URBAN OUTFITTERS, INC.

Second Quarter, FY'21 Conference Call
August 25, 2020

Participants

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

Good afternoon, and welcome to the URBN second quarter fiscal 2021 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three-month and six-month periods ending July 31, 2020.

The following discussions may include forward-looking statements. It's important to note at this time, the global COVID-19 pandemic has had and continues to have a significant material impact on URBN's business. Given an extremely high level of uncertainty about the duration and extent of the virus' near and long-term impact to the global retail environment, content discussed on today's call could change materially at any time. Accordingly, future results could differ materially from historical practices and results or current descriptions, estimates and suggestions. 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.

On today's call you will hear from Frank Conforti, Chief Financial Officer, URBN, Sheila Harrington, President, Free People and Richard Hayne, Chief Executive Officer, URBN. Following that, we will be pleased to address your questions. For more detailed commentary on our quarterly performance and the text of today's conference call, please refer to our investor relations website at www.urbn.com.

I will now turn the call over to Frank.

Frank Conforti

Thank you Oona, and good afternoon everyone.

Well, I said it last quarter and I will say it again, what a difference a few months can make. We started the quarter with just a few stores opened and finished it with almost all stores up and running. With the digital channel continuing to produce strong double-digit results across each brand, most stores operating, inventory well managed and disciplined expense control, we were able to maintain our strong financial position. We ended the quarter with over $670 million in cash and marketable securities while repaying $100 million of our borrowings from earlier this year. Given the incredibly difficult environment, it certainly feels good to put up a healthy operating income number of almost $70 million and over 8% operating profit rate.

Before I speak about our upcoming quarter, please note, obviously these are unusual times and there is a lot of uncertainty out there right now. Our thoughts on the third quarter are as of today, and as we have learned all too often in 2020, the environment can change at a moment's notice.

As we enter the third quarter of fiscal year 2021, it may be helpful for you to consider the following:

Our URBN 'comp' sales have started out the third quarter showing improvement from Q2 with almost all stores opened and our digital channel remaining double-digit positive at all brands. Based on our quarter-to-date performance and current view of the quarter, we believe our URBN Total Company Sales could land mid-single digit negative for the third quarter with both our Retail segment and Wholesale segment showing improvement from the second quarter.

We believe URBN's gross margin rate for the third quarter, could deleverage by approximately 200 basis points. The decrease in gross profit rate could be primarily due to the increased penetration of the digital channel resulting in deleverage in delivery and logistics expenses. This deleverage would not be fully offset by the possibility of store occupancy leverage. Please note, we are planning to complete and record many of our rent concessions in the third quarter which could result in occupancy leverage.

Based on our current sales performance and current plan, we believe SG&A could decline by approximately 10% for the third quarter resulting in SG&A leverage versus last year. We continue to manage our expenses tightly while monitoring our topline performance.

Our annual effective tax rate is planned to be approximately 30% for the third quarter. Due to the Company moving from a loss in the first quarter to a profit in the second quarter, the tax rate changes from quarter-to-quarter have been more significant than in the past. These changes in financial results also make the tax rate forecast more difficult than under normal circumstances.

Capital expenditures for the fiscal year are planned to be approximately $215 million. The spend is primarily related to expanded distribution facilities including the completion of our new omni channel distribution facility in the UK, as well as the planned start of construction on a new facility in the US. This spend is more than the previously discussed in Q1 due to the addition of the new and incremental omni channel distribution facility in Kansas. This additional facility is a direct result of our strong digital channel growth this year and is to support future digital growth. This facility will enable us to reach our store and digital customers in a faster and more cost-efficient manner.

Despite the increase in our capital plans for the current year, based on our current forecast, which as I noted could change at a moment's notice, we believe we can generate positive net cash flow over the remainder of current the year.

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.

Lastly, I want to personally extend a huge thank you to all of our teams. While I am sure 2020 has more challenges to throw at us, I think the teams have displayed their exemplary ability to execute at a high level despite all the challenges presented.

Now, I am pleased to turn the call over to Sheila Harrington, President of the Free People brand.

Sheila Harrington

Thank you, Frank, and good afternoon everyone. While this past quarter was certainly the most unusual quarter in Free People history, I am pleased today to report strong results from the brand and provide an update on our strategic growth initiatives.

The retail segment delivered record sales and profitability driven by robust 'comps' of 11% and a record low markdown rate, while total Free People brand delivered record second quarter operating profit. Although wholesale sales decreased, profitability recovered nicely from lows in the first quarter. The brands positive results reflect the strength of the product offering, merchandising and creative marketing, coupled with disciplined inventory and expense control. The team demonstrated tremendous agility amidst an uncertain economic backdrop. Their hard work and dedication throughout this period have put us in a position to continue to gain market share.

