URBAN OUTFITTERS, INC.

Fourth Quarter, FY'20 Conference Call
March 3, 2020

<u>Participants</u>

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

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

The following discussions may include forward-looking statements. Please note that actual results may differ materially from those statements. Additional information concerning factors that could cause actual results to differ materially from projected results is contained in the Company's filings with the Securities and Exchange Commission. To find disclosures and reconciliations of non-GAAP measures that we use when discussing our financial results, please refer to our earnings release in the Investor Relations section of our website.

We will begin today's call with Frank Conforti, our Chief Financial Officer, who will provide financial highlights for the fourth quarter. Richard Hayne, our Chief Executive Officer, will then provide more detail by brand and comment on our broader strategic initiatives. Following that, we will be pleased to address your questions. As usual, the text of today's conference call will be posted to our corporate website at www.urbn.com.

I will now turn the call over to Frank.

Frank Conforti

Thank you, Oona, and good afternoon everyone. Before I speak to some of our thoughts for the first quarter and full fiscal year 2021, I want to note that none of our thoughts below include any potential impacts of the coronavirus. As of now, we are monitoring the situation closely, planning for as many as foreseeable impacts as possible and doing everything we can to support our business, our employees and our business partners who may be impacted by the outbreak.

With that said, as we kick off the first quarter and fiscal year 2021, it may be helpful for you to consider the following:

Our URBN 'comp' sales have started out the first quarter in positive territory. Based on our quarter-to-date performance, we believe our URBN Retail segment 'comp' sales could register low-single to mid-single digit positive for the first quarter, while we believe Wholesale sales could remain high-single digit negative for the start of the year.

We do believe that Wholesale segment sales could begin to recapture positive sales growth in the second quarter and achieve positive sales growth for the 2021 fiscal year.

We believe URBN's gross margin rate for the first quarter could deleverage by approximately 100 basis points. The decrease in gross profit rate could be due to the Subscription & Wholesale segments for the quarter, while the Retail segment gross profit margin could be flat to positive for the quarter.

Let's talk about the several moving pieces we have in gross profit margin.

First, the operation of our Subscription segment business, Nuuly will have a negative impact on our gross profit margin for the quarter and most likely the year. Currently Nuuly's gross profit margin is negative as we continue to leverage our investments and work to achieve greater operation efficiency.

Next, Wholesale segment gross profit margin, while it could be healthy and improved in the second half of this year, it could negatively impact our first quarter gross profit margin due to higher markdown allowances given to department stores and high inventory levels. Please note that Wholesale segment achieved a very strong 21% operating profit margin in the first quarter last year. We believe the Wholesale segment could reset itself around a healthy mid-teens profitability rate going forward. If this were to occur, this would deliver a nice improvement from the back half of last year.

Lastly, if current sales performance continues, our Retail segment margin could come in flat to positive for the quarter due to improved product performance and lower overall markdowns.

Based on our current sales performance and financial plan, we believe total SG&A could grow by approximately 9% for the quarter and the year. Under this scenario SG&A growth would primarily relate to the following:

- Increased incentive compensation expense vs. the prior year. In the prior year, the company and several brands did not achieve their planned financial performance, therefore, a low rate of bonus dollars were paid.

- Increased marketing expense to support our Retail segment and Subscription segment sales growth.

As always, if sales plans or other items do not go as planned, we maintain a certain level of variable SG&A spending that we can adjust up or down, depending on how our business is performing.

Our annual effective tax rate is planned to be approximately 27.5% for the year and 34% for the first quarter. The higher rate in the first quarter is primarily due to timing.

Capital expenditures for the fiscal year are planned at approximately $250 million. The spend and increase to the prior year is primarily related to investments in additional and expanded distribution facilities.

We will be completing our new European Distribution Facility in FY'21. We started this project in FY'20. This new facility replaces our current one where the lease is expiring, and we were more than out of capacity. We believe the new and expanded facility will more efficiently support our growing European business for the foreseeable future.

Additionally, we will be starting construction on an additional Distribution Facility in the United States. This project will take approximately two years to complete phase one. This facility will support the growth and expansion of our retail segment business in North America as well as provide more efficient logistics processing speeds as well as faster and more consistent delivery times to stores and our digital customers.

Lastly, we will be opening approximately 39 new stores and closing approximately 9 stores during fiscal year 2021. Our store growth number is up slightly from previous years due to favorable lease terms being obtained in North America. Currently, we are successfully negotiating percentage rent and significant capital reimbursement on many of our new and renewal locations.

As a reminder, the forgoing does not constitute a forecast, but is simply a reflection of our current views. The Company disclaims any obligation to update forward looking statements.

Now it is my pleasure to turn the call over to Dick Hayne, our URBN Chief Executive Officer.

Dick Hayne

Thank you, Frank, and good afternoon everyone.

Today I'll speak briefly about our fourth quarter results and then provide some commentary on current business trends, the macro environment, and growth initiatives before turning the call over to your questions.

I begin with URBN's fourth quarter performance. While Q4's 4% Retail segment 'comp' beat our forecast, additional markdowns were needed to achieve those sales and clear excess inventory. All three brands entered the quarter with elevated retail segment inventory levels. All were successful in lowering them by quarter's end and thus, entered the new year with reduced weeks of supply and cleaner stock levels. This should benefit Q1 performance, but the effect of additional markdowns in Q4 was to drive margins and profitability lower.

