters Brand and 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](http://www.urbn.com). I will 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 2019 second quarter results versus the prior comparable quarter. Then I will share some of our thoughts concerning the remainder of fiscal year 2019.

Total Company or URBN sales for the second quarter increased 14% vs. the prior year. The increase in sales resulted from a robust 13% URBN Retail segment 'comp', 10% growth in URBN Wholesale sales, and a \$11 million increase in 'non-comp' sales. Foreign currency translation accounted for approximately 50bps of total sales growth for the quarter.

Within our URBN Retail segment 'comp,' both the Digital & Store channels delivered positive 'comps' during the quarter. Digital continued to lead the way, posting double-digit sales increases at each of our brands, driven by increases in sessions, average order value, and conversion rate. For the store channel, it is now the second quarter in a row that our store 'comps' have been positive at each of our brands. Positive 'comp' store sales resulted from increased average unit selling price, increased transactions and units per transaction. Store traffic for the quarter was up approximately 1% vs. the prior comparable quarter.

By brand, our Retail segment 'comp' grew 17% at Free People, 15% at Urban Outfitters and 11% at the Anthropologie Group. Our URBN Retail segment 'comp' was the strongest in May, followed by June and then July with all three months posting positive double-digit growth.

During the quarter we opened three new locations, including: one Free People store, two Anthropologie stores, and we closed one Anthropologie store.

Our URBN Wholesale segment sales grew 10% vs. the prior year. This growth was largely due to a 9% sales increase at Free People. Free People's growth was driven by domestic and international gains in department stores, specialty stores and digital businesses. These increases resulted from growth in several categories including women's apparel, intimates, and Free People Movement.

The remainder of our wholesale segment sales growth was due to the recently launched Anthropologie Home wholesale business.

Now moving on to URBN gross profit for the quarter. Gross profit increased 20% to \$356 million while the gross profit rate, improved by 180 basis points to 35.9%. The rate improvement was driven by lower markdowns at all three brands and leverage in store occupancy expenses due to the strong Retail segment 'comp'. These gains were partially offset by deleverage in delivery expense due in part to the increased penetration of the digital channel.

Given the news and questions we have received regarding China Tariffs, I wanted to briefly discuss our current exposure. Based on what has been publicly discussed, we anticipate little if any impact to our business in the current year. We will continue to follow future developments closely.

Now, moving back to discussing our second quarter performance. Total 'SG&A' expenses for the quarter were up 8% to \$239 million. Total 'SG&A' as a percentage of sales, leveraged by 136 basis points to 24.1%. The growth in SG&A expenses was primarily due to increased store payroll paid to support healthy store 'comps', higher marketing expenses that helped to fuel the strong Retail segment sales increase and increased bonus expenses earned as a result of the solid company performance.

In light of our performance, I did want to note that the Company has decided to make a one-time payment to all non-bonus eligible employees as a thank you for their hard work and contribution to URBN's excellent performance over the first half of the year. This payment is approximately \$2.5 million and is included in our second quarter 'SG&A' expenses.

Operating income for the quarter increased by 55% to \$117 million, with operating profit margin jumping by 316 basis points to 11.8% of net sales.

Our effective tax rate for the quarter was 21.7% vs. 35.1% in the second quarter last year. The significant favorability in the tax rate vs. the prior year is primarily due to the lower federal statutory rate resulting from tax reform enacted late last year. Additionally, please note that this quarter's effective tax rate was favorably impacted by approximately 70bps due to equity activity.

Net income for the quarter grew by 86% to \$93 million or \$0.84 cents per diluted share.

Turning to the balance sheet. Inventory increased by 3% to \$376 million which was primarily driven by a 3% increase in Retail segment 'comp' inventory.

We ended the quarter with \$649 million in cash and marketable securities and have zero drawn down on our asset backed line of credit facility. Capital expenditures were \$31 million for the quarter, and we are planning for approximately \$110 million in total capital expenditures for fiscal year 2019. The capital spend for fiscal 2019 is primarily driven by new, relocated and expanded stores followed by investments in home office space and technology.

As we enter the third quarter of fiscal year 2019, it may be helpful for you to consider the following:

I will start with sales. Given our current sales trend and prior year comparisons, at this point in time, we believe we could deliver sales 'comps' in the high single digits for the third quarter. Please keep in mind that as we enter the second half of the year, our prior year sales comparisons do get more difficult. If we did achieve a 'comp' in this range it would be consistent with the first half performance on a two-year stack.

