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Under Armour, Inc. (UA)

Q1 2019 Earnings Call

CORPORATE PARTICIPANTS

Lance Allega
Senior Vice President, Investor Relations & Corporate Development

Kevin A. Plank
Chairman & Chief Executive Officer

Patrik Frisk
President & Chief Operating Officer

David E. Bergman
Chief Financial Officer

OTHER PARTICIPANTS

Jonathan R. Komp
Robert W. Baird & Co., Inc.

Erinn E. Murphy
Piper Jaffray & Co.

Alexandra Walvis
Goldman Sachs & Co. LLC

Robert Drbul
Guggenheim Securities LLC

Edward Yruma
KeyBanc Capital Markets, Inc.

Michael Binetti
Credit Suisse Securities (USA) LLC

Matthew R. Boss
JPMorgan Securities LLC

Matthew McClintock
Barclays Capital, Inc.

Omar Saad
Evercore ISI

MANAGEMENT DISCUSSION SECTION

Lance Allega
Senior Vice President, Investor Relations & Corporate Development

GAAP AND NON-GAAP FIANCIAL MEARURES

- During our call we may reference certain non-GAAP financial information including adjusted and currency neutral terms which are defined in this morning's release
- We use non-GAAP amounts as the lead in some of our discussions because we feel they more accurately represent the true operational performance and underlying results of our business
- You may also hear us refer to amounts in accordance with U.S. GAAP. Reconciliations of GAAP to non-GAAP measures can be found in the supplemental financial tables included in the press release which identify and quantify all excluded items and provide management's view of why this information is useful to investors

Kevin A. Plank
Chairman & Chief Executive Officer

BUSINESS HIGHLIGHTS

Objectives

- With Q1 in the books we're off to a solid start to the year for Under Armour's business and brand
- As laid out in our last call, we are focused on four objectives as we work to deliver 2019:
    - First, the brand Amplifying our story and delivering innovative products and experiences that make our athletes better
    - Second, continuing to optimize our operations and investments to prioritize our premium athletic performance brand positioning
    - Third, building stronger relationships with our customers
    - And fourth, delivering on our financial plan to drive sustainable profitable growth over the long term

Under Armour Brand Performance

- With Q1 as a backdrop let's quickly touch on some of the progress we're making
- Starting with Under Armour brand performance, we're seeing strong momentum among athletes, products and experiences
- Perhaps the biggest athlete highlight was the NCAA basketball tournament where we had teams competing in both national championship finals with Notre Dame on the women's side and Texas Tech on the men's side

PRODUCT INNOVATION

- When considering that only five years ago we had just a handful of teams in the entire tournament to having 29 this year, we're excited to see our product innovation win on the court and our overall presence in basketball continue to drive brand heat and consideration
- In product, our big innovation stories for the year; Rush, Recover and HOVR are in the market delivering on our promise to make athletes better
- Rush and Recover use mineral-infused fabrics to enhance performance by recycling the body's natural heat to promote blood flow thereby improving endurance, strength and repair

UA HOVR

- Turning to UA HOVR with more than 12 styles across run, sports style, basketball and golf now available, we're driving positive results and reception
- In fact the HOVR Infinite running shoe was featured as the top pick by both Outside and Women's Running magazines and Runner's World featured the shoe on the cover of its spring 2019 shoe guide with the coveted Recommended Award

DIGITAL BUSINESS

- We're also continuing to build momentum in our digital business as we move to more aggressively integrate our Connected Fitness community at the intersection of train, compete and recover to connect even more deeply with our consumers
- From an operational perspective in order to deliver on our brand promise in this highly competitive landscape and most importantly, to be able to do it again and again, our investments must be optimized, targeted and return driven

STRATEGIC PLANNING PROCESS

- With a clear focus on athletic performance supported by an improved go-to-market process and the alignment of our category in regional structure now firmly in place, the integration into our long-term strategic planning process is considerably strengthening our ability to be consistent
- By operating more effectively across innovation, design, supply chain, marketing and sales, we're making the best decisions collectively for our brand
    - This cohesive effort further empowers our ability to reinvest back into our largest long-term growth opportunities, including footwear, women's, direct-to-consumer and our international businesses

Strategic Objective

OPENING OF NEW EMEA HEADQUARTERS AND UA BRAND HOUSE

- Two highlights supporting the strategic objective in the quarter included, opening our new EMEA headquarters in Amsterdam, which during this period of transformation and stabilization in this region meaningfully amplifies our culture and brand energy and gives great confidence in this team's ability to tackle its next chapter of growth
- We also announced the opening of the first UA BRAND HOUSE in India, where Michael Phelps joined Patrik and myself, along with others, to help celebrate our entrance into a market that is immensely passionate for sports and represents a solid opportunity for Under Armour over the long term

BRAND-RIGHT RELATIONSHIPS WITH KEY CUSTOMERS

- Next up is building stronger brand-right relationships with key customers, relationships that protect our premium positioning and allow us to mutually manage the marketplace with sustainable, profitable growth
- At the core of this effort has been a reset predicated on better segmented product, managed inventories and ultimately, improved service levels, all of which we've made excellent progress with

DIFFERENTIATION

- With respect to differentiation, throughout much of 2019, we're still in a bit of a hybrid period in between our previous go-to-market, the short-term things we were able to impact like SKU rationalization and channel optimization and our new go-to-market, which commercializes more meaningfully toward the end of 2019 and in the spring/summer of 2020

INVENTORY

- Of course, this is difficult if there's too much inventory in the marketplace, and in this respect, our global supply chain and sales organizations continued to do an extraordinary job managing our sourcing and customer relationships, getting our product for retail and empowering our ability to manage our marketplace more effectively
- With quarter end inventories down 24%, this is a significant accomplishment that allows us and our customers to ensure that our newest products are available at the right place at the right time, whenever and wherever consumers choose to engage Under Armour
- A key element of our success with our retail partners is how we service them, and I'm proud to say that we are seeing improved y-over-y service levels due to the ongoing process and structural improvements across our supply chain

