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Under Armour, Inc. *(UA)*

Q1 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Under Armour, Inc. First Quarter Earnings Webcast and Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session, and instructions will be given at that time. [Operator Instructions] As a reminder, today's conference call is being recorded.

I'd now like to turn the conference over to your host, Mr. Tom Shaw, Director of Investor Relations. Please go ahead.

Thomas D. Shaw

Director-Investor Relations, Under Armour, Inc.

Thanks, Sally, and good morning to everyone joining us in today's first quarter conference call. During the course of this call, we'll be making projections or other forward-looking statements regarding future events or the future financial performance of the company. We wish to caution that such statements are subject to risks and uncertainties that could cause actual events or results to differ materially. These risks and uncertainties are described in our press release in our risk factors section of our filings with the SEC. The company assumes no obligation to update forward-looking statements to reflect events or circumstances after the day on which the statement is made or to reflect the occurrence of unanticipated events.

Joining us on today's call will be Kevin Plank, Chairman and CEO, followed by Brad Dickerson, our Chief Financial Officer, who will discuss the company's financial performance for the first quarter, followed by an update to our 2013 outlook. After the prepared remarks, Kevin and Brad will be available for a Q&A session that

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will end at approximately 9:30 a.m. Finally, a replay of this teleconference will be available at our website at approximately 11:00 a.m. Eastern Time today.

And with that, I'll turn it over to Kevin Plank.

Kevin A. Plank

Chairman, President & Chief Executive Officer, Under Armour, Inc.

Thanks, Tom, and good morning, everyone. Q1 2013 was another great quarter of growth for the Under Armour brand, one that increases our confidence that the new products and initiatives we'll discuss today have us well positioned for another outstanding year in 2013 and beyond.

But first, the scoreboard. Total revenue is up 23%. Apparel revenue is up 22%; and footwear revenue's up 27%. In Apparel, there are a number of great things to talk about: our continued strength in Fleece in Women's; the strong performance of our Youth business, which is a great indicator of the breadth of our brand equity; and the success of our new partnership with Marvel Entertainment and DC Comics, our Alter Ego superhero product.

But, first, I want to talk about the fundamentals and our ability to continue to grow our business at a market-leading pace while reaching new consumers with great new products and new distribution. This is an essential element of our growth strategy and one that we continue to execute extremely well, driving 20-plus-percent top-line growth for the 12th consecutive quarter in total revenues and the 14th consecutive quarter in Apparel.

In Q1, the best illustration of this strategy was our success in bringing newness to the market with our new apparel products. It's safe to say that we've never had the breadth of new products in the market as we do right now. Even in our most basic business, like Tech Tees, we've brought stripes and more colors into the line and are flowing them into the market faster. This focus enables us to build multiple expressions for the athletes and make it available faster and in more ways than ever before.

At the time of our IPO in 2005, we were predominantly a compression brand known for two things: moisture wicking and cold-weather protection. As we've grown to where compression was only 14% of our business in 2012, we continue to move away from dependence on cold weather with more focus on providing a broad range of fabrications and we've even decided that cotton didn't have to be the enemy.

Coming out of the cold weather season, we came back to our partners with an entirely new line of products, differentiated from the more seasonal, cold-weather apparel. We essentially extended the season with a lighter weight, more versatile assortment to help create traffic in stores during what's traditionally a slower traffic time of year. We've seen great success with this program at retail so far, and believe there are other opportunities throughout the year for this type of transitional product. When we combine this improved ability to execute the fundamentals with a consumer-focused product innovation, the result can create a lot of attention in the market and that's what we've accomplished with our Alter Ego products.

One of the most talked about programs at retail right now, our Alter Ego line takes some of our core SKUs and embellishes them with classic superhero characters like Superman, Iron Man and The Batman, among others. It was the most successful product launch ever on our e-commerce site and we just started shipping it late in the quarter to our wholesale accounts. With Alter Ego, we're not talking about the volume of [indiscernible] (04:36), but it does keep us at the forefront of our consumers' minds and helps to create traffic in our partner stores. And while we are selling some of the product in youth sizes, the overwhelming majority of it is being sold in our Men's business.

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Our Youth business continues to perform above expectations and most importantly provides us great confidence that our brand is resonating not only with the high school athlete but with the next generation of athletes as well. Our growth in Youth is broad-based. We're seeing strong numbers across genders, channels and product categories. Our girls business, our department store business and our baseball and basketball businesses all performed strongly in Youth in the quarter as we continued to gain traction beyond our core.

In Women's, we are seeing a return on investment we've been making in the business as we continue to add talent across the organization. Driven by strong Q1 performance across our studio line, our new capri pants offering and extended Armour Bra line, our growth in Women's is great proof of how well our brand resonates with the female consumer beyond the high school and collegiate playing fields. With our New York office opening later this year, we'll be better positioned to bring additional design talent and new thinking into the Women's organization. We'll be talking more about our plans for the UA woman at our Investor Day in June and believe we're in great position to reach new consumers in Women's in the balance of 2013 and beyond.

Our Fleece story was a highlight in Q1 just as it was in Q4 of 2012, with revenues doubling this past quarter. This is a great example of how we've been able to draft off our core Baselayer business and take a market leadership position in the adjacent category of Fleece. We've built up great equity with our consumer by providing cold weather protection with lighter weight fabrications, and we believe that's helped drive our growth in Fleece.

So next, on to footwear. Our strengths and capabilities continue to grow in footwear, and we continue to make solid gains across all aspects of our business. We are gaining authenticity with the more technical running consumer with our Spine technology platform. This is a great example of delivering innovative product stories and telling them around multi-season platforms as opposed to one-off introductions. We've gained market share in performance running and are gaining credibility with our retail partners as we continue to see improved sell-throughs at accounts like Dick's Sporting Goods, Hibbett Sports, Finish Line and Foot Locker, where we can tell the Under Armour performance story.

