

# **URBAN OUTFITTERS, INC.**

Third Quarter, FY'13 Conference Call  
November 19, 2012

## **Participants**

Richard A. Hayne, Chief Executive Officer  
Frank Conforti, Chief Financial Officer  
David McCreight, CEO, Anthropologie Group  
Margaret Hayne, President, Free People Brand  
Ted Marlow, CEO, Urban Outfitters Group  
Wendy B. McDevitt, President, Terrain  
Glen A. Bodzy, General Counsel  
Freeman Zausner, Chief Operating Officer  
Barbara Rozsas, Chief Sourcing Officer  
Calvin Hollinger, Chief Information and Logistics Officer  
Matt Kaness, Chief Strategy Officer  
David Ziel, Chief Development Officer  
Bill Cody, Chief Talent Officer  
Oona McCullough, Director of Investor Relations

## **Oona**

Good afternoon, and welcome to the URBN third quarter fiscal 2013 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three month period ending October 31, 2012.

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. Meg Hayne, President, Free People Brand, will provide a brief update on the Free People Brand. Richard Hayne, our Chief Executive Officer, will then comment on our broader strategic initiatives. Following that, we will be pleased to address your questions.

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](http://www.urbanoutfittersinc.com).

I'll now turn the call over to Frank.

Thank you Oona, and good afternoon everyone.

We are pleased to announce another quarter of record results for Urban Outfitters. We are proud of these results and especially happy with the progress we've made year-to-date. We entered the year with a clear plan and now we are seeing the benefits of executing that plan. Each quarter we have delivered an acceleration of the sales growth rate versus the prior comparable quarter. In addition, we delivered significant improvement in gross profit margin and operating profit margin rate versus the prior comparable quarter.

Before I discuss the specific financial results in detail, let me remind you that URBN quarterly financial periods are based on calendar months, not a 4-5-4 retail calendar. This means that Hurricane Sandy, which hit the northeastern United States on October 28<sup>th</sup>, impacted the last four days of our third quarter. In total, 106 of our stores were affected by Sandy, and while we suffered little permanent damage to our stores, there were many store closures. These ranged from a few hours to more than a week. Additionally, we believe our direct-to-consumer channel was negatively impacted by customer power outages in the northeast, including a portion of New York City. We believe the effects of Sandy reduced our retail segment comparable net sales growth rate by approximately one percentage point in the third quarter and will have a measurable but lesser impact on our fourth quarter results. URBN carries business interruption insurance which should cover a portion of these losses, however, the third quarter results do not include a provision for an insurance reimbursement.

Turning now to the financial results, total Company net sales for the quarter increased by 14% to a third quarter record of \$693 million. This increase was driven by a strong direct-to-consumer growth rate of 36% and an \$18 million increase in non-comparable net store sales, which includes 11 new stores opened during the quarter.

Total Company comparable retail segment net sales, which includes net sales from our stores and direct-to-consumer channel, increased by 8%. This includes increases at Free People, Urban Outfitters, and Anthropologie of 24%, 7% and 6%, respectively. Total Company comparable store net sales declined by 1% driven by a 2% decrease in the average unit selling price and a 3% decrease in units per transaction, each of which were partially offset by a 4% increase in transactions. I believe it is important to note that if it were not for direct-to-consumer returns at the stores, which we currently charge against store sales, our comparable store net sales would have been low single digit positive. I will address this further toward the end of my comments.

Free People Wholesale net sales increased 9% to a quarterly record of \$41 million. This increase was partially offset by a small amount of net sales related to Leifsdottir, which was transitioned to the Anthropologie brand in the previous year.

Gross profit for the quarter increased by 21% to \$261 million. Gross profit rate improved 222 basis points to 37.6%. The increase in gross profit rate was primarily due to a reduction in merchandise markdowns.

Total selling, general and administrative expenses for the quarter increased by 17% to \$167 million. Total SG&A, as percentage of net sales, increased by 75 basis points to 24.1%. The increase in rate is primarily due to higher incentive based compensation in the current quarter.