- We're just running a better play, period

Financial Plan

- With that, let's finish out on our fourth area of focus, which is delivering on our financial plan
- In the quarter, slightly higher-than-planned revenue and gross margin, along with more disciplined cost management, delivered a better-than-expected bottom line
- With this slight over-delivery, we favorably adjusted our full year outlook
- This is not to say, however, that this will be our typical approach moving forward
- In fact, if we were to see additional top line or gross margin expansion above our plan, we may choose to further invest in marketing and product initiatives to support building the long term Under Armour brand

SUMMARY

- To sum it up, there is, of course, still more work to do on this journey
- Yet it is one we are really pleased with the progress we've made to ensure that we put ourselves in the best position to win
- There's little doubt that we're running more efficiently with clearer, greater purpose than even just a year ago
- Great brands endure and Under Armour will emerge from 2019 as an even stronger brand and company for our consumers, customers and shareholders
- We are exactly where we want to be

Patrik Frisk

President & Chief Operating Officer

FINANCIAL MEAURES

Discipline, Stability and Process Improvement Efforts

- Today's results are a good indicator that the discipline, stability and process improvement efforts are working
- Our go-to-market framework continues to strengthen our business by driving greater efficiencies, quicker decision making, and repeatable executions across our product, category and regional portfolio
  - And it's this repeatability just like training that is necessary and a vital foundation as we step up everyday to compete in the global market
- When competing the margin of victory can oftentimes be determined by one shot or by losing focus for even one moment

Multiyear Transformation

- Throughout our multiyear transformation, we have obsessed every detail, process and decision to ensure that we build the appropriate muscle over time to be able to compete consistently at the highest level
- By remaining disciplined and committed to optimizing our greatest strengths as a brand rooted firmly in premium athletic performance, we are indeed exactly where we want to be

Regional Performance

NORTH AMERICA

- Turning to our business
- Let's take a look at our regional performance in the quarter beginning with North America
- Revenue was down 3%, a little better than planned due to a slight benefit from operational enhancements and improved service levels
- As expected, our results reflect fewer sales to the off-price channel and softer demand in our direct-to-consumer business as we work to reset toward a more premium price point
- All said, we're right on track with our revenue expectation for the full year being relatively flat
- In the near-term with our foundation stabilized in this region, I am looking forward to digging in deeper with the North American team and continuing to execute against our long-term strategic plan by working to reestablish Under Armour as the performance authority in our largest market

OTHER REGIONS

- Turning to our other regions
- And as a reminder on our last call, we spoke about applying the lessons learned in North America in 2018 across our international business in 2019 including distribution optimization and strategic inventory management actions to ensure that we protect our premium brand positioning

ASIA PACIFIC

- Starting with Asia Pacific
- Revenue was up 25% with growth in wholesale, driven by continued expansion with key partners and higher sales to the off-price channel as well as sustained momentum in direct-to-consumer

EMEA

- In EMEA, revenue was up 3% driven primarily by growth in our direct-to-consumer business and revenue from Latin America was up 6%, driven primarily by wholesale
- And keep in mind that this result was negatively impacted by a few points from the change in our business model in Brazil
- Also of note is that toward the end of the quarter Mexico, we converted nine partner doors to owned locations; a measured investment in this region's largest market

Category Highlights

HOVR INFINITE

- Now turning to some of our category highlights
- HOVR Infinite is definitely creating opportunities for our run business with accelerating visibility and considerations seen across the price points throughout our running business, our disciplined approach to our channel allocation strategy means we are delivering the right volume of premium products for our consumers and customers at the right time
- Having gone from just two HOVR run styles last year to five today and more to come this year, our aperture is opening to include highly technical runners, an accomplishment we're particularly proud of

CONNECTED FITNESS ECOSYSTEM

- With the expansion of our digitally enabled footwear offering along with our Connected Fitness ecosystem of apps, content and experiences from training, competing, recovery and nutrition, tracking has never been easier
- Among our target consumer, the focused performers who use our apps, especially advanced features like training and running plans and gait coaching, we're seeing higher rates of engagement and conversion to buying Under Armour product than those who don't use our plans, all of which demonstrates that when we combine innovative product with premium experiences to make athletes better in the moment of sweat, we win

SPORTS STYLE

- In our sports style category, by leveraging our innovation technologies and remixing them with street-inspired design language in products like Forge 96 and HOVR SLK we're providing unique opportunities for athletes to stay in brand and creatively express themselves as they travel to and from their active use wearing locations
- And in our core sports category, the incredible roster of athletes and teams we support have had some amazing performances and moments in the first four months of the year
  - This category as we discussed at our Investor Day is at the heart of our brand
  - It's where we authenticate our position in performance, earn trust with consumers, and deliver products that make our athletes better for the moments they compete

TRAIN CATEGORY

- Wrapping it up with our train category, it's all about Rush, Recover and HOVR this year
- All of these innovations platforms purposefully consider the athletes' holistic fitness journey by delivering products that recharge, return and recycle their energy giving them every edge to improve their performance
- And with our first UA HOVR training shoe coming this fall, we're excited to continue to build on the momentum we've seen thus far and drive even greater consideration and opportunities to grow our footwear over the long term

Operational Perspective

- So before wrapping it up, I would be remiss to not mention that from an operational perspective, our Rush campaign which launched a couple of weeks ago was our first apparel innovation that was commercialized and launched globally through our fully integrated go-to-market process
- While still very early, we are encouraged by the initial reception and sell-through
  - This gives me great confidence that when we run disciplined repeatable plays, trust the process and deliver innovation that has style, performance and fit, we win

CLOSING REMARKS

- So in closing, we're making significant progress against multiple initiatives that prioritize our investments to high returns that support our largest global growth opportunities and strategic plan