So while large opportunities like performance running remains a focus for our team, we've also kept our attention on categories that help authenticate us with athletes like baseball and football cleats. In football, we're building on the equity we gained in 2012 with innovative products like our Highlight cleat that is already off to a solid start this year. We've expanded the Highlight cleats with 32 color assortments to serve teams and athletes at every level, and it will be the featured innovation story for UA Football this season in places that athletes shop like Eastbay. Innovative product like this and our great roster of UA athletes across both football and baseball enable us to be authentic and be a market leader at retail as well.

In a category like basketball, our strategy is simpler. Be authentic on the court and build the relationship with the young consumer. That strategy is on display when UA teams like La Salle make a run in the NCAA tournament; or when the Clippers' DeAndre Jordan dunks and takes over YouTube; or when point guards like Raymond Felton of the Knicks and Brandon Jennings of the Bucks help lead their teams to the NBA playoffs.

But what you don't see is the relationship we are building with the younger consumer on the court, not because of marketing, but because we are making real headway in building product they respect. And that authenticity is where we are focused, making the best product for players at the NBA, collegiate, high school, grassroots and AAU levels. Once that authentic on-court relationship is well established, it will enable us to bring a much wider range of product to market in this category.

I talked earlier about our Q1 brand holiday and how effective it was in driving traffic to our site in our retail partners. The strategy behind these holidays is pretty simple: cluster our marketing and communications at specific times of the year across all our platforms and drive our consumers into retail. Maybe a little old-fashioned

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in today's modern world of reaching consumers, but in Q1, our strategy worked. Our Direct-to-Consumer business grew 31% in the quarter, accounting for 26% of total revenues. Our Factory House business was strong and we saw a solid uptick in our e-commerce business in both our average order value and our traffic on the site, driven without question by our I Will brand holiday campaign.

When we opened the UA brand house in Baltimore this February, our goal was to provide the widest breadth of Under Armour products in one retail experience. As part of that, we specifically saw the opportunity to create greater awareness for our Women's and Footwear businesses specifically. And while it's still a very early read, that's exactly what we've seen to date.

As we expand the breadth of our product, Women's, Footwear, Youth, accessories and outdoor, we continue to look for opportunities to broaden the access points to new consumers. We believe the way we're able to showcase the full Under Armour experience at our brand house in Baltimore is an integral step in helping us tell our story. And our existing retail partners will benefit as well as we learn more about our consumer and what they want from our brand.

I talked earlier about how the pace of our product development is helping us grow our business at a market-leading rate while reaching new consumers with great new product and new distribution. Our Q1 results are a great example of our ability to execute this from a distribution perspective as well. Our wholesale business, with our long-established retail partners like Dick's Sporting Goods, The Sports Authority, Academy, and Hibbett Sports is very healthy and accounted for the bulk of our growth in the quarter.

On the department store side, partners like Macy's, Nordstrom, Dillard's, and Belk saw growth with new initiatives like Women's, Youth and Underwear. So our distribution equation continues to work well, grow our share and drive traffic in our wheelhouse distribution of sporting goods while, at the same time, strategically growing in the department store channel to reach a broader range of new consumers.

We talk a lot about continuing to grow our share with the core UA consumer while introducing the brand to a new audience and we see the three brand holidays planned for 2013 as a key driver of that strategy. The first brand holiday was highlighted by our television campaign, which focuses on innovation and the next generation of athletes. The spot features Sloane Stephens, the number-two ranked American in women's tennis; Bryce Harper who's also a great star for the Nationals in Major League Baseball; Canelo Alvarez who's fighting tomorrow night for three super welterweight titles; and Armour39, our new biometric performance-monitoring system for athletes. We are extending the campaign into the current quarter, amplifying elements of the spot that resonated strongly with our consumer.

As I mentioned earlier, we're really excited about how the campaign has driven traffic to both our retail partners and our e-commerce site and we feel this regular cadence will help do that on a consistent basis going forward.

And lastly, we've signed on to be the official supplier for the U.S. women's and men's gymnastics teams this year, enabling us to take a prominent place with a global audience at the next two Summer Olympic Games. I reference the global audience because reaching that consumer outside the U.S. market is a key piece of our growth strategy going forward. I'm just back from a trip to Asia of five markets in six days and came away emboldened by the size of the opportunity for the Under Armour brand outside of the United States. Our strategy to grow these markets is straightforward: set priorities, go where the opportunities are most evident, and invest in new market to see future growth.

With new leadership in our international business plus new talent in place in Europe and emerging markets like China and Brazil, we are establishing that pathway for growth internationally. We'll be discussing our

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international priorities at our Investor Day in June. But it's important to understand that our 2013 product portfolio gives us confidence that we enter this next phase of growth with the product muscle to match the power of our brand.

So in summary, another great quarter for Under Armour, one where we've seen a good return on the investments we've made in businesses like Women's, Footwear, and Retail. Our track record in this area is well established. We have continuously invested as we continue to grow and we look forward to giving you more color on those investments and strategies at our Investor Day on June 5.

And with that, I'll turn it over to Brad.

Brad Dickerson

Chief Financial Officer, Under Armour, Inc.

Thanks, Kevin. I would now like to spend some time discussing our first quarter financial results and our updated 2013 outlook. Our net revenues for the first quarter of 2013 increased 23% to $472 million. Apparel grew 22% to $346 million during the quarter from $283 million in the prior year, representing the 14th straight quarter of at least 20% growth for our largest product category. Two of the largest contributors to our apparel growth during the first quarter were our new HeatGear Sonic Baselayer line and our expanded fleece assortment, with fleece revenues for the quarter nearly doubling year-over-year.

We saw additional gains in Women's with new introductions in Studio, Armour Bra and running. Growth in our Youth business also continues to be impressive.