Now moving on to gross profit. We believe URBN's gross margin rate for the third quarter, could improve by approximately 100 basis points. This improvement could be driven by lower merchandise markdowns and leverage in store occupancy expense as a result of a strong sales 'comp'.

Based on our current plan and sales performance, we believe 'SG&A' could grow at approximately 8% for the third quarter and 6% for the fiscal year 2019. The growth in 'SG&A' could primarily relate to increased incentive-based compensation as a result of URBN's strong current year performance, digital marketing investments and increased store payroll to drive and support our sales growth. At

this point in time, we believe we could deliver ‘SG&A’ leverage in each the third and fourth quarters vs. the prior year.

Our annual effective tax rate is planned to be approximately 24% for the third quarter and 23% for the fiscal year 2019.

We are planning to open 18 new stores for the year, while closing 13 stores. For further detail on store changes by brand, please see our investor metrics sheet posted to [URBN.com](http://URBN.com).

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 Trish Donnelly, our Urban Outfitters Brand Global Chief Executive Officer.

### **Trish Donnelly**

Thank you, Frank. And good afternoon everyone.

I am excited to report the Urban Outfitters brand delivered a positive 15% global Retail segment ‘comp’ for the second quarter. Both North America and Europe produced positive ‘comps’ – with each of these geographies delivering positive ‘comps’ in their digital channels, as well as their respective store channels.

We doubled our first quarter 8% sales ‘comp’ with the all-important apparel categories continuing to lead the way. Both the men’s and women’s apparel businesses delivered double-digit growth. The increases were fueled by both the tops and bottoms categories in each gender, as well as one-piece dressing in women’s. We continue our commitment to and evolution of our speed-to-customer model, which has enabled us to better chase trend. This, in turn, is providing our 18 to 28-year-old core customer with fashion-relevant product in a more timely way. By operating in this speed-to-customer business model, the Urban Outfitters brand delivered our fastest inventory turns ever and our lowest markdown rate ever for a second quarter.

As I mentioned earlier, our 15% ‘comp’ was driven by strong digital as well as store ‘comp’ performance. Our global digital business saw double-digit growth driven by increases in sessions, in average order value and improvement in conversion. Total global digital customers increased approximately 20% over prior year, with growth in all three segments: new, retained and reactivated. Digital sales across all geographies have benefitted from our UO Rewards loyalty program. We expanded our program into France and Germany this past quarter, and now have over 5-million customers participating globally. Enrollments have improved by double-digits over the past year as our members continue to be our brand promoters by engaging with us frequently in our app, visiting our stores, and advocating UO on social media. Customers in UO Rewards have proven to shop more frequently and have higher order values compared to the average. We are very encouraged by customer engagement with our UO Rewards program and will continue to build upon current feature sets to attract even more loyalists.

Now moving to performance in our stores. Stores had a very impressive quarter, with total comparable sales outpacing positive store traffic. Sales results were positive across all regions, with topline improvements in both average transaction value and conversion. One of the initiatives we launched during the quarter was ‘self-checkout’ at our Herald Square store in New York City. The Urban Outfitters customer is clearly voting for self-checkout, with the percentage of self-checkout transactions highly exceeding expectations. Not only is this a convenient way for our customers to transact, but it also allows us to reposition labor to further service customers and drive conversion on the selling floor. Given its success, we are currently working on plans to roll out self-checkout to additional UO stores.

Our marketing and PR teams continued their outstanding work in connecting with and engaging our customers in new and innovative ways through social media channels, brand partnerships, music initiatives, in-store events and influential press outlets. Within social, Instagram, our largest channel, once again saw double-digit growth during the quarter – with global followers now topping 8-million. Shoppable Instagram, which we launched last quarter, continues to grow as our customers become comfortable with this platform as a means of purchasing. Pride Month saw high customer engagement, with UO’s posts garnering over 4-million social impressions. For the third year in a row, the product teams created a Pride capsule with proceeds again going to GLSEN. Also, on Instagram, we were very proud to be recognized by ListenFirst Media as having the #1 most-engaged posts of all retailers during Earth Day – not only through promoting awareness to environmental conservation, but also by creating t-shirts with the National Parks Foundation whose proceeds went towards the funding of national parks. We continue to partner with and support organizations that are important to and resonate with our core customer base.