Turning to more detail within the retail segment. Stores delivered negative 'comps' due to store closures for a portion of the quarter and tepid traffic once stores reopened. The Free People store teams did a stellar job maintaining a safe and welcoming environment for both our employees and customers and although traffic was negative, conversion and AOV were higher. Conversely, the digital channel delivered phenomenal growth throughout the quarter which drove positive total retail segment 'comps'. Most exciting, was the triple digit gain of new customers to the brand. All categories, apparel, intimates, Movement, shoes and accessories recorded positive regular price 'comps' within digital. Similar to North America, our European retail segment delivered significant growth in the digital channel and in new customers to the brand. We will continue to build on this brand awareness with two new store openings in the UK in the back half of the year.

Moving on to wholesale. Within this channel our brick and mortar partners experienced the same pandemic-driven challenges as our store channel. While wholesale has retrenched, it creates a very strong opportunity to "reset" and align the wholesale division with the success of the retail division and to rebuild healthy partnerships which will reinforce strong creativity and brand discovery. Although our total wholesale revenues were down, we were pleased that many of our digital partners shared similar success to our digital channel driven by our strong product deliveries. The momentum in the digital wholesale business provides us confidence as we plan the future. We believe wholesale revenues in the back half of the year, although negative, will build on the improvement we delivered in the second quarter and return to growth and solid profitability in early FY22.

Now for an update on our largest strategic growth initiative, FP Movement. Movement, Free People's activewear line, outpaced total brand growth in the quarter and was positive in all channels. Most impressive was the unprecedented triple-digit increases in our digital channel. Growth was achieved across both performance and nonperformance classes. In the second quarter, our marketing teams continued to increase our investment in Movement, with strategic digital and creative brand prospecting tactics, including the FP Movement ambassador program. Building on our brand's "Moving Together" campaign, the team began virtual workouts in the first quarter and hosted a Free People Virtual Retreat over Memorial Day weekend that supported the fitness and wellness space in a unique way. Our FP Movement customer base grew by 175%. With the growth of brand awareness, digital sales, and the success of our 50 shop-in-shops within our Free People stores, we are excited to open the first FP Movement standalone location in Los Angeles this fall. This will be followed by a location in Boulder, CO, in the fourth quarter. These stores are the first of several scheduled for next year. This quarter's tremendous success across all channels and categories re-enforces the large growth opportunity. FP Movement has a unique position in the fitness and wellness space, and we believe it has the ability to rival total Free People brand revenue.

Reflecting on the last several months, we all know retail, and most definitely fashion, have always been about change, and change is necessary to be successful. The second quarter showed us how fast this can happen, and our teams reacted with a resounding response of true excellence. The experience of these last few months makes us even more confident in our future growth. I would like to personally thank our global sourcing partners and our entire vendor community that has always felt like an extension of the brand. This quarter, more than ever, their partnership was instrumental in helping us manage through this uncertain environment.

Before I close, I would like to thank, Meg Hayne, Barbara Rozsas, and the entire Free People team for their outstanding work in the most difficult of times. Your dedication, creativity and love of the brand inspire me every day.

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

Dick Hayne

Thanks Sheila. I want to congratulate you, Meg, and the team for delivering a phenomenal quarter. Free People reported strong positive 'comps', great margins, and well controlled inventories and expenses. This produced record second quarter profits. Record profits amid a global pandemic with the supply chain impaired, and stores closed for much of the quarter – now that's impressive! My thanks to you and the entire team for an exceptional effort and outstanding results.

Good afternoon everyone. Today I will discuss our overall results for the second quarter, talk about performance by channel, then by brand, and give my thoughts on the second half, before turning the call over for your questions.

In Q2, the Company faced the most difficult macro-business environment in my fifty plus years in retail. Nonetheless, I am pleased to report URBN produced healthy revenues and operating profits for the quarter. All brands were profitable and together, they delivered one of the lowest markdown rates and best full price selling in URBN history.

Overall results were driven by the strength of our digital channel, exemplary expense and inventory control and our ability to create and offer compelling products. Delivering a positive financial performance in this environment reflects the hard work, resilience, and agility of our teams, and I want to thank them at the outset. I especially want to recognize and thank the production team and our partners around the world who kept product flowing into the brands under almost impossible conditions and the fulfillment teams for ensuring digital orders flowed out to customers. Due to our strong second quarter results, we enter the fall selling season with positive momentum and clean inventories at all brands.

Let me now recap our second quarter performance by channel. I'll begin with stores. Not surprisingly, the store channel had a very tough quarter. Besides the original wave of COVID-related closures, stores in North America faced civil unrest, a 'second wave' of infections, government and landlord-imposed restrictions on occupancy and hours of operations, and consumers who were ordered to stay at home. Our stores were unable to open for business approximately one-third of the days in the quarter and when they were open, registered less than half the normal flow of customers. Fortunately, the customers that did enter were shoppers not lookers. We experienced the highest quarterly conversion in memory and fewer promotions were needed to drive sales.

On the other side of the Atlantic, our European stores saw a wide range of store traffic patterns. London stores resembled New York City – late to open and anemic traffic once they did; the rest of Europe was similar to North America, except for Germany, which outperformed all other geographies with some German stores actually booking days of year-over-year traffic gains.