Our Direct-to-Consumer net revenues increased 31% for the quarter, representing approximately 26% of net revenue compared to approximately 25% in the prior-year period. In our retail business, we opened one new Factory House store during the first quarter, increasing our domestic Factory House store base to 102, up 21%, from 84 locations at the end of last year's first quarter. We remain on pace to open 10 Factory House stores during 2013. As Kevin mentioned, we also introduced the first UA brand house store in Baltimore during the first quarter.

In e-commerce, we achieved the highest growth rate in the past four quarters as our brand holiday helped generate improved traffic and average order values.

First quarter Footwear net revenue increased 27% to $81 million from $64 million the prior year, representing approximately 17% of net revenue. New running products, led by UA's Spine Venom, continues to be the largest contributor to category growth.

Our Accessories net revenues during the first quarter increased 22% to $36 million from $30 million in the prior-year period. We experienced strong results in headwear and headbands, which helped offset the planned wind-down of our current inventory of bags as we begin to relaunch the category toward the end of the second quarter.

International net revenues increased 41% to $31 million in the first quarter and represented over 6% of total net revenue, highlighted by strong growth with our Latin American distributors.

Moving on to margins; first quarter gross margins expanded 30 basis points to 45.9% compared with 45.6% in the prior year's quarter. Three primary factors drove this performance during the quarter. First, we continued to realize lower product input costs, primarily driven by North American Apparel, which positively impacted gross margins by approximately 100 basis points. Second, our overall sales mix was less favorable year-over-year, which

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negatively impacted gross margins by approximately 35 basis points. Third, we continued to look through some of our recent supply chain challenges resulting in higher airfreight, which negatively impacted gross margins by approximately 35 basis points.

Selling, general and administrative expenses as a percentage of net revenues deleveraged 390 basis points to 43.1% in the first quarter of 2013 from 39.2% in the prior year's period. The SG&A expense rates fell below our initial guidance of 44% to 45%, largely driven by a partial shift in certain marketing costs to the second quarter and overall top-line performance.

Details around our four SG&A buckets are as follows. First, marketing costs increased to 13.3% of net revenues for the quarter from 11.5% in the prior-year period, primarily driven by our new I Will global marketing campaign. Second, selling costs increased to 10.7% of net revenues for the quarter from 9.8% in the prior year period, primarily driven by the growth in our Direct-to-Consumer business. Third, product innovation and supply chain costs increased to 10.5% of net revenues from 9.8% in the prior year period, largely related to our expanded West Coast distribution facility and higher incentive compensation expenses. Finally, Corporate Services increased to 8.6% of net revenues for the quarter from 8.1% in the prior-year period, primarily given higher incentive compensation expense.

Operating income during the first quarter declined 45% to $13 million compared with $24 million in the prior period. Operating margin contracted 350 basis points during the quarter to 2.9%. Our first quarter tax rate of 39.9% was unfavorable to the 36.6% rate in last year's period when we received a state tax credit. As a result of our higher planned SG&A expenses during the first quarter, our net income decreased 47% to $8 million compared with $15 million in the prior period. First quarter diluted earnings per share declined 47% to $0.07 compared to $0.14 last year.

Now moving over to our balance sheet; total cash and cash equivalents at quarter-end increased 140% to $256 million compared with $107 million at March 31, 2012. Long-term debt, including current maturities, decreased to $60 million at quarter-end from $76 million at March 31, 2012. Inventory at quarter-end was unchanged year-over-year at $324 million.

Our investment in capital expenditures was approximately $11 million for the first quarter. We currently expect 2013 capital expenditures at the high end of our initial guidance range of $80 million to $85 million.

Now moving on to our updated outlook for 2013; our prior outlook called for 2013 net revenues of $2.2 billion to $2.22 billion, representing growth of 20% to 21% and 2013 operating income of $255 million to $257 million, representing growth of 22% to 23%. Based on our current visibility, we are raising our net revenues outlook to a range of $2.21 billion to $2.23 billion, representing growth of 21% to 22%.

We are also raising our operating income outlook to a range of $256 million to $258 million, representing growth of 23% to 24%. Below operating results, we continue to expect a full-year effective tax rate of 39% to 39.5% and fully diluted weighted average shares outstanding in the range of 108 million to 109 million.

With our first quarter results in the books, we have several updates to 2013 quarterly timing. First, net revenue. We currently see slightly stronger net revenues growth in the third quarter relative to the second and fourth quarter growth rates. Part of this third quarter growth rate reflects a modest shift of our back-to-school footwear ship dates from June to July. We also see the greatest sell-in impact from our new bags program during the third quarter.

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Second, gross margins. While first quarter gross margins came in slightly better than expected, we anticipate the remainder of the year to be relatively consistent with our prior guidance. We expect approximately a 100 basis point gross margin expansion in the second quarter driven primarily by favorable year-over-year product costs.

In the second half of the year, we continue to expect favorability from lapping last year's incremental airfreight and the excess disposition strategy at our outlet stores. These second half gains are expected to be offset by sourcing of key product to suppliers with better expected delivery performance but at a higher cost. This sourcing impact will be more pronounced during the third quarter as last year's sourcing changes and related costs commenced during the fourth quarter. Combining these factors for the full year, we continue to expect modest 2013 gross margin expansion from the 47.9% level in 2012.

As for SG&A, as we have discussed, our marketing strategy in 2013 is predicated around three brand holidays, which consists of consolidating spending at three key junctures during the year. While we deleveraged marketing expenses by 180 basis points during the first quarter, expenditures were less than anticipated given the decision to extend a portion of the first quarter campaign spend into the second quarter. Based on this action, approximately $5 million in marketing shifted from the first quarter to the second quarter.