David E. Bergman
Chief Financial Officer

GUIDANCE

Corporate Costs

- Given today's results, we are on track to deliver on our full year expectations
- And as we progress through the final year of our operational transformation we continue to run more efficiently and effectively toward driving long-term profitable growth
- Before we dive into Q1, I'd like to briefly touch on the change in how we are now reporting our segments
- As discussed on our last call, starting with Q1 2019 we have realigned our segments to exclude certain corporate costs and are now reporting these costs as Corporate Other
  - This includes the portion of global corporate overhead costs which to-date, have previously been recorded primarily within our North American operating segment

Supply Chain, Digital and IT

- A few examples include support functions like supply chain, digital and IT as well as the portion of sports marketing related to marquee athletes leveraged globally to grow brand awareness and consideration
  - We feel this change provides improved visibility with respect to the performance and underlying business results of our operating segments
- For easier comparability, we recast certain historical financial information to reflect this change, which was filed separately in our 8-K this morning

Q1 RESULTS

Revenue by Channel

- Now turning to Q1 results
- Revenue in Q1 was up 2% to $1.2B, or up 3% if you exclude the impacts of foreign currency
- Clicking down, let's start with revenue by channel

WHOLESALE BUSINESS, DTC AND LICENSING

- Our wholesale business was up 5% to $818mm driven by strength in our international business and slight growth in North America
- Direct-to-consumer revenue was down 6% to $331mm, due to softer demand and impacts from our shift toward more premium price points and lower levels of discounting
- DTC was 27% of total global revenue in the quarter
- Licensing was down 18% to $22mm driven by softer demand across our Japanese and North American businesses

APPAREL REVENUE, ACCESSORIES BUSINESS AND CONNECTED FITNESS

- By product category, apparel revenue was up 1% to $775mm
- Footwear revenue was up 8% to $293mm, primarily driven by growth in our run category

- And within our accessories business, revenue was down 11% to $82mm, primarily driven by continued softer demand and planned lower volume in North America related to a relaunch within our bags and backpacks business
- And finally Connected Fitness was up 4% driven by subscription revenue

Gross Margin

- Turning to gross margin
- We saw a 100 basis point improvement to 45.2% in Q1
- To walk you through the components of the improvement, gross margin was positively impacted by approximately 90BPS of supply chain initiatives including more favorable product costs; 60BPS related to prior year impacts from restructuring efforts; and 30BPS of regional mix, primarily due to the higher gross margin Asia Pacific business outpacing the growth of our other regions
    - These improvements were partially offset by approximately 70BPS of channel mix due to higher margin businesses including licensing and DTC, representing a smaller mix of the business in the quarter
    - This was coupled with a higher composition of off-price sales related to planned inventory management initiatives

SG&A Expense, Operating Income, Interest and Other Expense

- As a reminder for 2019, we expect the mix of off-price sales to be down y-over-y, therefore, providing a tailwind to our full year gross margin
- SG&A expense decreased 1% to $510mm, which was slightly better than expected due to the timing of certain expenses shifting out of Q1 along with overall cost management
- First quarter operating income was $35mm
- Interest and other expense was $5mm and our effective tax rate for Q1 was approximately 27%
    - Taking this to the bottom line, net income was $22mm or $0.05 in diluted EPS for the quarter

BALANCE SHEET

Cash and Cash Equivalents

- On our balance sheet, cash and cash equivalents were up 2% to $289mm
- Total debt was down 36% to $590mm
- CapExs were down 23% to $27mm and inventory was down 24% to $875mm, demonstrating our continued commitment to operational excellence
- Also in Q1 we implemented new FASB standard on lease accounting, ASU 842, which requires all assets and liabilities related to our operating leases of 12 months or more to now be recognized on our balance sheet

2019 OUTLOOK

- Turning to our 2019 outlook
- There is no change to our expectation that revenue should increase approximately 3% to 4% with relatively flat results for North America and a low double-digit percentage rate increase in our international business

Gross Margin and Operating Income

- Gross margin is now expected to increase approximately 70 to 90BPS compared to 2018 adjusted gross margin due to ongoing supply chain initiatives including more favorable product costs and lower airfreight coupled with channel mix benefits from lower sales to the off-price channel and a higher overall percentage of DTC
- Recall that in 2018 we had approximately 40BPS of negative gross margin impact due to our restructuring efforts
- Therefore, on a GAAP basis, gross margin should be up approximately 110 to 130BPS in 2019
- We now expect operating income to reach $220mm to $230mm, taking up the bottom end of the range by $10mm
- Moving forward, we will continue to evaluate and prioritize investments in key strategic areas to support our long-term growth initiatives, balanced with driving operating margin rate improvements

Interest & Other Expense, Tax Rate, EPS and CapEx

- Interest and other expense net is now planned at approximately $35mm as we paid off our outstanding term debt in the quarter
- And we now expect to be towards the higher end of our effective tax rate range of 19% to 22%
- Diluted EPS is now expected to be in the range of $0.33 to $0.34 and CapExs are expected to be approximately $210mm

Revenue

- Before we turn it over to Q&A, I want to provide some color on the balance of the year
- Based on our factors previously discussed, we expect second quarter revenue to be up 1% to 2% led by growth in our international and direct-to-consumer businesses tempered by a slight decline in our North America business
- As a reminder, Q2 2018 was our highest growth quarter of last year, with elevated inventory management actions as we work toward healthier inventory levels in North America

Gross Margin

- Second quarter gross margin should be up approximately 80 to 100BPS vs. last year's adjusted gross margin, or up 130 to 150BPS on a GAAP basis due to improved product costs and regional and channel mix benefits
- Within channel mix the benefits are primarily being driven by lower planned sales to the off-price channel compared to the prior year along with improving expectations for our DTC and licensing businesses

SG&A, Operating Loss and Inventory

- We expect second quarter SG&A to be up about 4% to 5% driven by additional planned marketing to support our innovation stories including Rush and HOVR along with increased facility, distribution and store expenses associated with the expansion of our international business as well as some of the timing shifts I mentioned earlier
- In total, when taken into context for H1 2019, SG&A should grow at a rate slightly higher than the rate of revenue growth
- Second quarter operating loss is expected to be approximately $25mm and diluted loss per share is expected to be approximately $0.06

- And finally, we're expecting inventory to decline at a mid-teen percentage rate at the end of Q2, which should then start to normalize during H2 landing closer to flat as we enter 2020

QUESTION AND ANSWER SECTION

Jonathan R. Komp
Robert W. Baird & Co., Inc.