August store traffic to date has improved slightly over the July rate, and we expect to see continued slow improvement throughout the third quarter, but it remains unclear if store traffic will ever rebound to pre-COVID levels. Clearly some customers still prefer shopping in stores. Therefore, so long as the economic model works, we are committed to maintaining or even enlarging our store fleet as part of our omni channel strategy. During the quarter, we had active conversations with many landlords and made considerable progress; most offered rent concessions for the periods when stores were unable to open. We will continue the conversations and closely monitor the economics of our store portfolio, adjusting the fleet size where necessary.

Q2 weakness in the store channel was largely offset by outsized strength in digital. We believe the stimulus checks that went out in May helped to fuel some of this demand, however, our overall digital business posted very strong double-digit 'comp' sales in each month of the quarter and that strength has continued in the first three weeks of August. Besides sales, other digital metrics were also impressive with sessions and orders showing mid double-digit gains. Conversion improved, as well. Perhaps the most noteworthy metric was the number of new digital customers the brands attracted. Total new digital customers across all brands jumped by 76% on a year-over-year basis. This gives us confidence the digital channel will continue to produce robust growth during the back half of the year.

Now I'll discuss second quarter performance for both larger brands, starting with Urban. Stores performed as expected, but the digital channel produced amazingly high double-digit comps. As a result, Urban's retail segment 'comp' sales declined by only 8%. Better yet, the brand in North America delivered powerful double-digit, full price 'comp' increases. The women's apparel, renewal, intimates, and home categories performed best. Like Free People, Urban registered a record low quarterly markdown rate and ended the quarter with 'comp' inventory down 18%. Great digital sales, extremely low mark-downs and tight expense control combined to produce higher operating income in the quarter than in the same period last year. That's quite an accomplishment given the macro-environment. My congratulations to Trish, Meg and the Urban teams for a job extremely well done.

Urban enters the fall selling season with strong momentum. Since many schools have postponed their opening date for several weeks or decided to hold virtual classes this Fall, we expected the back-to-school selling season to produce lower sales on peak days but extend longer into September. However, with most of the back-to-school season now booked, Urban's August 'comp' sales to date show little change from Q2 levels.

Turning now to Anthropologie, this brand was more impacted by the pandemic than our other two. Anthro is known for offering more structured apparel geared for work and events such as graduations, weddings, dinners-out and parties. In Q2, many women worked from home and most events were cancelled, so the need for this kind of attire vanished. Anthro's apparel team was able to adjust its on-order, chasing into more casual, less structured looks. This resonated with the customer and drove notable improvement in sales and less need for markdowns as the quarter progressed. The home category produced very strong regular price comps throughout Q2. Ending inventory, at cost, was down 15% which creates flexibility for the brand to chase emerging trends. I thank Hillary, Meg, and the Anthropologie teams for quickly and correctly reacting to the trends. This enabled the brand to post a profit for the second quarter.

As we look to the back half of the year, we expect the extreme uncertainty of the past four months to moderate and believe the COVID threat could begin to wane which should help improve store traffic. Even so, we will continue to plan our businesses conservatively, keeping inventories lean and chasing into trend right product. We are fortunate to have well-developed digital capabilities across our portfolio. These have enabled us to capture consumer demand as stores remain handicapped. We expect continued strength in the digital business and have taken extra measures to ensure we have the capability to scale with customer demand during the Holiday period. These include adding staff in our existing fulfillment centers earlier, installing addition equipment in those centers to boost efficiency, using the Nuuly distribution facility to ship fast-turn items, and staffing stores to allow for more pack and ship processing.

Current business shows third quarter-to-date retail segment performance running slightly ahead of second quarter results. We believe total third quarter comps may remain negative but are planning improvement on a sequential basis. For Holiday, we are planning for an extended Holiday shopping period, with sales beginning earlier, reaching a plateau sooner, but missing the peaks characteristic of prior years as consumers seek to avoid crowds. If our COVID prediction is correct, we believe Holiday sales could be positive, but still heavily promotional.

In summary, all fashion retailers felt the effects of the pandemic in Q2. Companies with pre-existing conditions and those more reliant on physical stores, felt the effects most acutely. URBN entered the period with a well-developed digital capability, powerful brands, seasoned merchant and production teams and a strong balance sheet. We reacted quickly and took the necessary steps to mitigate the effects of this scourge. Our second quarter results are a tribute to the strength of our brands and effectiveness of our teams. We believe URBN and its brands will emerge from the COVID fog better positioned for the future and, therefore, are beginning to make new strategic investments. An example is our recent announcement to commence building another large fulfillment facility. This complex in Kansas will give us the operational capacity to continue growing our digital businesses in North America. We have also recently completed a similar facility in the UK which will allow for expansion in Europe. Our goal is to continue expanding the URBN family of brands and bring our unique products and experiences to more customers around the globe.

In closing, I thank all brand and shared service leaders, their teams, and all associates world-wide. As I said earlier, our positive performance in an incredibly difficult environment is a direct reflection of the skill, hard work, and dedication of our teams. So, thank you! I am honored to work with all of you. Thanks also to our many partners around the world who are helping us navigate through this pandemic, and thanks to our shareholders for their continued support.

That concludes my prepared remarks. Thank you, and now for your questions.