This does not change our spending plans from the duration of the year and we still expect meaningful leverage of marketing expenses in both the second and third quarter followed by a more consistent year-over-year rate of spending in the fourth quarter. For the full year, the marketing expense rate is planned relatively flat with last year's 11.2% level.

Combining our other three SG&A buckets for the duration of the year, we expect expense leverage to occur in both the second and third quarters with expense deleverage planned in the fourth quarter. In all, we continue to expect a relatively consistent rate of overall SG&A spending for the full year and modest full-year operating margin expansion from the 11.4% achieved in 2012.

Finally, a few thoughts on inventory. Inventory growth has come in below sales growth for the past four quarters and we have known that we would continue to balance our inventory management efforts with our ability to service our customers and drive and improved fill rates. As we lap last year's supply chain challenges, we expect inventory growth will outpace revenue growth during the second and third quarters before closing the year slightly ahead of sales growth.

We would now like to open the call for your questions. We ask that you limit your questions to two per person so we can get to as many of you as possible. Operator?

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Camilo Lyon of Canaccord Genuity. Please go ahead.

Camilo R. Lyon
Analyst, Canaccord Genuity, Inc. Q

Thanks and nice quarter, guys.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc. A

Thanks, Camilo.

Camilo R. Lyon
Analyst, Canaccord Genuity, Inc. Q

Not to – Kevin, not to completely front row on the Analyst Day, but could you give us an early look on what direction international is taking now that Charlie has been there for about six months? What markets are you going to be focusing on first; perhaps what sports will you leverage to penetrate those markets?

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc. A

Yup. Well, you're going to get a really great dive on Investor Day on June 5 so we're looking forward to that, and I think really introducing Charlie to the investment community and getting, I think, the same confidence that we have internally with what – externally with what he's brought to the team here.

So, first of all, at a very high level, evolving the Under Armour business from being a North American company who's simply selling product in other countries to truly embracing being a global company, it's an initiative that we took on back in 2005 and 2006 when we first launched into Europe, and over the last seven or eight years, continued to make that evolution. Today I think that our goal is to be a global company that surely has three components where we're doing business, which would be the Americas, Asia and Europe.

So checking off the list, we've seen success in international. We've got confidence that our brand will translate. But if you look across where we've been successful, it's time for us to make, I think, longer-term investments. I think we've always talk about our growth being we're very fortunate to have a successful apparel business with the growth that you've seen in 14 consecutive quarters of growth there, north of 20%, as well as our Direct-to-Consumer business. And then we're starting to look for footwear, and then you'll see international come on and become important for us.

So Latin America for us, for one, Mexico, these markets I don't think we really considered were part of the conversation when we talked about things like Europe and China; places like Mexico, places like Brazil, places like Chile, Argentina, Peru are places where we believe that we can be successful.

Latin America is something that is really seeing some of the biggest profits that we're looking at from an international basis right now and really beginning to drive. We've recently announced hiring a new MD as a

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consultant right now that we anticipate moving into a full-time role in the near future as well in heading up our Brazilian business. And we'll look for sort of market entry there at the appropriate time.

Europe, we're in our seventh year. We've got a – we really are encouraged by the signs that we see. We feel that we're at the tipping point. When you look at sort of that seven-, eight-year timeframe, it's the point where things start to really begin to work for you; leveraging some of those assets that we've signed on the European side that we think play really on a global basis, whether it's Tottenham who's sitting in the top four, five or six at the league at any point in time in the English Premiership and, again, something that plays globally; or the Welsh Rugby Union which just recently won the Six Nations Championship for the second year in a row.

So we feel like we've got assets and continue to see assigned global assets, and that's something which is – again, part of the evolution as a company is moving away from just signing collegiate teams and things here domestically but really taking those dollars and having the discipline to spend on a marketing basis ahead of where we're seeing sales. So I think we've been encouraged by what we've seen by that happening.

Asia, I mentioned in my script that I just got back from a five-city tour over six days which was – it was a lot of work but it was something, I think, it was really eye-opening, too, and coming back encouraged and emboldened by the opportunity that we have there; Tokyo, Beijing, Shanghai, Hong Kong and Taiwan. And while it's a mixture between some of our manufacturing partners as well as some of the distribution opportunities we have, extremely encouraged. I mean, begin with Japan which now is in our 13th year of doing business together, a business that approached $US200 million in 2012 and we see on a current-currency basis, growing north of 30% and 40%. So really a very powerful partner for us and something that is well positioned. In fact that we – that's what probably gives us the greatest confidence that we can continue to grow.

So all these things, though, they pale and I'm giving you sort of the long-winded version or answer on our growth strategy, but a lot of it's about our evolution to being truly a global company. And so supply chain is one of the first things that Charlie has really dug into while being here in getting ourselves the capability to be fast, to be able to deliver and make sure that we can keep our – and service our retailers at the expectation levels that they have but, probably more importantly, that we have of ourselves.

So we are investing globally. The ROI on it is something that what we saw in Japan is something that's paying back for us. We've seen what we've done in Europe, we believe, is beginning to pay back for us. And that's both in terms of the revenues that come in as well as just some of the brand equity investment. So we understand that international is going to be a long-term play. We feel like we're in probably year seven or eight of that commitment and understanding that it's something that's not going to happen overnight, but we feel very good about our leadership and, frankly, the way we're positioned.

Camilo R. Lyon
Analyst, Canaccord Genuity, Inc.
Q

Sounds great. Thanks for that detail. And, Brad, moving on to, just touching on the supply chain, something that Kevin mentioned, how are the improvements in the planning process of supply chain helping to drive improvements in the gross margin part of the equation? And can this be a source of upside as fill rates improve throughout the year?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.
A

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Yes, Camilo. I think it's a couple of things there from a short-term and a longer-term view. So, obviously, from a short-term view, we've talked at length over the last few calls about some of the near-term challenges we had, especially relative to fleece and servicing of our fleece business and some of the challenges we had last year.