Q

I want to follow-up on some of the comments really implying momentum that might be building on the premium footwear side with the run category. And then Patrik your comments on the initial response to the Rush apparel that's in the marketplace and I just want to understand maybe what you're seeing in terms of how some of those factors are really showing up in the marketplace and just given that you're still projecting slightly lower North America revenue in total, at what point do you think some of these new initiatives are enough to really drive an inflection in the overall business?

Patrik Frisk
President & Chief Operating Officer

A

Hi, Jonathan, this is Patrik. Yeah, we're really excited about what's going on in especially our run category right now with our second year into the HOVR platform. If you remember, we launched HOVR last year with two styles. That was the first time we really did it in a coordinated play in this new kind of go-to-market approach that we've had for the last little while in terms of doing it in a coordinated global launch. That was very successful. We're not expanding that with five styles this spring and adding more this fall. And what you're seeing is our ability to really do it in a coordinated repeatable way and we're seeing the same kind of encouraging results in terms of sell-throughs this year that we did last year now with more product in the marketplace.

So, we're really encouraged by this because it shows that when we do it right in terms of innovation, in terms of messaging, in terms of distribution segmentation and allocation, the consumer responds. And so we are now thinking about how we can scale that, of course, going forward.

And with Rush, it's a similar story. It's a limited allocated approach from our end, applying the same kind of methodology and discipline that we've done in the HOVR Run category and we're very encouraged by our ability to now execute also in apparel in the same way.

So, this is a beginning of a play that you will see from Under Armour and we just feel really encouraged by what we see early on. Now, remember Rush has only been in the market a few weeks, so there'll be more to come on that in the next call that we have for the next quarter.

Jonathan R. Komp
Robert W. Baird & Co., Inc.

Q

Okay, great. And then maybe a follow-up on just the gross margin progression that you're seeing especially with the inventory work down which has been impressive and given the comments that you could look to reinvest some upside if there were some, but when you look at gross margin starting to recover and the state of inventory today and yet you're only projecting a modest recovery in the gross margin relative to where it was several years ago. Can you just talk about as you continue to focus on a more segmented and premium product approach if there's kind of any upside potential that you see is the really into 2019 and 2020 from a gross margin perspective?

David E. Bergman
Chief Financial Officer

A

Hi Jonathan, this is Dave. We are definitely excited about the progress we're seeing in gross margin and bringing it back up to where we want to be longer term. When you think about the full year, a lot of it is driven by the supply chain initiative that we've talked about before and really starting to see more of a full year impact of those initiatives that we're starting to see some benefits in the back half of 2018.

When you think about the vendor and cost optimization we've been, doing reducing the SKU count, reducing the number of key vendors that we work with and really driving those costs down through those negotiations, also just with better pricing strategies as we kind of use deeper analytics around the architecture there, but then also just improved GTM process and supply chain management are also allowing for less airfreight. So, a lot of good things coming out of the supply chain initiatives as the processes and the transformation really kind of take hold for more of a full year impact this year.

But then from a channel mix this year as well, we are stepping off the off-price channel and we want to continue to do that in the future and we also have a higher DTC mix as we finish out the year as well. So, all of those things are going in our favor and we're excited about the continued improvement as we go forward as we talked about back at our investor call in December.

Erinn E. Murphy
Piper Jaffray & Co.

Q

I guess just following up on Jonathan's question on product momentum. I'm curious what you're seeing from some of your key customers in terms of how they're thinking about future space allocations just given some of the momentum you've seen over the last kind of three to nine months from some of your footwear initiatives and apparel. Are they actually changing what they're looking for in fall or spring of 2020? And then just a follow-up on the direct-to-consumer business. What did you see in the digital side of your business this quarter? Thank you.

Patrik Frisk
President & Chief Operating Officer

A

Yeah, hi. Erinn, this is Patrik. I think what we're really excited about in – and every region is a little bit different here. But in North America, we now feel that we've stabilized this region. And as you see by our inventory numbers, done a lot of work over the last year, year and a half actually to really clean-up the marketplace. So it's a much healthier marketplace and we clearly see that when we're providing newness into the channels it really works really well for us. So we're going to continue that work with our retail partners with a strategy to really win with the winners.

And I think earning it back takes a little time and that's really what you're seeing from the brand now. But as I said before around what we're doing in terms of some of these more premium offerings, we're learning a lot from our ability to actually execute and drive sell-throughs when we do it in a coordinated play. So we'll continue to do that and we'll earn our place back into the retailers. We feel really good about how the channels now are cleaning up in North America.

In our other markets, it's a little bit of a mix. In Europe, it's a mix between partnerships as it relates to doors and also in terms of wholesale. And we've done the same kind of work there that we've been doing in North America, right now. I'm very encouraged by some early results there too with these new initiatives around HOVR and Rush and so forth in terms of being able to coordinate it. And in Asia of course we continue to build-out our direct-to-consumer business. We'll be doing about 300 more doors a year. We're building a store every 36 hours or so. So we're still on track to really drive that business. But it is a process and it's going to over time improve. I would say that from a global perspective we now feel that we're much more balanced and we've stabilized in North America which gives us great confidence for the future.

Erinn E. Murphy
Piper Jaffray & Co.

Q

Great. And then just on the digital business, I was just curious what you saw there in the quarter.