Operating income for the quarter increased by 27% to \$94 million, with an operating profit margin of 13.5%.

Net income was \$60 million or \$0.40 per diluted share.

Turning to the balance sheet, total inventories at the end of the quarter increased by \$28 million to \$395 million, an 8% increase versus the prior comparable quarter. The growth in total inventories is primarily related to the acquisition of inventory to stock new and non-comparable stores and to support the significant growth in the direct-to-consumer channel. Comparable retail segment inventories were flat and comparable store inventories were minus 6%.

Lastly, we ended the quarter with \$456 million in cash and marketable securities.

As we look forward to the final quarter of fiscal 2013, it may be helpful for you to consider the following:

For fiscal 2013, we are planning to open approximately 49 new stores, with approximately 10 new stores expected to open in the fourth quarter. By brand, we are planning approximately 18 new Urban Outfitters stores globally, 15 new Free People stores, 14 new Anthropologie stores and 1 new store each for Terrain and BHLDN.

We are planning for continued year-over-year margin rate improvement with a goal of producing 200 to 250 basis points of improvement for fiscal year 2013 versus fiscal year 2012. As previously discussed, we believe our margin rate improvement opportunity is greater in the fourth quarter than in the third quarter based on last year's fourth quarter results.

We continue to focus on effectively managing our selling, general and administrative expenses, but remain committed to investing in our business to drive long-term growth. This means increased spending, partially driven by the opening of our new West Coast fulfillment center, increased marketing and customer acquisition efforts and further investments in technology systems and people. Given our investments, we expect total selling, general and administrative expenses to increase in the high teens in the fourth quarter.

Capital expenditures for fiscal 2013 are planned at \$190-\$210 million driven primarily by new stores, the expansion of our home office, and the completion of our new fulfillment center in Reno, NV.

Finally, our fiscal 2013 annual effective tax rate is planned to be approximately 36.0%.

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.

Before I pass the call on to Meg Hayne our Free People Brand President, I want to alert you to a planned change in how we will report URBN comparable net sales beginning with the first quarter of fiscal year 2014.

Starting in fiscal year 2014, we will no longer report URBN comparable store or direct-to-consumer net sales rates. We will continue to report comparable retail segment net sales, which combines our stores and direct-to-consumer channel. This change reflects the changes we see in consumer behavior and our growing ability to present each Brand as an 'omni-channel' experience. With the growth of mobile and on-line sales that can occur anywhere including inside one of our stores, combined with our offer to customers to return products to any store or to the fulfillment center, the line between 'store' sales and the 'direct-to-consumer' sales has become increasingly blurred. For example, we know that if direct-to-consumer returns into stores were posted against direct-to-consumer net sales instead of our current practice of posting them against the store to which they were returned, third quarter comp store net sales would have been low single digit positive and all Brands would have shown a positive store 'comp' net sales for the quarter. As we continue to erase the boundaries between these channels in order to please our customers, the change in reporting provides our investors with a better understanding of our business. Therefore, we have decided to report the 'omni' net sales number which is the most clear and accurate picture of our business. As always our overriding objective is to do what is best for the customer.

Thank you for your time, I will now turn the call over to Meg Hayne our Free People Brand President.

Thank you Frank, and good afternoon.

This quarter has been an exciting one for the Free People Brand – we executed many initiatives that I am proud to share with you.

Let me start with Wholesale. In Q3, the Wholesale business posted their best quarter ever with record sales and our highest shipping month in history. Overall, quarterly sales exceeded last year by 9%.

Customer reaction to the product has been excellent, with a number of our Wholesale accounts reporting plus 20% sell-throughs on a weekly basis. During the quarter, our Brand launched a new relationship with Nordstrom's in which Free People built a lifestyle-branded shop filled with exclusive product, fixtures and displays, and staffed with trained, brand-appropriate sales associates. We opened our first 800 square foot shop-in-shop in their flagship store in Seattle. The sales lift from this shop has been dramatic, and we expect to expand this concept into other Nordstrom 'doors'.