And because of that, some air freight that we've had to incur towards the end of last year and early this year. Also, along with resourcing some of that fleece product as we get into the back half of this year and then, obviously, that resourcing coming at a higher cost to us as we move into countries that are maybe – have some more high duty attached to them. So there is some near-term challenges that we've talked about at length the last few quarters that we'll see in the back half of the year and that's included, obviously, in our margin guidance for the back half of the year.

As far as longer term goes, though, a lot of positive things on the supply chain side. I kind of put it in the people, process, technology type three buckets. From a people perspective, probably the most important as far as the first step, a lot of new leadership in the building the last 18 months or so. I think we have about five new VPs in the last 18 months just in the supply chain side, and three of them are on the planning side. So a lot of great leadership there, which turns into much better processes and more disciplines in how we forecast our business, how we order our business and how we flow inventory.

And the last thing, I think, is systems, too, and I think we've talked the last few quarters, again, at some investments we're making in systems on the demand side and supply planning side of our business, which will help to give us a lot more visibility, not only to ourselves, but give more clear visibility to our suppliers, which enables us to make better commitments out going forward.

So although we see some near-term challenges here, I think some of these things that we've been working on in people, process and technology going forward should be a catalyst for us to start to see not only – continue to improve our inventory management going forward in 2014 and beyond, but absolutely that should play a part in what we had hoped to be some gross margin gains as we get into the outer years. And obviously, that's another topic at Investor Day that we'll go into a little more detail on also.

Thomas D. Shaw
Director-Investor Relations, Under Armour, Inc. A

Operator, we'll take the next question, please.

Operator: Our next question comes from Sharon Zackfia of William Blair. Please go ahead.

Sharon Zackfia
Analyst, William Blair & Co. LLC Q

Hi. Good morning.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc. A

Hi there.

Sharon Zackfia
Analyst, William Blair & Co. LLC Q

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Just two questions, if I could. I guess, first, on the updated revenue guidance, obviously, 23% revenue growth in the first quarter, I think you raised to 21% to 22% for the full year. So is there anything that's kind of giving you caution as you look forward to the rest of the year?

And then secondly, on the Brand House in Baltimore, it sounds like you're learning a lot there and it's pretty exciting. Do you see the opportunity for that kind of presence in other markets either domestically or internationally? And when you mentioned kind of leveraging that with your wholesale partners, could you give us some more detail on that?

Brad Dickerson

Chief Financial Officer, Under Armour, Inc.

A

Sharon, I'll take the revenue question first. Not really changing too much as far as our outlook for the year goes. I think you can look at Q1 and say that we came in a little bit better than anticipated. I think maybe the weather helped a little bit in Q1 as far as a little bit of an upside for us in our business as we had some good transitional product out of Q4 last year into the first few months of this year, which put some freshness on the floor. And obviously, we had the ability to service that colder-weather business the first few months. In addition, our e-commerce business came in a little bit better than we anticipated in the first quarter, which was good. That obviously helped on the gross margin side a little bit too.

So looking forward, as we look past Q1, we don't see a lot of change in our – from our initial guidance back in January for the rest of the year. We still have to look at the back half of the year and play a part in how not only we, but our customers, our retail customers, are managing their Q3 and Q4 inventory levels for fall, winter, obviously coming out of two warmer winters. So there's probably an impact to that relative to some view towards the back half of the year. But other than that, I think really a lot more of a consistent view for the rest of the year than we had back in January.

Brad Dickerson

Chief Financial Officer, Under Armour, Inc.

A

Sharon, let me jump on the Brand House question that you asked about. First of all, I think we're really pleased with what we've seen so far and we're certainly not declaring victory at any level. Again, this is the type of store that we would typically open in a warehouse or someplace and make it more of a lab store. Having the ability to have real live bodies walk through and get a read on how the consumer reacts to it is something that's been eye-opening; it's been very telling and produced a tremendous amount of learning for us at the same time.

So just some of the specific learnings we've had is that localized products have been really important to it. So I think there's something that people really personalize with Under Armour about being that local hometown hero. And so when we play on that, whether it's graphic programs and other things that really make the product feel like it's part of the community is very important. Doing that on a broad base is something that – is why we have been a wholesale distributor for a long time, because our partners do it very, very well.

However, two of the big priorities we had was successfully elevating Women's and Footwear. That's two areas that we've seen really great growth, actually trending pretty far in front of what we've done or what we're doing currently in our wholesale business. Footwear, for instance, is a – as a category, we're doing nearly 2X the volume that we're doing with our wholesale accounts.

So I think really highlighting getting the breadth of product, the ability for us to create an unedited merchandising assortment is something that really plays well for us and finding out the opportunities that we have with the

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consumer. Again, the primary goal of even having this store to begin with was to be able to get closer to our consumer and learn and use this, frankly, as a tool to enhance our wholesale relationships.

As I say that, though – and international becomes more and more important and the needs that Charlie has across markets and whether it's in Mexico, whether just coming back from the trip in Asia, particularly through China, where we've got four stores open today. We've got several more planned to open before the end of the year and some are wholly owned shops and some are shop-in-shops as well, but in all of them, it's about ourselves controlling our retail presentation and the way that we look. And so becoming expert at that is something we really want to keep close to home and ensure that we have that capability on a global basis. And then we'll be thoughtful and strategic here in the U.S., not over-cannibalizing any of our existing partners, but frankly, where we can find new consumers.

So we are committed to having one additional store before the – it will open before the end of the year and, again, continue the learnings going on. But in order for us to be the global brand that we expect to be, having and being proficient in specialty retail, we think, is extremely important in part for our performance here in the States, but probably more importantly as we look to go abroad and become the world's number one performance athletic brand.

