

## URBAN OUTFITTERS, INC.

First Quarter, FY'19 Conference Call  
May 22, 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 Group  
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 first quarter fiscal 2019 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three-month period ending April 30, 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. Andrew Carnie and Hillary Super, Co-Brand Presidents of the Anthropologie Group will provide an update on the Anthropologie 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 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 first 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 first quarter increased 12% vs. the prior year. The increase in sales resulted from a strong 10% URBN Retail segment 'comp', 13% growth in URBN wholesale sales, and a \$17 million increase in 'non-comp' sales. Foreign currency translation accounted for approximately 160bps of total sales growth for the quarter.

Within our URBN Retail segment 'comp,' both the digital and store channels delivered positive 'comps' during the quarter. Digital continued to outperform stores, posting a double-digit sales increase, driven by increases in average order value, sessions and conversion rate. For the store channel, this marks the first quarter in four years our store 'comps' have been positive at URBN and each of our brands. Positive 'comp' store sales resulted from increased average unit selling price which was partially offset by decreased transactions and units per transaction. Store traffic for the quarter was up slightly vs. the prior comparable quarter.

By brand, our Retail segment 'comp' was positive at all three brands for the third straight quarter with increases of 15% at Free People, 10% at Anthropologie Group and 8% at Urban Outfitters. Our URBN Retail segment 'comp' was the strongest in March, which benefitted from the Easter holiday calendar shift, followed by February and then April. If you combined the months of March and April in order to remove the Easter holiday shift and looked at the average of the two, each month in quarter performed very consistently.

During the quarter, we opened four new locations, including: two new Free People stores in North America, two new Urban Outfitters stores in Europe and exited one Urban Outfitters store in Europe.

Our URBN Wholesale segment delivered 13% sales growth vs. the prior year. This growth was largely due to a 10% sales increase at Free People. Free People's growth was driven by domestic and international growth in department stores, specialty stores and digital businesses. These increases resulted from growth in several categories including women's apparel, intimates, and FP Movement.

The remainder of the sales growth was due to the recently launched Anthropologie home wholesale segment. The majority of Anthropologie's growth was driven by domestic sales followed by international sales. While Anthropologie home wholesale is still in the very early days, we are pleased with the results and excited about the meaningful opportunity going forward.

Now moving on to URBN gross profit for the quarter. Gross profit increased 17% versus the prior comparable quarter to \$281 million. Gross profit rate improved by 130 basis points to 32.8%. The improvement in gross profit rate was driven by lower markdowns at all three brands and leverage in store occupancy cost due to the strong retail segment 'comp'. These gains were partially offset by lower initial margins due in part to lower penetration of private label merchandise and deleverage in delivery expense due in part to the increased penetration of the digital channel.

Total 'SG&A' expenses for the quarter were up 4% to \$227 million versus the prior comparable quarter. Total 'SG&A' as a percentage of sales, leveraged by 224 basis points to 26.5%. The growth in 'SG&A' expenses was primarily due to increased marketing expenses helping to fuel the healthy sales increase. The leverage in 'SG&A' as a rate to sales was driven by the strong topline growth, continued savings associated with the fiscal 2018 store reorganization project and the current year benefit associated with the non-recurring store reorganization expenses incurred in the prior year.

Operating income for the quarter increased by 156% to \$54 million, with operating profit margin leveraging by 354 basis points to 6.3%.

Our effective tax rate for the quarter came in at 23.6% vs. 44.1% in the first 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 the first quarter effective tax rate was favorably impacted by approximately 120bps due to equity activity.

Net income for the quarter was \$41 million or \$0.38 cents per diluted share.

Turning to the balance sheet. Inventory was \$405 million, which was up 13% versus the prior year. Retail segment 'comp' inventory increased by 8% at cost. The remainder of the increase primarily related to increased wholesale inventory.

We ended the quarter with \$515 million in cash and marketable securities and have zero drawn down on our asset backed line of credit facility. Capital expenditures came in at \$25 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 second 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' fairly consistent with our recently completed first quarter rate.

Now moving on to gross profit. We believe URBN's gross margin rate for the second quarter, could improve at a rate similar to the improvement delivered in the first quarter. This improvement could be driven by lower merchandise markdowns and leverage in store occupancy expense.

Based on our current plan and sales performance, we believe ‘SG&A’ could grow at approximately 6% for the second quarter and 5% for the fiscal year 2019. The increase in spend could primarily relate to increased digital marketing investments as well as incentive-based compensation. At this point in time, we believe we could deliver ‘SG&A’ leverage in each quarter vs. the prior year.