The success of the Free People product at retail has translated into strong future bookings, as well. Orders for future deliveries at the end of the quarter were running ahead of that date last year and orders booked at the October "Magic" show in Las Vegas were the highest in the Company's history. As the Free People Brand recognition grows, we are also seeing more, and bigger orders from international customers, including a newly opened account in Mexico.

In order to facilitate this trend toward global distribution, Free People signed an agreement with World Co., Inc. in October which should help us gain more recognition and sales in the Japanese market. At first, World will focus on increasing wholesale distribution in Japan with current and new accounts. As we gain a better understanding of the Japanese culture and customer preferences, we hope to launch shop-in-shops soon after.

Now let me turn to our direct-to-consumer channel. The direct team produced an exceptional quarter. In September, the direct channel recorded the highest sales volume of any month in our eight year history, that is, until October surpassed it one month later. The September and October catalogs were two of our best to date, both generating more sales and more Social Media 'likes, loves and buzz' than any previous catalog. We are particularly pleased with the creative effort that went into our September catalog. Its success can be attributed to a combination of season-right product, a clever concept, strong, brand-appropriate styling and beautiful photography. As a result, traffic at freepeople.com reached new highs in early September as our catalog hit homes.

Our international direct business continues to grow, as well. Total international orders for the quarter jumped by 66%, with Australia leading the group with growth of 155%. Furthermore, we are happy to report we successfully launched freepeople.co.uk. This should establish a base for Free People to expand throughout Europe.

Turning to stores, our goal for fiscal 2013 was to open 15 new stores including our first international stores. We reached that goal by opening five additional stores in Q3 and two of those stores were in Canada - one in Toronto and one in Calgary. Our entrance into the Canadian market has exceeded our expectations and customer feedback has been exceptional. In total, Free People now operates 77 stores. As we have added more product and more product categories in our assortments, we continue to experiment with the proper size for a Free People store. Next year we expect to open several slightly larger stores and to relocate and/or expand several of our existing, smaller stores. This is part of our on-going focus to drive top-line growth and profitability in all of our channels of distribution.

Of all of the initiatives we set out to accomplish in fiscal 2013, none was more important than creating and offering fashion-appropriate product. And I believe this has been our greatest success. Our third-quarter product offering was significantly improved over last year. Trending categories fueled the fall season. We had many strong key items, fashion leaders, layering pieces and attitude builders. The customer told us, at every point of contact, through sales, through feedback to the sales associates and through Social Media – we had what she wanted and she liked the way we presented it.

This is our mission and ongoing commitment - to build a dynamic, lifestyle brand that pleases our customers through product and through image and makes her confident in her wardrobe and her life.

I will now turn the call over to Dick.

Thanks Meg, and good afternoon everyone.

Free People delivered a great quarter! Congratulations, to you Meg, and the entire Free People team.

And the Free People Brand was not alone. Both the Urban Outfitters and Anthropologie brands produced strong third quarter results, as well. Overall, it was the best third quarter in the Company's history.

We built on the positive trends established in the two preceding quarters. Total sales, retail segment comp sales, gross margin dollars and rate, as well as operating profit and margin, all improved in the third quarter compared to the prior year.

All brands continued to deliver on three of the four major goals we established at the beginning of the year.

- The number one goal was to make steady improvement in productivity by offering more compelling products and by employing more effective marketing techniques. In the third quarter we successfully accomplished both.

The product offered by each brand improved in the third quarter. Regular price selling accelerated and the corresponding need to use markdowns to clear less desirable merchandise fell by over 200 basis points. This was driven by improvement at all brands but especially at Anthropologie where regular price selling improved across all product categories. As a result, productivity increased for the quarter with total retail comp sales rising by 8%, Free People Wholesale sales increasing by 9% and retail comp sales improving at each brand.