Sharon Zackfia
Analyst, William Blair & Co. LLC
Q

Okay. Thank you.

Operator: Our next question comes from Jim Duffy of Stifel. Please go ahead.

Jim V. Duffy
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Thanks. Good morning. Hey, Brad, you mentioned in the script, mix was a drag to gross margin. Can you talk a little bit more about which were the categories that mixed up to work against the margin?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.
A

Yes, Jim, for Q1 – for the first quarter, again, most of these mixes were somewhat anticipated coming into the quarter. Factory House was a little bit of a drag as far as our excess versus made-for mix. That was more of a overhang from last year's excess product that had carried into the first quarter. So that came in a little bit more on the excess side than we anticipated in the first quarter. And also, on the Latin America side, we talked about good growth in our revenues in Latin America. Most of that is distributor-based business, which comes at a little bit lower gross margin, so that also impacted – that was anticipated and impacted the mix of our Q1 margins.

Jim V. Duffy
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Got you. And then you're having good success with the Spine platform, can you speak to any updates on where you are with Footwear gross margin and opportunities for improvement there over the balance of the year and looking forward?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.
A

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Yes. On the Footwear margin side, we've been talking – the Footwear gross margin is being kind of in the low 30s for us as an overall company. We're seeing relative consistency there right now year-over-year in Footwear gross margins. Again, I go back to my comments earlier on the supply chain side about short term versus long term. I think in the near term, we'll see relative consistency in Footwear margins overall as we get through the year. But in general, longer term, not – pretty consistent with my overall comments on supply chain. A lot of things going on relative to how we plan our business, how we buy and flow our inventory, which should help – which obviously helps us manage excess inventory.

And obviously, just on the Footwear side especially, the ability for us working with our vendors and our suppliers, and obviously getting talent in-house to be much more efficient and effective around cost management on the Footwear side should give us some abilities longer term.

Jim V. Duffy
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Great. I look forward to seeing you guys in Baltimore in June.

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.
A

Thanks, Jim.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.
A

Thanks, Jim.

Operator: Our next question comes from Lindsay Drucker of...

Lindsay Drucker Mann
Analyst, Goldman Sachs & Co.
Q

Hey. Good morning, everyone.

Operator: ...I'm sorry, Goldman Sachs. Please go ahead.

Lindsay Drucker Mann
Analyst, Goldman Sachs & Co.
Q

Hey. Good morning, everyone. I just had a couple questions. First of all, on the Direct side, can you sort of parse how e-commerce was versus your stores, and then within stores, how comps were versus maybe some of the new store productivity?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.
A

Yes, Lindsay. We don't really break out in our DTC numbers retail versus Web for the most part. But what I can tell you is with the 31% growth in DTC, the Web had a higher growth rate than our retail stores. That's pretty much all I can tell you. We don't really get into the differences in – quantify the differences between the two.

And also, we really don't talk about comps. For the most part, you have to remember that we have a lot of changes going on with some high growth in a lot of our doors and Factory House over the last couple years. Plus, we're also

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upsizing a lot of doors, increasing square footage and so forth, too. So the comp number's a little bit challenging and difficult and I think a little less meaningful for us right now in our evolution.

Lindsay Drucker Mann
Analyst, Goldman Sachs & Co.

Q

Okay. Are we totally past some of the conversion issues and other problems that you guys had experienced on your website several months ago and we're looking towards a better operating platform?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.

A

Yes. I'd love to say we're totally past it. I think we had some good signs in Q1. I think we still have some work to do. Probably the biggest positive impact we saw was just really aligning that brand holiday Kevin was talking about with our business on the e-commerce side. And that – really making sure that we're driving the right traffic, and we saw increase in traffic relative to when we were spending during the brand holiday. And also saw our average order values increase, which I think is a combination again of the brand holiday and also some better fill rates in our overall supply-chain side of our business, too, especially on the e-commerce site.

So I think there's some positive signs there. We like the direction we're heading in. I don't think we're ever satisfied relative to where we are; we still see some room for improvement. But definitely with our growth rate really kind of approaching last year's growth rate relative to where we were in Q1 with the Web, we feel like we're heading back in the right direction again.

Lindsay Drucker Mann
Analyst, Goldman Sachs & Co.

Q

Okay. And then lastly, just pretty favorable spread between your inventory and sales growth; just curious if you had any comments on that and how we should think about the implications for gross margins for next quarter.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.

A

Yes. Again, if you look at the rest of the quarters, if you go back to last year, we talked about some challenges in getting product in on time and so delivery was kind of a challenge last year, especially as we got into Q3 and Q4 last year. So I think some of this, with inventory – we're guiding to have inventory growth ahead of revenue growth. Part of it is just kind of lapping some challenges we had last year. So we definitely anticipate flowing product much more efficiently this year, especially our fleece product, and that will cause some quarter-end growth over last year.

And by the fourth quarter, again, we're just kind of guiding slightly ahead of revenue growth. Again, I think some of the supply chain challenges lasted through Q4 into Q1 of this year. So, again, a little bit more of a comp issue to where we were last year more than anything.

As we've stated in the past, right now we're really focused on kind of that three turn in inventory. We were probably a little bit ahead of that last year, in the back half of the year especially, so we're focusing more on that three turn right now, which just means that we'll have inventory grow a little bit ahead of revenue. We're really focused right now on just more supply chain efficiencies, fill rates, servicing our customers and staying around that three-inventory turn.

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Lindsay Drucker Mann
Analyst, Goldman Sachs & Co.

Q

Great. Thank you.

Operator: Our next question comes from Omar Saad of ISI Group. Please go ahead.

Sam S. Lee
Analyst, International Strategy & Investment Group, Inc.

Q

Hey, guys. Good morning. It's Sam Lee in for Omar. Congrats on another strong quarter.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.