Our annual effective tax rate is planned to be approximately 25% for the second quarter and 24% for the full fiscal year 2019.

We are planning to open 18 new stores for the year while closing 10 stores. For further detail on store changes by brand please see our investor metrics sheet posted to [www.URBN.com](http://www.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 Dick Hayne, our URBN Chief Executive Officer.

## **Dick Hayne**

Thank you, Frank and good afternoon everyone.

At this time, it’s my pleasure to introduce the Anthropologie Co-Presidents, Hillary Super and Andrew Carnie.

Hillary has been with Anthropologie a little more than a year and during that time has succeeded in improving the product offer in all areas she oversees, which includes apparel, intimates, accessories, beauty, and the BHLDN wedding business.

Andrew oversees all home product and has grown that business by 60% since his arrival four years ago. He also launched a successful wholesale business for Anthropologie home products, and, now oversees Anthropologie international and the Terrain outdoor living concept as well. Both he and Hillary are strong merchants with a passion for the Anthropologie customer. I know they’re excited to share their Q1 results and plans for future growth.

Hillary, Andrew, welcome to our quarterly conference calls. Hillary let’s begin with you.

## **Hillary Super**

Thank you, Dick, and good afternoon everyone.

I will start my commentary discussing Anthropologie Groups' first quarter results and then move to more specific accomplishments in the women's apparel and accessory categories.

As Frank mentioned, I am pleased to report we delivered a 10% retail segment 'comp' in the quarter, with all categories delivering positive 'comps'. Apparel and accessories continued to gain momentum from the positive results experienced in the fourth quarter, while home, beauty, and Terrain continued the sales momentum they have enjoyed over the previous several years. As a brand, we delivered nicely positive store 'comps' with all regions posting positive results driven by increases in traffic, UPT's and AUR. The digital channel experienced strong double-digit growth for the quarter driven by improvement in sessions, AUR and conversion. From a channel perspective, we continue to see our customer shift to digital, however it is exciting to see that we were able to drive positive 'comps' in stores as well, driven by better regular price sales and stronger merchandising messages.

Our strong retail segment 'comp' was coupled with healthy merchandise margin and operating profit improvement. Improvement in merchandise margin was due to a reduction in markdowns driven by improved product execution and well controlled inventory. Partially offsetting the improvement in markdowns was deleverage in our initial merchandise margins due to a higher penetration of market brands versus the prior year. As we move forward, we believe we have a significant opportunity to expand merchandise margins driven by both lower markdown rates and higher initial margins. Although we drove healthy improvement in our markdown rate vs. the prior year we still have opportunity to get back to our historical low rates. Additionally, as we increase our own brand penetration in the apparel category to a more normalized level, we should see nice improvement in initial margins.

Turning to apparel and accessories specifically; our product execution continues to improve, and we are pleasing our customer more. Notably the brand drove increases in retained, reactivated and new customer counts across both channels. We experienced broad success in apparel with particularly strong performance in bottoms and separates. As Dick has mentioned on previous calls, we believe there is a shift in fashion that is creating demand for newness and variety. We saw strong demand for fashion throughout the quarter despite an unseasonably cold spring and have seen our demand accelerate in May. Additionally, the accessories category delivered exceptional performance, driven by almost all classes.

Turning to our customer and our brand. When I joined Anthropologie 14 months ago, it was clear that the apparel and accessory assortments were no longer resonating with our customer. Since then, we have leveraged our various listening posts to deepen our connection with our customer. Two key themes have emerged from this work:

- First, she wants fashion, but on her terms. Her terms are: it must be flattering, versatile, effortless, unique, and have a strong price/value relationship. She will pay for quality and differentiation.

- Second, she is emotionally invested in our brand, and we are part of the story of her life. Although we have disappointed her somewhat in recent seasons, she has been patiently and passionately waiting for us to capture her heart again.

With this in mind, we have evolved the way we work to meet her needs.

- We have cultivated a more collaborative team culture with earlier and more frequent alignment points between the product, sourcing and creative teams.
- We implemented a speed calendar with close to 50% of our product on a 12 week or less lead time.
- We moved to a 360-degree messaging strategy, aligning our creative content across all channels with our inventory investments. Our February pants campaign and March occasion dressing campaign are examples of this and were both quite successful.
- We raised our fit and quality standards and implemented a new process to support this.
- As our brand performance improved over the last several quarters, we have committed as a team to increasing our offering, and I am happy to report that we have made significant progress on this beginning in the second quarter.
- Additionally, we are doing a better job of serving all of the occasions of her life. Our customer has come to know us as a destination for special occasion and more recently, weekend casual wear. We have extended our offer to include more desk to dinner options as well as loungewear, which we believe has significant growth potential as we move forward.