Patrik Frisk
President & Chief Operating Officer

A

Yeah. I think in digital, it also – again it's a little bit of a mix. As we're move – we're stepping off the gas in terms of promotional activity and moving into more premium price points. We're doing that across the world. And so we're – it's a measured play from our perspective. We feel really good about our plan. The plan is still the plan. The same thing that we talked about at Investor Day in December, that's still holding true and we're really executing on that plan right now. So, we're encouraged by what we're seeing in terms of the response in terms of what we're doing from a full price perspective in that channel and we're going to continue to play our play.

Alexandra Walvis
Goldman Sachs & Co. LLC

Q

So my question is on the marketing spend. You mentioned a little bit of a ramp in marketing spend into Q2 to support some of those new product stories with Rush and Recover and HOVR and so forth. And you also mentioned some timing shifts going on there. I wonder if taking a step back you could comment on how happy you are with the level of overall marketing spend in the business. The rate came down a little bit in 2018 vs. 2017, and I wonder if you could talk about the ongoing efficiencies that you have there and some of the discipline in that marketing spend which is perhaps offsetting the ability to support some increased spend behind these new initiatives.

Patrik Frisk
President & Chief Operating Officer

A

Yeah, Alex, this is Patrik again. We're really encouraged by the go-to-market ultimately because that's the one process that we have where we're able to now also use a lot of our learning's from an analytics perspective.

So as we learn more, we're also understanding much better how to get a good return on investment, right, a good ROACE on our spend. And as we see opportunities, like Dave said, if we have opportunities we'll certainly be looking to see what we can do about those opportunities going forward.

But right now, we continuously see more effectiveness in our spend, as we drive our business through the go-to-market and using more and deeper analytics to really drive the business.

David E. Bergman
Chief Financial Officer

A

And this is Dave. When you think about just from a total dollar perspective, we're going to continue to kind of maintain in that 10% to 11% to 12% range of revenue, but we are ticking that up a little bit as a percentage this year vs. last year.

But I think the more important thing is the power of that spend is going to be a lot better, because we did step out of multiple commitments through the restructurings in 2017 and 2018, that probably didn't give us the return that we were hoping for.

So now, we still have that same percentage or even a little bit higher percentage of revenue that we can invest in a smarter way. So we should be able to get more bang for the buck which we're excited about.

Kevin A. Plank
Chairman & Chief Executive Officer A

That's a good point. We've got enough. We've got plenty of money. And we've said in the past is that we're big enough that we can do just about anything, we just can't do everything.

And so I think being more thoughtful and strategic and targeted with how we're spending those dollars, but we've got plenty of money we just need to make sure we're putting toward the right thing. I think you're seeing the brand do that.

Patrik Frisk
President & Chief Operating Officer A

Yeah.

Alexandra Walvis
Goldman Sachs & Co. LLC Q

Splendid, that's really clear. Thanks so much. I wonder if I could ask one more here on the direct-to-consumer business. You mentioned in your prepared remarks that some of the softness there was a result of softer demand.

And I wonder if you could elaborate on that comment specifically where that was being seen and perhaps the drivers of that.

Patrik Frisk
President & Chief Operating Officer A

Yeah. It needs to be taken into the context of what we're doing in terms of protecting our premium positioning as a brand and stepping off the gas in terms of being discounted online and so forth. So, as you do that it would be normal to see some softening in demand for sure.

So, we're expecting that to continue a little bit. And again, I reiterate the fact that we're on plan. We planned to do this just like we said in December in our last call and we feel really good about where we're at. We're right on plan right now. So you're going to see us continue to move to that more premium position across digital across the world.

Robert Drbul
Guggenheim Securities LLC Q

I just wondered, you talked a lot about the NCAA tournament but can you just talk about how basketball is performing for you, especially with what's happening in the NBA playoffs as well [ph] tonight? (35:03)

Kevin A. Plank
Chairman & Chief Executive Officer A

Yeah. You want to talk about that?

David E. Bergman
Chief Financial Officer

A

Yeah, Well, I think just a large part of the story that we wanted to paint in basketball was that if you look back at just the men's side of the NCAA tournament in 2014 we had one team. We had one team in the NCAA tournament.

This year we had 17 teams or 25% of the bracket. And that was all done through a strategy that we put in place. So, we typically, we overestimate what we can do in the short term and underestimate what we can do in the long-term, and that's something I think we're really proud of.

When you look at our basketball resume today, and again, back in 2014 we had less than 1,000 high school teams. Today we have more than 5,000 high school teams. We had just a few of the mid-majors. We put a strategy in place to go sign mid-major teams which were costing us money, but actually the kind of teams that we make money on. We were just getting started with Stephen Curry. We've since signed Joel Embiid. So, two all-stars on our roster today, both in the playoffs. So basketball from a brand sports marketing standpoint I think we're demonstrating that our product works. I mean, two teams in the final four, one in the championship game on the men's side, one in the championship game on the women's side.

So we've demonstrated that the product that we build we are capable and it's leaning into our performance there. So we believe that you'll continue to see that play out at the grassroots authenticity level. Again from 1,000 high schools in 2014 to more than 5,000 that we have today. So that's just it in the United States. And obviously it's a global game, but I think if you have to look positioning wise Under Armour is – we are one of the top two positioned basketball brands in the world right now.

And you'll see that begin to inflect with a signature series like we have with Stephen Curry and what he means and represents to us. But this is a long game. This is not something that's going to happen overnight, but we think that we're grinding them down and we'll continue to build our presence in a sport like basketball. We like our resume. We like our positioning and we like the future.

Robert Drbul
Guggenheim Securities LLC

Q

Got it. And could I just ask a question in the U.S. business North America specifically, can you just talk about like the outlook in sporting goods for you guys, athletics specialty, chain stores, just what you expect the rest of the year to get you back to flat from what we're seeing right now?