The effectiveness of our marketing efforts grew significantly during the quarter as well. The creative execution of all of the Brands' catalogs and websites improved as did the in-store visual presentations. The third quarter total web-based marketing 'spend' almost doubled on a year-over-year basis, while the marketing 'spend' on catalog operations decreased by 3%. Total Company marketing expense rose by 21% compared to last year's third quarter. The result of re-allocating and increasing our marketing budget was a 32% increase in total web traffic, a 200% jump in sales coming from mobile devices, a 50% increase in sales coming from Social Media sites and a 36% growth in total direct-to-consumer sales. The Anthropologie brand launched its website redesign on October 1 and customer response has been positive with conversion rate, average order value and sales growth all improving. During the quarter we also invested in additional personnel to help create future gains in marketing productivity and drive future sales. Bob McElroy joined the Company as Global Head of the direct-to-consumer business for the Anthropologie brand and David Norton joined our Shared Service executive team as Chief Analytics Officer.

- The second goal was to open new channels of distribution and acquire more customers. Again, we succeeded. During the quarter, as Meg mentioned, the Free People Brand signed an exclusive agreement with World, Inc. to distribute Free People Wholesale product in Japan. The brand also launched freepeople.co.uk, and entered the Canadian retail market by opening two new, successful stores. Domestically, Free People opened two additional stores during the quarter and drove a 40% increase in visitors at freepeople.com.

This year, Urban Outfitters Europe opened three new stores in Germany. Not only are those stores generating strong sales, but they are helping to drive demand at our fast-growing German website, urbanoutfitters.co.de, which saw an 88% surge in demand during the quarter. Domestically, the Urban Brand opened 2 additional stores in the quarter and the urbanoutfitters.com website attracted 25% more buyers compared to the same period last year.

Finally, the Anthropologie Brand opened four new stores in the US during the quarter and, as I mentioned, successfully re-launched its website. In total, the brands opened 11 new stores in the quarter bringing the year-to-date total, as of October 31<sup>st</sup>, to 39 and total direct-to-consumer businesses attracted 32% more visitors versus the same quarter last year.

- The third goal was to expand the product offering, especially in the direct-to-consumer channel. Web-exclusive product at each brand continued to grow during the quarter and now accounts for 37% of the direct-to-consumer business. This is almost twice the penetration versus the same quarter last year. The growth in web-exclusive product is one important reason the direct-to-consumer business accounts for an increasing share of total sales each quarter.

- The final goal, which was not met, was to launch or acquire new concepts. We concentrated less on this goal so that the brand teams could focus exclusively on improving results within the existing concepts.
- Finally, even though it was not a goal discussed externally at the beginning of the year, let me share the powerful results produced by the Company's 'pick, pack and ship' initiative launched toward the end of the second quarter. If you recall, this initiative allows us to fill customer demand from any of our points of inventory supply including each fulfillment center and all of our stores. During the third quarter, \$23 million dollars of direct-to-consumer initiated demand was filled from the stores. Without this initiative, we estimate that one-half of that demand would have been lost due to out-of-stock positions in our fulfillment centers. In addition, this initiative has helped us to lower markdowns and enabled the brands to plan their inventory with tighter weeks of supply. Clearly, however, the biggest benefit of 'pick, pack and ship' is our ability to better serve our customers.

In summary, we are pleased with the progress made during the third quarter and throughout the year. We announced at the beginning of the year we were focused on steady improvement in the metrics that measure our business. Our teams have delivered just that. In the third quarter better product, increased product offerings, better and more efficient marketing, additional new stores, and careful control of inventories and expenses have resulted in increased sales, improved gross margins and higher profits. I am proud of our brand leaders and their teams for delivering these record results.

Going forward, we are mindful of the challenges we face in the competitive retail landscape but we have demonstrated that our concept of building compelling brands that focus on the customers' lifestyles can produce superior results. We will not waiver from that concept. We have built brands that resonate deeply with customers. Our strategy to grow these brands is clear and we have strong teams in place to execute this strategy. That is our formula for success.

I thank our entire senior team including our Brand leaders, the heads of our Shared Services and all of our 20,000 co-workers world-wide for their hard work, their dedication and their inspiration. I also thank our shareholders for their continued support.

That concludes my prepared remarks, so at this time we will open the call to your questions.