Anthropologie is a brand built on creativity, uniqueness and emotional connection. As a team, we have re-committed to putting this mindset, along with our customer, at the forefront of all that we do.

Before I hand the call over to Andrew, I would like to personally thank everyone who contributed to the positive performance of the women's business. Your commitment, passion and sheer talent are an inspiration to me every day.

### **Andrew Carnie**

Thank you, Hillary. I would like to congratulate you and your team for driving the turnaround in apparel and accessories.

Good afternoon everybody. I am pleased to speak to you about our home business, the recent launch of wholesale, our international growth and the Terrain outdoor living concept.

Starting with home, this quarter marks the 15th sequential quarter of positive 'comps' for the home category. In addition to the sustained sales growth, we continue to grow merchandise margins through sourcing strategies and operational efficiencies.

Our strong growth in the home category is driven by several initiatives:

- Continue to broaden our on-line assortment with unique products customers can only find at Anthropologie; an example of this was the recent and successful launch of outdoor furniture.
- Improving the omni-channel experience; we aim for all customers to have a seamless experience on every device and every channel.
- We continue to lead in creative imagery, providing customers unparalleled ideas and inspiration.
- Finally, mini-home showrooms. We recently introduced within ten Anthropologie store locations, providing customers the ability to touch and feel our assortments and have a decorating service, each store has new technology to make buying home a seamless experience for each customer. The initial customer response and results are extremely positive. We will continue to roll this out later in the year.

As a result of our efforts, we continue to see nice positive momentum within the home business with particular strength in the digital channel, with sales continuing to grow in high double-digits, driven by improvements in sessions, increased UPT and conversion.

The digital channel now accounts for over half of first quarter sales this year compared to less than a quarter three years ago.

In addition to Anthropologie, we continue to bring our Terrain outdoor living brand with its unique aesthetic, service and experience to more customers.

This summer we plan to open another Terrain concept, which includes a store, café, restaurant and event space in Devon, Pennsylvania. The new opening will take our Terrain concept to three large sites. This year we are actively looking for additional locations to bring this unique experience to more customers.

In addition to the concept stores, we have two Terrain shops within the Anthropologie large format stores. Terrain has far exceeded our expectations in these shops producing excellent sales per square foot and an overwhelming, positive customer response. Based on this performance, we are adding five additional shops within larger Anthropologie stores.

Moving on to wholesale. We believe the expansion of Anthropologie home into the wholesale channel is a critical component of our growth strategy.

Wholesale enables us to build Anthropologie awareness both in North America and internationally, with the added benefit of improving our merchandise margins through increased volumes. In March, we launched Anthropologie home wholesale in North America, in partnership with Nordstrom. The product assortment is primarily gift, table top and textiles. Nordstrom follows the success of Anthropologie UK wholesale launch with John Lewis in fiscal 2018. The assortment is available in 15 Nordstrom stores and online. Early reads have been extremely strong leading to reorders within the first week. We anticipate the assortment being offered in many Nordstrom locations by the end of the year, with an expanded assortment choice online.

Finally, and continuing the international growth theme, Anthropologie Group has tremendous opportunity outside North America. We believe in the long-term we have the potential for half of brand sales to come from outside the United States. Our current international business is UK centric with all stores located in the UK and a majority of sales occurring in the greater London region.

The brand is now well established in the UK and the strategy shifts to becoming more diverse in terms of geography and sales channels. We will be opening our first continental European store this week in Dusseldorf, Germany. We are actively looking to expand further into Germany and other major regions across Europe by opening physical stores, while expanding the digital reach and developing wholesale strategies to establish a brand presence in our target markets.

The entrepreneurial culture at Anthropologie and URBN encourages our teams to think outside the box in terms of driving growth and, with this in mind, we are always looking at new ideas and concepts to grow the business.

Hillary and I are excited to continue to explore new opportunities for the brand. With that being said, we are very focused this year on delivering the best product and experiences to our customers.

We would like to take this moment to thank Meg and all our teams at home office, in addition to the thousands of associates in stores for a great quarter. These are the people that work every day to make the Anthropologie Group an exceptional brand experience and wonderful place to work.

I will now hand over to Dick, thank you.