Patrik Frisk
President & Chief Operating Officer

A

Yeah. Hi, Bob. It's Patrik here. I think coming back to what I said a little bit earlier, first of all, we feel really good about where we're at in North America right now moving our brand into that premium athletic positioning again. We've stabilized the region. We're working hard to really win with the winners and we're doing that through servicing our accounts better, launching better product, making sure it's on time, it's the right product, the consumers responding, segmenting the product correctly, allocating it correctly. What – behind all of that though there is a long game here, because what happens is once you're out of favor, you've got to get back in favor. And that takes a little bit of time and we're kind of caught in the calendar a little bit right? So we're working our way through that, earning our trust back with the retailers.

Having said that, we feel that going forward into 2019 like Dave said, we're on plan. So in other words we're able to continue to run the play that we've orchestrated. We feel very good about that. We feel very good about the partnership that we have with our large retailers in every channel right now. We feel we have better segmented product, better innovative product and we're understanding better how to talk to the consumer. And we're able to orchestrate the play through to go-to-market and you'll continue to see that from us this efficiency play if you like in terms of ability to execute. So we feel great about 2019 and we're also really, really looking forward to continue to fight in 2020.

Edward Yruma
KeyBanc Capital Markets, Inc.
Q

It seems like one of the kind of call outs in the past couple quarters has really been the strength of international. I was wondering if you could give us a little bit more color on performance in Asia Pacific specifically China and then as you think of broadly I know it's a little early days in India, but kind of what gets you really excited about the market? And from a dimensioning perspective, how big could that market be over time for you? Thanks.

Patrik Frisk
President & Chief Operating Officer
A

Hi, Ed, this is Patrik. I would say that in general in international right now we feel really well about the balance that we have; stabilizing North America, continuing to have strong growth across all of our initiatives in Asia and taking a really good premium positioning approach in Europe, and as well as Latin America.

I would say that India specifically is something we're excited about. But again, India is a long-term play for us. We want to be present in that market. It's a huge market for the future. We're very encouraged by what we're doing there. We're going to be opening a number of new stores this year. First, signs are very positive. But again, India is much more of a longer-term play. But it's an important play for us. We want to make sure that we're everywhere in the world where the focused performer wants to engage with us and India is certainly one of those places. And we had a great time going there and engaging with the consumer face-to-face myself and Kevin. And we're looking forward to continuing to drive the business there.

Edward Yruma
KeyBanc Capital Markets, Inc.
Q

And maybe one quick follow-up. Kevin as the brand is probably newer to the APAC consumer I guess how have you changed the way you go-to-market from a brand perspective and I guess what's the perception of the brand today? Thanks.

Kevin A. Plank
Chairman & Chief Executive Officer
A

I think a lot of lessons learned. We want to be careful. We're proud I think of the work that the team has done, just some of the metrics that we've put up as a company, particularly the ability to drive inventory down and drive gross margin up. I think it demonstrates health in the brand and something that's very, very positive for us. But we're a long way from declaring victory. I mean, it is a journey and as we sit here in our 14th year as a public company, I get the luxury of perspective of looking back and just see all that's been accomplished.

I look at the lessons that we've learned in North America as a North American brand and we're in the middle of that journey again, because in order to be a great brand you have to be an enduring brand and that means you have to continue to reinvent yourself and I feel us doing that. But our ability to take the lessons that we've learned here in North America, and now apply them globally, specifically in markets like Asia Pacific where getting healthy, making sure that while top line is critical for us as we grow, we want a strong business and it's being able to implement the things that we've painstakingly done through our transformation over the last couple two to three years here that looking at things like our go-to-market process having that in place, the ability for us to upgrade our systems across the world. And so we'll have – a lot of the pain that we've taken in the last few years is something that's going to set us up, where getting us to $5B was a lot of physical muscle lift.

I feel a lot better about our ability to be able to do it by being a lot smarter and our ability to get from $5B to $10B is going to be a lot more thoughtful, a lot more experience and not requiring so much sort of physical labor. So I think we can be a much smarter brand. And you're seeing us apply that in APAC. The global operating model that we now have in place, it really empowers the regions. And so little to be said about what's happening in Europe and it kind of feels like it's the same story that's playing out in each region around the world. And so we're obviously like many we're incredibly excited about what Asia-Pacific, China in particular can mean for us. But we've got great leadership. We're setting up our new headquarters, Asia Pacific headquarters in Hong Kong right now and it's a lot of upside. But it is – it's taking the lessons that we've learned here and getting smarter and becoming a true global brand. But we also know as exciting as Asia Pacific and other regions around the world, winning here at home in the U.S. is something which is paramount to this brand. And you'll see us get smart about that too.

Michael Binetti
Credit Suisse Securities (USA) LLC

Q

So could you just speak to the past? I think can you just remind us is mid-single-digit increase still the target for direct-to-consumer this year? And then off the number in first quarter that's – obviously a pretty meaningful swing in the rest of year. Would you mind just kind of giving us the past maybe some of the components you see back from Q1 to get to that mid-single-digit increase for the year?

David E. Bergman
Chief Financial Officer

A

Yeah. Michael, this is Dave. We still are on plan. And so the mid-single-digit increase for DTC full year is still the plan and that's what we're driving through. And yes, you do see a low number in Q1. But there's a lot of underlying reasons, some of those we've given before relative to some of the doors that we're working through, also some of the changes in how we're continuing to optimize conversion.

We also had the Easter shift that we've talked about that affected us a little bit more in North America relative to Q1, Q2 flow. So that was a challenge on Q1 as well. And Q1 was also of 2018 our largest growth DTC quarter. So the comp is tough in Q1 as well. So there's a lot of different factors in play there. We're also opening a fair amount of new doors around the world especially in the Asia Pacific region as we go through Q2 through Q4. So again multiple things at play there, but we feel good about the mid-single-digit guidance for full year on DTC.