Brand partnerships have always been an important part of the Urban Outfitters experience and the teams are working exceptionally well with our partners. The marketing and merchant teams worked together on a wide range of campaigns this past quarter – collaborating with well-known brands, as well as emerging artists. Some of the noteworthy campaigns included the exclusive UO x Adidas World Cup collection; the UO x Fila product collaboration inspired by Pierre Cardin; and, most recently, our Laura Ashley & UO exclusive women’s apparel collection. We also had some very successful in-store partnership events during the quarter including a one-day pop-up at Urban Outfitters Melrose, with Chinatown Market and Carrots featuring on-site t-shirt customization. Not only did this event contribute meaningful sales to the store that day, but we also saw significant increases in the digital demand within surrounding zip codes.

Turning to global growth initiatives, we continue to focus on international franchise partnerships, and opened our third store in Israel with Fox Group. Reaction to Urban Outfitters in Israel has been very promising, and we plan to open more stores with Fox Group next Spring and beyond. As we penetrate new territories, our direct-to-consumer business sees outsized growth. Outside of North America and Europe, our ‘rest of world’ business is under-penetrated, and we see global growth as a significant opportunity and a priority for the brand. We have seen impressive success with Tmall Global on our digital platform, and we plan to look at additional opportunities in the China market. During the quarter, we hosted our first ‘offline’ pop-up shop event in China and, given customer attendance and response to Urban Outfitters product, we know we have an exciting opportunity in this market and will continue to explore the digital side as well as potential brick and mortar positioning in the future.

The Urban Outfitters brand has much to look forward to in the back half of the year. In addition to new franchise stores, we will be opening two additional 'UO-owned' stores in the United Kingdom. We will also ship our first-ever wholesale orders with a small, select group of best-in-class retail and digital partners. And, from a product standpoint, we are launching our first-ever own-brand beauty line, called ohii. Cruelty- and Paraben-free, ohii will be available globally, on-line and in stores in September.

In closing, second quarter was very exciting for the Urban Outfitters brand, and we continue to be optimistic as we enter the back half of the year. Of course, we know our comparisons get more difficult but Fall product is off to a strong start in both the apparel and non-apparel categories, and I believe we have the global talent in place to drive growth. I would like to thank Meg, the UO Leadership Team, and our home office and field teams on a job well done this past quarter. The 15% 'comp' was exceptional – and your commitment to giving our customers relevant product and excellent service in exciting retail environments and innovative digital experiences drove these results.

Thank you. I will now turn the call over to Dick.

### **Dick Hayne**

Thanks, Trish. Congratulations to you, Meg and the entire UO team on both sides of the Atlantic for producing such exceptional results. The design and merchant teams are delivering product assortments your customers are loving. I know you believe, as I do, there is plenty of fashion newness to continue to drive attractive 'comps' in the back half of the year, so keep up the great work.

Let me now turn to an analysis of URBN's second quarter results. Over the last six months, I have spoken on these calls about the strengthening of the US economy, growing consumer confidence and a changing fashion silhouette. These factors have combined to create a brisk tailwind for fashion retailers. As they did in the first quarter, our brand teams in Q2 took full advantage of this opportunity. Exciting fashion execution at all three brands drove a 13% increase in total Retail segment comparable sales and 91% quarter-over-quarter increase in earnings per share in the second quarter.

All three brands reported double-digit Retail segment 'comp' sales driven by strength in apparel and accessories. Both the digital and store channels at each brand registered robust sales growth and even though digital 'comps' continued to outpace stores, total store 'comps' were the best they've been in eight years.

Positive store 'comps' were driven by better store traffic at all brands, and an increase in AUR, which in turn, was driven largely by fewer markdowns as a percent of sales. The markdown rate improved at all brands, but we believe opportunity remains for further improvement in the back half of the year, especially at the Anthropologie brand.

Trish discussed Urban Outfitters' Q2 results, now let me turn your attention to second quarter results at the other two brands starting with Free People. Total sales, including wholesale, grew by 15% on

a quarter-over-quarter basis. Retail segment sales increased by 19% in total and 17% on a ‘comp’ basis. This marks the 11<sup>th</sup> consecutive quarter that Free People has produced positive Retail segment ‘comps’. Not only did the digital channel produce double-digit ‘comp’ increases in Q2, which we’ve come to expect, but the stores registered double-digit ‘comp’ gains, as well. Increases in customer traffic and conversion led to an increase in transactions, driving ‘comps’ in both channels.