### **Dick Hayne**

Thanks, Andrew. Congratulations to you, to Hillary, and the entire Anthropologie Group for posting very impressive results. I know you both believe, as I do, there's plenty of room for further improvement and continued growth across all categories, channels and geographies. I look forward to seeing the two of you and your teams build on the Q1 successes.

Let me now turn to an analysis of URBN's first quarter results. When we spoke in early March, I asserted that the economic and fashion winds had shifted 180 degrees and were now at our back. Job and wage growth, tax cuts and strong consumer sentiment, combined with a changing fashion silhouette to create a retail-friendly environment.

It seems however, I underestimated the power of that tailwind and how well our teams would execute. Results came in stronger than anticipated. A 10% 'comp' sales increase and a 280% quarter-on-quarter increase in EPS beat my expectations handily.

All three brands performed at a high level. In addition to the expected strong digital demand, each brand produced nicely positive store ‘comps’ – a first in over four years. Store traffic, which has been improving for the past three quarters, turned slightly positive in the first quarter. Better store sales came primarily from an increase in AUR which in turn, was driven largely by fewer markdowns and to a lesser degree more nationally-branded product. The total company markdown rate in Q1 was the lowest of any quarter in the last ten years. Better fashion execution, strong demand for apparel and accessories, plus disciplined inventory control reduced the need to take markdowns and drove strong ‘comps’ and full-priced selling. Happily, not only have these trends continued in May, they’ve strengthened.

Hillary and Andrew just discussed Anthropologie, now let me briefly review Q1 results for the other two brands starting with Free People. The Free People brand produced a nearly flawless performance in Q1; all categories and channels excelled. The Retail segment ‘comp’ increased by a very impressive 15%. Digital ‘comps’ outpaced the stores, but both channels delivered double-digit regular price ‘comps’. All other performance metrics – traffic, number of transactions and conversion rate were nicely positive in both channels, as well.

Meanwhile, wholesale delivered yet another great quarter posting double-digit revenue growth. Wholesale sales were fueled by gains in all product categories – collection, intimates, shoes and Movement and all customer groups – department stores, specialty stores and pure play, digital businesses. The wholesale business also continued to experience good growth in international markets where quarter-on-quarter revenues increased by 24%, paced by sales to European customers.

Strong product performance in all channels included outsized growth in Free People’s two expansion categories, FP Movement and denim. These categories were supported by robust marketing campaigns and more exposure in stores. Marketing for Movement included community events with local fitness instructors that were coordinated with social campaigns and landing pages featuring key influencers. As a result, the number of Movement wholesale accounts grew by 24% and Movement wholesale sales jumped by 41%. The Free People merchant and design teams completely reimaged the denim offer for spring/summer, adding more choices, alternative fits, a variety of new silhouettes, and expanded inseam and size offerings. This drove a 200% increase in Free People wholesale denim sales in Q1 over the same period last year. Going forward, the brand will continue to focus on expanding both categories.

In sum, Free People’s first quarter was outstanding, and I thank Meg, Sheila and their retail, digital and wholesale teams for planning and executing such a powerful performance.

Now I’ll focus on the Urban Outfitters brand, where total Retail segment ‘comps’ in the first quarter grew by 8%. Like the other brands, Retail segment ‘comps’ were driven by apparel and accessories; in Urban’s case, this includes both men’s and women’s.

Looking at performance by channel, the brand delivered positive ‘comps’ in both the digital and store channels in North America and in Europe. Within digital, the brand saw nice increases in sessions, AOV and conversion with international markets being particularly strong. In China, Urban won the “Most Popular Brand for the Young Generation” award from Tmall Global.

Store ‘comps’ for the quarter were driven primarily by higher AUR. All geographic regions and all store types posted positive ‘comps’. In Europe, the brand opened its first freestanding store in Paris in February. It immediately became one of the top-grossing stores in Europe and set an opening day sales record. In April, Urban’s first franchise store located on the outskirts of Tel Aviv opened. It has performed well above plan, and we look forward to supporting additional store openings in Israel this year.

The Urban marketing and PR teams continued their outstanding work of engaging and inspiring customers through social channels, brand partnerships, music initiatives, and influential press outlets. We were pleased to have the brand recognized by ShareIQ as having the highest social media engagement rate among our peers for the first quarter of 2018. Urban’s eight million Instagram followers are a tribute to the strength of the brand and the skill of the marketing team. Excellent marketing is certainly one of the driving forces behind positive ‘comps’.