Michael Binetti
Credit Suisse Securities (USA) LLC

Q

Okay. That's helpful. And then on the – just maybe some housekeeping on the gross margin, I think you mentioned that the channel mix was 70BPS headwind in licensing DTC smaller mix within the quarter. Could you – would you mind breaking out how much was from licensing in DTC? And then I think rolling forward licensing should still be a headwind baked into your Q2 gross margin, but it sounds like DTC starts to improve pretty quickly here. So maybe that changes? Then finally how much does the pivot to lower off-price on a global basis y-over-y after being higher y-over-y and first quarter start to add to the gross margin as we get into Q2 and through the rest of the year? Any way to quantify that?

Kevin A. Plank
Chairman & Chief Executive Officer

A

There was a lot to that question. But when you look at Q1 the channel mix impacts, there wasn't one of the two that was that much more over-indexing there. Obviously, as we move further into Q2 and beyond the higher off-price starts to flip the other way and becomes actually a nice tailwind for us and pretty substantial as we finish out the year as we are planning to run off-price or to the off-price channel as a lower mix of our business in total for the year.

And then when you look at the DTC side, that will flip to start to be accretive to gross margin as well as we get out of Q1 and as we go through the rest of the year. And the licensing impact is not very significant on the full year at all. And so we really haven't called that out on the full year.

Michael Binetti
Credit Suisse Securities (USA) LLC

Q

Okay. Kevin, if I can sneak one more in just bigger picture. At the Analyst Day you were guiding for several hundred basis points of SG&A leverage from 2018 to 2023. It sounds like you found some investments that you find pretty attractive today. But that's a lot of SG&A improvement over the long range. So, you didn't change your outlook for revenues whatsoever obviously today, so there should be a lot of natural leverage in the model here, but does the target change or the timing of the ramp back to that SG&A level that you laid out at the Analyst Day change at all in your mind?

Kevin A. Plank
Chairman & Chief Executive Officer

A

You didn't really mean to ask me that question did you? Go ahead, Dave.

David E. Bergman
Chief Financial Officer

A

Michael, this is Dave. Obviously we've got a full year play here and we did deliver a little bit better than we expected in Q1. Again some of that is timing. So we're trying not to get overexcited about that. And obviously as Kevin mentioned in the script that as we work through the rest of the year, if we overdrive in some areas we may choose to reinvest to continue to fuel the brand for the rest of the – later this year or mainly into next year and longer term.

So, again, we feel good about where we are. We're running the play and the SG&A leverage that we expect in 2020 and beyond as noted in the Investor Day back in December that's what we're still holding to and we feel good about it.

Matthew R. Boss
JPMorgan Securities LLC

Q

I guess first on inventory management. Where did you see the primary delta vs. the down mid-teens forecast? And maybe Kevin, what's your view on the global athletic inventory position today? And then on that same note, how best to think about the spread between inventory and sales in the back half of the year?

David E. Bergman
Chief Financial Officer

A

Okay. Matt, this is Dave. Relative to inventory, we did finish a little bit better than we expected. That was largely driven by some timing of receipts within our international regions but also coupled with slightly better-than-expected Q1 sales. We're definitely proud of our progress there. As you think about it our inventory dollars haven't been this low since 2016. And back then we had $1B less in revenue. So definitely going in the right direction.

The other good thing to note is that within that y-over-y inventory balance, the mix of excess within that vs. current product has also gone down significantly. So not only is the inventory down 24%, but the health of the mix of that inventory and the underlying numbers is significantly better as well.

So, the actions we're taking are really working and paying off for us. And if you – I kind of want to give a quick shout out, I mean, the supply chain team, our regional commercial teams supported by finance, they're all driving through the GTM revisions and the inventory management initiatives. And it's really great to see that coming together and we're excited about what that's going to mean as we go forward.

Matthew R. Boss
JPMorgan Securities LLC

Q

Great. And then just a – maybe just a follow-up on the expense front, how best to think about SG&A dollar growth vs. revenues in the back half of the year? And then just maybe any update on the progress of your restructuring cost efficiencies and when we would see a potential impact from that?

David E. Bergman
Chief Financial Officer

A

Yeah. As I mentioned in H1, we are spending a tiny bit ahead of revenue as I mentioned. And you can see if you kind of back into our guidance that on a full year perspective, we're looking at maybe slight SG&A leverage. Again, we've got a lot of investments we want to continue to make even though we're driving savings and efficiencies in other areas. So, by default that means that the back half of the year, SG&A should grow slightly below revenue to be able to pull that off and that's what we're planning through and driving at, at this point in time.

When you think about longer term, the SG&A leveraging will come through a lot stronger in 2020 and beyond. Some of the restructuring efforts that we drove through in 2017 and 2018 have a delayed impact as far as some of those actual exits. So some things we negotiated in 2017 or 2018, you actually are not exiting some of those agreements until some point in 2019 or later in 2019, and so you don't see the real benefit of that full year until 2020 and beyond. So there's a lot of different initiatives at play there. But we're excited about the leverage we can drive in 2020 and beyond.

Matthew McClintock
Barclays Capital, Inc.

Q

I was wanting to talk about that from a high-level perspective, you've consistently outperformed the expectations that you've put out there, the plan that you've put out there. Today is a great example of that. Where are you finding the most resistance today to your turnaround plan or your turnaround efforts? That'd be my first question.

Patrik Frisk
President & Chief Operating Officer

A

Hi, Matt, this is Patrik. Thanks for that question. I don't really see a lot of resistance. I think it's more of a continued plan rollout because the reality of course is that we're working inside of a calendar that would shorten now. It used to be 22 months. It's now 17 months. So it is a steady progressive march towards a better future. And what you're seeing now here as we turn the corner into 2019 is a lot of the work really starting to pay off. We've stabilized our largest region. We've started to really go into a healthier marketplace for the Under Armour brand, where inventories to Dave's earlier point are now actually much, much, much healthier and actually from a position of strength if you compare it even back to as far as 2016. So it is a long play.