A

Thanks, Sam.

Sam S. Lee
Analyst, International Strategy & Investment Group, Inc.

Q

My first question is on Footwear. It sounds like you guys had a lot of success in running with the Charge and Spine platforms, but can you talk a little bit more about your plans for basketball and the opportunity there? I mean when do you see this moving from building an authentic brand, Encore, to more accelerating the pace of product introductions? And what will be the sign that you're there?

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.

A

Well, as we enter year seven in Footwear, and again, just a little bit of history for anybody that isn't familiar with it. But 2006, we introduced football cleats; 2007, baseball cleats; 2008, training shoes; 2009, running shoes; and 2010 was basketball. So I think some of the success that we're seeing on the cleated side, particularly in football and baseball, has taken us six, seven, eight years to get there and really have breakthrough innovation with things like the Highlight cleat that is – (a), it's driving volumes on a unit basis. It's important. It's certainly not mass, but it really is driving at 100 – last year $130 and this year you'll see us price similarly. And so, driving consumers with that $100-plus price point will be very important, but it's also going to do a tremendous amount to drive a lot of that volume in that $60, $70, $80 sporting goods wheelhouse.

So we'll continue to take advantage of that. I think basketball and, frankly, all of our categories are no different. You've mentioned some of the success that we're seeing in running right now. I don't think we're declaring victory by any stretch, but we're very encouraged by what we're seeing. The new Spine Venom is selling really well and really where we've focused within our key sporting goods distribution in places where we own 20%, 25%, 30% of the apparel floor space and making sure that we have a footwear presentation that matches that.

So we're excited I think about the commitment and, frankly, the recommitment we're getting from many of our accounts of getting us the presentation that we think is – that we're earning. So that will take time to happen. But all those categories, I think, from cleated, we know it's very small but it leads us to the larger categories of running and, of course, what we think we can do in basketball.

So as we're heading into playoff season here, a lot of good things, I think, particularly around what basketball can be and can mean for us. We've had a couple of shoes. One thing we know is that playability on court is very important. The consumer, particularly where we're very strong in sporting goods, that consumer is very much a team athlete who's looking for product that they can wear and that they can play with. And so our strategy is really

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around winning that athlete. We've got great partners between Footlocker and Finish Line that have really given us commitment. And obviously, they really own I think the – they own the basketball consumer at least. But on more of the performance space this is something we really want to make sure that we authenticate ourselves and we win.

And so it's going to be time and I think that we've demonstrated our ability and our patience to have that. I think we're very proud of the product that we have. I think we're proud of the growth that we've made in the product where, as I mentioned in my script, just the playability that we have from the professional ranks with – I think we've got seven or eight players under contract and we've got 15 or 20 more that wear our shoes because they like them, are very encouraging signs that go down to the impact we've made to the collegiate level, both in the men's and women side, through AAU and particularly at the grassroots levels.

So I think we're telling people that we're in this fight for a long time. I think that we can win here and we can be successful. And I think that the signs we have are very encouraging. S, our footwear business, as a whole, we went through that phase and I began this answer with listing over the years the categories we've launched into. We're not launching any new categories anytime soon. Our commitment and our focus is becoming excellent in the categories that we're in today. My original partner, Kip Fulks, is driving that business for us and we're very encouraged by what we've seen. And I think we've got a good team and we're going to continue to bring talent to our team and bring the resources that we need to become a market leader in that – in footwear as a whole.

Sam S. Lee
Analyst, International Strategy & Investment Group, Inc.

Q

Great. Thanks, Kevin. I'll let others jump on here. Thanks.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.

A

Thank you.

Operator: Our next question comes from Chris Svezia of Susquehanna Financial. Please go ahead.

Chris Svezia
Analyst, Susquehanna Financial Group LLLP

Q

Thank you for taking my questions. Good morning, everyone. Brad, a question for you; I'm just curious on the gross margin trajectory, any color you can add about the back half? Are things, particularly in the third quarter from a sourcing perspective, going to mitigate the opportunity to show any gross margin growth? And then maybe in the fourth quarter, is there an incremental opportunity maybe driven by Direct-to-Customer? Just any color you can add about the cadence when you think about gross margin in the back half.

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.

A

Sure. So, as we've been guiding, the front half of the year definitely has the gross margin upside versus the back half of the year. And again, that's consistent with our comments during the last earnings call back in January.

Again, front half of the year, we're comping a pretty tough cost environment last spring – spring/summer 2012, relative to cotton product that was being sold at that point in time and some of the cost challenges there. So the front half of this year, comping that, we had some upside benefit year-over-year so that's the biggest driver in the benefit.

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As we get to the back half of the year, we're talking about a modest full-year gross margin benefit, with the benefit in the front half. What that kind of guides to is maybe a slight decrease in the back half of the year in gross margin. What you have going on there is some things working in our favor, like air freight would work in our favor as we are more efficient on the supply-chain side. But we have talked about resourcing a lot of our fall/winter product, specifically our fleece product, resourcing that from where it was last year to where it's going to be this year. It will help service our business better but it will come at a little bit higher cost. So, unfortunately, that resourcing in the near term is probably going to more than offset some of the benefits we have in air freight in the back half of the year.

Most of that is going to be pronounced early. If you look at the timing of that in the back half of the year, if you imagine what we were going through last year as we talked about the challenges in delivering fleece, specifically in Q3; so we were delivering fleece last year in Q3 from some lower-cost suppliers but we were having some challenges in getting it here on time. And we had talked about commencing the resourcing of some of that fleece, really, in Q4 last year. So we started to see some of the cost of this fleece escalate a little bit in Q4 last year so we just talk about kind of year-over-year comps and year-over-year view.

Q3 will be a much tougher comp as we're comping this lower-cost fleece last year that wasn't really delivering on time. As we get into Q4, we're comping a little bit better in the current year versus last year because we had already started to move some of that fleece supply, if that makes sense.