Better Retail segment sales led to a reduced need to take markdowns and an increase in store productivity. Thus, sales were up, merchandise margins improved, and expenses leveraged, all of which pushed operating margins sharply higher.

The wholesale segment delivered yet another solid quarter with 9% quarter-over-quarter revenue growth. This growth was fueled by gains in all product categories, across all major markets and within all customer groups, including department stores, specialty stores and pure play, digital businesses. Free People’s excellent results across all channels came from powerful performances in their apparel, accessories and intimates categories. The two expansion categories, Free People Movement and denim, produced particularly robust growth.

During Q2, the brand focused some of its marketing spend on experiential events designed to engage customers and connect them with the brand. One such event was a ten day ‘Endless Summer’ pop-up shop in the Shoreditch neighborhood in London. In addition to their ability to interact with Free People product in a beautifully fit-out shop, customers had access to a number of workshops and community events. The result: Free People sales in UK for the quarter jumped by almost 40%, more than twice the rate of growth of total international sales.

To summarize, Free People’s results in the second quarter and first half of FY19 were exceptional. The brand enters the third quarter with significant momentum, and we believe it is well positioned to deliver compelling results again in Q3. I want to congratulate and thank Sheila, Krissy, Meg and their retail, digital and wholesale teams for delivering such a powerful and profitable performance.

Moving on to the Anthropologie brand, I am pleased to report that Q2 Retail segment ‘comps’ accelerated from the Q1 level and reached 11%. Like the other brands these ‘comps’ stemmed from outsized strength in accessories and apparel but all categories, including home, beauty and the Terrain business produced nicely positive ‘comps’, as well. Also like the other brands, Anthropologie delivered double-digit growth in its digital channel and solidly positive store ‘comps’. All regions posted ‘comp’ store gains driven by increases in traffic, UPT’s and AUR, while digital sales benefitted from these metrics, as well as, better conversion.

The brand produced healthy gains in merchandise margins, including a slight increase in IMU and a nicely lower markdown rate. This, along with solid expense control, led to double-digit operating margins. We believe the brand has opportunity to produce even more margin improvement in the back half of the year for two primary reasons:

- One, the assortment is becoming more balanced between own-brand product and market brands which should benefit IMU, and
- Two, as the Anthro customer increasingly adopts the new silhouette and the apparel merchants adjust their assortments to reflect this change, we believe the brand could drive more full-

price sales, decrease the need to take markdowns and return the brand to be more in-line with its historic markdown rate.

On the international front in Q2, Anthropologie opened its first store in Germany. The new Dusseldorf store is performing well. This gives us confidence to pursue growth within continental Europe more aggressively. To that end, Anthropologie hired Peter Ruis as Managing Director for Europe. Peter has had a long and successful career in fashion retailing, including, until recently, as CEO of Jigsaw in London. He brings strong leadership skills and many years of merchant experience in Europe. We are delighted to welcome Peter into our URBN family and are excited about Anthropologie's expansion plans in Europe.

Future international developments for the Anthropologie brand include, the plan to join the Urban brand by opening its first franchise location in Israel this year and to join both the Free People and Urban Outfitters brands on TMall's global website this month. Both Free People and Urban are enjoying great success on this platform and all three brands hope to expand their TMall relationship and sales in China next year.

So overall, Anthropologie produced a very strong second quarter and first half. I want to thank Hillary, Andrew, Meg and their teams for delivering such an impressive performance.

In conclusion, the first six months of fiscal year 2019 showed significant acceleration in sales and profitability at all three brands. This performance resulted from a healthy economic backdrop, a strong fashion cycle and above all, improved execution by our teams. Economic and fashion winds continue to blow in our favor, and I believe our brands can continue to execute at a high level, delighting customers with fashion-right products and compelling shopping experiences both on-line and in-stores. While year-over-year comparisons become more difficult in the back half of the year, I'm confident and optimistic about our brands' ability to deliver superior results.

Finally, I want to thank our brand and shared service leaders and their teams for executing two nearly flawless quarters. I particularly want to recognize and thank our 20,000+ hourly associates worldwide – those who work in our stores, our distribution and fulfillment centers. Without their hard work and dedication, this performance would not have been possible. I also recognize and thank our many partners around the world. Finally, I thank our shareholders for their continued support. That concludes my prepared remarks. Before I turn the call over for your questions, I remind you to please keep your questions to one per caller, so we have time to accommodate more parties.

Thank you, and now for your questions.