We are very confident simply because we're doing it through this go-to-market process where we are now orchestrating the play further out and then driving it home and learning from every time we actually go to market with a new season or a new launch. And then we're affecting future seasons from the learnings. So we're not meeting a lot of resistance anywhere. It's just that it takes a little bit of time to drive this through and we're feeling more and more confident that a lot of the things that we're doing are really working. But it will be continued work. Like we said at Investor Day in December, 2019 is still the last phase of our Protect This House chapter. And we feel really good about the plan that we currently have in place for 2019 and will continue to drive into 2020.

Matthew McClintock
Barclays Capital, Inc.
Q

Thanks for that. And then as a follow-up just on Europe. You talked about putting the global operational plan in place or infrastructure in place, et cetera. You're empowering the local regions. But just Europe, there's a lot of brands that have had a hard time cracking Europe as a whole and I was wondering from a local level, from more of a local level, what needs to be different about the approach there? And Patrik, please chime in because given your experience, but what needs to be different about the local approach to Europe to make it successful? Thanks.

Patrik Frisk
President & Chief Operating Officer
A

Yes. Europe is a little bit of a harder market to crack overall, right? You've got to really win it country-by-country. And in the U.S. of course you can scale quickly. And when it goes the other way it goes the other way quickly. In Europe, it is really a country-by-country approach. So for us what we've done with this global operating model that we put in place is we've ensured that with the new leadership in place in Europe and the structure that we have in Europe, we're now empowering the regional team to really prioritize how to win in Europe, right?

And you're doing that through a geographic play country-by-country, but also through a category play. And that's why we're so encouraged about some of the things that we talked about earlier around HOVR and Rush for example is because we're also seeing the effectiveness of this approach for our teams in Europe now that we're structured in this new let's say more empowered way for the region. So it is a country-by-country, channel-by-channel, category-by-category approach you need to have in Europe.

And you actually need to think about it that way because you cannot try to win in Europe all at once, right? It's really a longer-term plan and a very strategic plan in terms of how you do that. So it's feeding off global, driving regional and we feel that we have a plan in place now with great leadership over there. We're seeing some very exciting early response and results based on this new approach. And we're very, very diligent and deliberate about making that a premium approach. So we're not getting on top of our skis. We're making sure that we're thinking through the strategy and playing the play in a very orchestrated fashion and the go-to-market is enabling our teams to do that.

Omar Saad
Evercore ISI

Q

Just one kind of follow-up topic guys. Nice job in the quarter. And I'd really love to hear the premiumization strategy and really trying to reduce the reliance on discounting, especially in the DTC and online channels. Maybe if you could kind of elaborate on where we could expect to see that go from a consumer standpoint. Are you going to take the outlet side off the website? How do you really kind of keep that website and the e-commerce piece, that most premium product?

And then how do we think about that premiumization strategy in the physical channels whether it's your own stores or different wholesale channels, especially as it relates to the U.S. market which everyone knows tends to be the more competitive market and more discount-driven market vs. others overseas? Thanks.

Patrik Frisk
President & Chief Operating Officer

A

Yeah. Thanks Omar. This is Patrik. Yes. So, we have a plan in place for all the channels right and all the categories in terms of how we think about this. But it starts with understanding what goes where, right? So, it begins with a category channel segmentation strategy and then an ability to execute against that. So, the go-to-market is allowing us to do that and that's why we come back to this conversation around HOVR and Rush. That's pinnacle product being positioned in the marketplace and that's also what the brand is talking about right now which is important to us to really show up in a premium way.

I mean, who would have thought that we were going to be on the cover of Runner's magazine two years ago? I wouldn't have thought so certainly, but we are. And we're now starting to really connect with that more premium consumer looking for the best possible product in that category for example. And we're taking and applying that same methodology across everything that we do. You've seen the efficiency that we're getting through our SKU reductions. You've seen the benefit that we've gained from better allocation as we launch some of these more premium programs. We've taken discounting down in our digital space and also having less promotional days in our outlet channel over the last two years.

All of those things are contributing to this march towards a better more healthy brand. And it's enabled by the fact that we have – we're doing it with less product. So, fewer SKUs, more focus, and more strategic and process that enables us to play the play. That's really how we're thinking about it.

Kevin A. Plank
Chairman & Chief Executive Officer

CLOSING REMARKS

- Yes. I'd love to actually just finish up on that comment on what we're doing to driving premium brand
- The interesting thing about looking at the journey that our brand has been on in 23 years in, the 13 or 14 as a public company, and just seeing each one of these chapters as they've unfolded and when you talk about things like the premium positioning, I think it's perfect place of what and how we want to talk about our business. But understanding that what we need to do in order to become a great operationally excellent company in order to deliver on that premium position, particularly at the size and scale that we are now
- There's a lot of things that you can physically lift when you're smaller business, but we've just outgrown that

- And so I think we're going to really look back and appreciate the years of 2017, 2018, 2019, especially when you can look like 2018 where all the restructuring and growth that we had in getting healthy that we had while still growing the business over $200mm
- So, the one thing we know is that great product is going to win and that's one thing that continues to happen no matter what and the proof positive of that is just the athletes continuing to win in our brand. And again whether it's Brady winning Super Bowls, the NCAA finals for men's and women's in basketball, whether it's Steph and Joel Embiid in the finals of the NBA championship, whether it's Bryce Harper in baseball, the list just goes on and on. But the one thing I want people to know is that we are also going to continue to get louder as a brand
- We've been pretty quiet
- We've been talking about product stories
- We've been telling people about HOVR and Rush and that's what you see in our marketing
- But as we continue to get free and flexible, we get to move things around, you'll continue to see us get louder about telling people what and why this brand is so special. And the fact is that everything we build, everything we make does something. It makes our brand unique and it gives us an advantage and an edge especially to our consumers that allows them to give them superpower
- So we look forward to continuing to drive on that and really proud of the progress that this team has made
- I think the operational excellence that's being put in is something that will continue to come out and driving that premium brand position that we're all looking for
- So we have work to be done
- We are going to continue to win for our consumers, for our customers, for our shareholders and we look forward to that challenge