Also, in the Factory House side, we talked about last year moving a lot of excess product to our Factory House stores and that had a negative impact on our margins. We talked about that thing a little bit of a benefit this year in the back half of year. We still see a little bit of a benefit there but again, that's just going to be a slight benefit versus last year and will not help offset some of those resourcing of products in the back half of the year.

Chris Svezia
Analyst, Susquehanna Financial Group LLLP
Q

Okay. That's helpful. And just real quickly on the – can you remind us again how much of your business now on the outlet side is made for as we go into the back half versus last year?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.
A

Yes. On the made-for side for retail, we're probably in the – for the back half of the year probably in the high 50%s or so, close to 60% made for last year. This year, we probably see that maybe more in the – maybe closer to 70%, upper 60%s, so a little bit of a lift in made for year-over-year.

Chris Svezia
Analyst, Susquehanna Financial Group LLLP
Q

Okay. Okay. That's all I have. Thank you. All the best.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.
A

Thank you.

Operator: Our next...

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Thomas D. Shaw
Director-Investor Relations, Under Armour, Inc.
A

Operator, we have time for one more question.

Operator: Okay. Our final question comes from Faye Landes of Cowen and Company. Please go ahead.

Faye I. Landes
Analyst, Cowen & Co. LLC
Q

Yes. Hi. I was hoping you could – actually, two things. First of all, as you know, we've seen very strong growth from other suppliers of athletic footwear. Do you think the – is the market as a whole growing so dramatically or is something else going on?

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.
A

Hi, Faye. I'm not sure that – we're pretty focused on our own business and so we've got a dogfight that we go after every day. And, obviously, we understand our competition is pretty good on the footwear side. And so breaking into that is something that – we're digging in the trenches and while a rising tide raises all ships, and of course, that's a great scenario, I'm not sure that we're banking on that either.

We're viewing this as we need to (a), take share from others and so we're identifying places where we can win to do that. And then more importantly, we're also identifying places where we can create new share and create new opportunities. I think, again, what we've done in cleated with seven or eight years of expertise under our belt, creating silhouettes, styles and, most importantly, innovation that the market hasn't seen before.

So we're happy to be a part of a rising tide, but I think we're not – we're certainly not banking on it. But with 27% growth in the quarter, we're very happy with our team. I think we're making good progress. I think we see continued much brighter days ahead and we are adamantly committed to Footwear.

Faye I. Landes
Analyst, Cowen & Co. LLC
Q

Okay. Terrific, and then – but then on apparel, though, there's where everything seems to be growing, correct, right now?

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.
A

On the apparel side? Yeah...

Faye I. Landes
Analyst, Cowen & Co. LLC
Q

Yeah, that's what I was asking about. Nike had great apparel numbers. Also, C9, for instance, just seems like there's just tremendous robustness on the athletic apparel category in general. Is that a fair...

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.
A

I don't read the paper that much, Faye, so I'm focused on...

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Faye I. Landes
Analyst, Cowen & Co. LLC

Q

You're lucky, because -

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.

A

I read the Under Armour reports. I know. No, no, no. We're aware of what's happening out there so I think there's a good trend, obviously. I think sporting goods, sports apparel, athletic wear in general there's – obviously seems to be a bit of a trend toward it. A lot of factors pointing in toward that. The way we're positioned, I think, again, we're beneficiaries, but I don't think that – we're not playing our business to be part of some short-term or mid-term trend as much as we're building ourselves for long term. It's what keeps us rooted in authenticity in sport, but it also sees us expanding, particularly on things like the Women's side where I spoke a lot about just our commitment to expanding our distribution there as well as expanding our product line. And frankly, selling product where women shop, as well as having a point of view with product that women want to buy.

And so, with new leadership in place, our commitment to doing some of the things we're doing at our New York office, having Leanne on board. You'll have a chance to meet Leanne at Investor Day as well. And I think here, from the broader vision we have on the Women's side, as well as – I think a lot of the growth, as the market leader in men's apparel, as very close to that as we continue to drive on the women's side, too. We understand that we dictate the tempo for much of the trends that happen in the market.

And so, we believe that with the innovation we're bringing with things to the Men's side like Sonic Baselayer, from an innovation standpoint, with exciting new stories we have like Alter Ego, with some of the things we're doing on the Women's side from our capris, our Bottoms Bar, and also what we're doing just with color and becoming, frankly, a better company. We've been at it 17 years now and at some point you're going to start figuring it out.

So we're very proud of the team. First and foremost is that we think we're getting better. I think we're working together for a longer period of time and we believe that we can be the market leader and best in class. And so we expect to be the ones that are setting that tempo and dictating those trends.

Faye I. Landes
Analyst, Cowen & Co. LLC

Q

All right. Terrific. Well, congratulations on all that. One quick cleanup – one quick housekeeping. And I may have missed this, so I apologize. Footwear, did you break out – give us a sense of how much of the Footwear in the quarter was cleated and non-cleated?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.

A

Faye, we did not, but what I'll tell you is, by far, from a volume perspective and from a growth perspective in Q1, by far, running was the leader of that.

Faye I. Landes
Analyst, Cowen & Co. LLC

Q

So running was bigger than cleated?

Brad Dickerson
Chief Financial Officer, Under Armour, Inc.

A

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Yes. Yes.

Faye I. Landes
Analyst, Cowen & Co. LLC

Q

Okay. Terrific. Right. Thanks a lot.

Kevin A. Plank
Chairman, President & Chief Executive Officer, Under Armour, Inc.

Thanks, everybody, very much, and our hearts and prayers are with Boston. Thank you very much.

Operator: Ladies and gentlemen, this does conclude today's conference. You may all disconnect and have a wonderful day.

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