My thanks to Trish and Meg and the entire Urban team on both sides of the Atlantic for creating such positive brand buzz and producing an excellent quarter.

I’ll now move on to discuss our company’s current growth initiatives. As outlined and discussed previously, we believe future opportunity for growth will come primarily from three sources, the digital and wholesale channels across all geographies, and international expansion using all channels of distribution. Given the current benign retail environment, we plan to pursue these opportunities aggressively.

The digital channel continues to produce our strongest growth. As previously reported, digital penetration of total Company, Retail segment ‘comp’ sales exceeded 40% for the first time last quarter. Rapid digital growth has been achieved by offering larger and better product assortments, creating compelling visual imagery and effective marketing and building sites that make digital shopping easier and more enjoyable. Our proprietary technology shared by all three brands includes web and mobile platforms that are fast, reliable and scalable.

The digital and brand teams working together continue to research and test new ways to enhance the digital experience. For example, this month, both the Urban and Anthro brands launched their new online marketplace. This exciting new feature enables a curated assortment of third party sellers to list and sell merchandise on our brand websites. After a thorough test period, each brand plans to expand its marketplace to include complimentary brands, products and services with a goal of expanding the online assortment offered to the customer and increasing site traffic. Other recent site enhancements include the addition of two alternative payment methods – Apple Pay and Afterpay. The latter has recently entered the US market from Australia with URBN as their American launch partner. Afterpay allows customers to ‘purchase’ and receive products and then pay for them over time with no interest charges or credit checks. If US customers behave similarly to those in Australia, this service could raise our conversion rates and boost average order values.

Moving to the second growth initiative – the wholesale channel. We believe all three brands have an opportunity to grow their reach and their revenues using this channel. For Free People, there's still significant opportunity to increase the domestic wholesale business through category expansions like FP Movement and denim. Globally, the brand can expand wholesale revenues by entering new markets and increasing penetration in existing ones. For Anthropologie, Andrew has discussed the successful launch of home wholesale and his plan to open additional doors and expand the offer. Besides these initiatives, the Anthropologie and Urban brands have identified other existing categories and product lines with amazing opportunities for wholesale distribution and will be actively pursuing these.

The final growth initiative is international expansion. Here we expect to build on the strong momentum created over the past 12 months as the Urban brand has opened highly successful stores in Vienna, Milan and Paris. These stores are already four-wall profitable and the halo effect on the corresponding digital business adds even more value. For instance, since opening the Paris store in February, the Urban brand has seen a 60% quarter-over-quarter increase in digital sales coming from France. This year, the Urban brand plans to open two additional stores in Europe and facilitate the opening of several additional franchised stores in Israel. Anthropologie, as Andrew suggested, is set to open its first store in Continental Europe this month and Free People hopes to open its first two stores in Europe later this year or early next. And finally, we continue to seek additional markets where our brands could have a physical presence. We're testing some of these by first establishing a digital presence. For example, both the Urban and Free People brands are having considerable digital success in the China market by partnering with Tmall. And while current sales are relatively small by our North American standards, the opportunity is obviously enormous and the rate of growth is currently almost triple-digit.

One final observation – this about stores. As I reported earlier, each brand delivered nicely positive 'comp' store sales in the first quarter. As you may recall, last year we enacted a major store restructuring across all brands in North America. That initiative simplified the store organization and permitted us to become more productive and efficient. The restructuring has been largely successful and along with the 'tail wind' factors I've discussed and better product execution, 'comp' store sales have gone from negative to positive. Each brand is currently in the process of enacting further store initiatives around improving product assortments, product adjacencies and enhanced service levels. One quarter a trend does not make, but 'comp' store sales so far in Q2 are stronger than Q1, and we are currently enjoying positive store traffic and higher AUR. If Q1 signaled a turning point in the direction of store 'comps', that would be exceptionally good news for URBN stakeholders. Notwithstanding the excellent progress our company has made growing the digital channel, 'comp' store sales remain a meaningful driver of our top and bottom line results.

In conclusion, we're confident and optimistic about our prospects for the second quarter and the entirety of fiscal 2019. URBN brands are powerful and all three are resonating strongly with their chosen customers. We believe all possess significant, untapped opportunities for growth. With fashion trends strong, the economy healthy and consumer sentiment at a 14-year high and our teams executing exceptionally well, we believe the time is perfect to invest for growth.

In closing, I thank our brand and shared service leaders, their merchant, creative and operating teams and our 24,000 associates worldwide. Your hard work and amazing dedication and creativity produced a truly excellent quarter. 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.