Of our three brands, Urban had the most challenging Holiday season, posting a flat 'comp' on higher markdowns and lower margins. Sales of women's apparel did perform slightly better than total but were also largely driven by higher mark-downs. By contrast, reaction to the Spring women's apparel assortment has been more favorable in both North America and Europe, and Urban's 'comp' sales have improved. We're encouraged by this trend, although it's still early to make predictions for the entire quarter.

Moving to the Anthropologie brand, 'comps' in Q4 were up an impressive 6% driven by positive results in both stores and digital. Product execution and marketing improved in the fall, driving that fiercely loyal Anthropologie customer back into stores during the holiday season. The brand did not disappoint and provided the customer with what I believe is a best in class store experience. This drove positive 'comp' store traffic and sales.

The brands' Holiday promotional calendar matched last year's in terms of number of events, depth of discounts and event duration. Even so, sales generated this year by those promotions came in significantly higher than last year and led to a higher markdown rate and lower margins. Anthro's inventories in Q4 started out high but were gradually reduced during the quarter and ended in excellent shape. As for Q1, 'comp' sales-to-date have maintained the fourth quarter trend. The leadership team is especially pleased with customer reaction to the new optimistic and colorful spring apparel assortment.

Once again, the outlier during the fourth quarter was the Free People brand. Retail segment 'comps' of +9% blew away plan. Sales were paced by full price apparel and robust digital growth. A standout was FP Movement, Free People's activewear brand. Sales of Movement product almost doubled during the quarter and the number of new customers grew by over 120%.

In addition to strong 'comp' sales, the Free People retail segment also achieved better margins and profits. The customer showed us she is very willing to spend at regular price when offered must-have products. The sales momentum created in the fourth quarter has continued into the first, and we believe Free People could be poised to deliver another outstanding retail quarter in Q1.

Unfortunately, the brand did not produce the same excellent results in the wholesale channel where, after many years of solid growth, revenues declined by 12%. Lower profits were driven by weakness in and chargebacks from the North American department store customer segment. All other customer segments – specialty stores, digital businesses and international partners – showed healthy year-over-year revenue gains.

The Wholesale team readjusted allocations to department stores during the quarter and the brand now believes that while Q1 will most likely see softer sales, the channel should return to solid profitability. After that, Wholesale's revenues and profits are planned to stabilize and then start growing again. This short-term blip in no way changes our enthusiasm for the channel or our commitment to our wholesale partners.

Now let me turn your attention to the macro environment. The US consumer is in excellent shape. The economy is strong, jobs are plentiful, and consumer sentiment remains high. She's optimistic and willing to spend when offered compelling products. As we think about the current year, we see plenty of fashion newness in women's apparel – more than enough to drive nicely positive 'comps'. Women's fashion is currently leading the 'comp' gains at all three brands. Traffic is up on a year-over-year basis in both stores and on-line, and she's not just looking, she's buying.

There is, however, one large caveat to this optimism – the COVID-19 virus. The risk to our company is two-fold. The first is to our supply chain. Fortunately, we significantly reduced our sourcing penetration in China over the past two years, moving from over 40% to less than 15% for production of our internally designed product. Getting accurate and reliable information from China is currently difficult, but we believe most Chinese factories and mills have re-opened with output running approximately 50% of capacity. The expectation is output will grow steadily over the next two weeks as workers clear the virus incubation period and return to work. In case that doesn't happen or happens more slowly, our teams are working diligently to secure alternative sources in other regions. We are aware that some delivery delays in the April/May time frame are likely. This would impact product flow and could increase landed costs, as well, as we form new factory relationships and use expedited shipping.

The second risk is disruption to the communities where we have stores, offices and fulfillment centers. We have no store exposure in Asia and our office in China is small. However, there is the potential for flare ups to disrupt communities in Europe and North America. At this time, we have no way to quantify this risk. The bottom line is COVID-19 creates supply chain uncertainty and could create demand uncertainty, as well. We are aware of these risks and have taken actions and made plans to mitigate their effect to the best of our abilities. Keeping our associates safe is obviously our highest priority.

Now allow me to talk briefly about three exciting growth initiatives at URBN. The first is Nuuly, our subscription rental and resale business. Six months after launch, customer acquisition is ahead of plan and today stands above 27,000 active subscribers. Feedback remains overwhelmingly positive and back-of-house operations are functioning smoothly, even in areas like laundry where we had no experience prior to launch. It is still early, and we have much to learn about this business model, but the reaction so far has excited us for the future. We will share more detailed operating metrics later in the year.

Another bright spot is FP Movement that I spoke about previously. Movement offers highly differentiated product and is gaining market share in the rapidly growing women's fitness and wellness space. The brand currently operates across all three distribution channels, including a landing page on the Free People website, more than 250 wholesale accounts and over 50 dedicated Movement shops within existing Free People stores. This year the brand will open three standalone FP Movement stores and plans to significantly increase that number in the next few years. Over the longer term, I believe Movement has the opportunity to rival the other URBN brands in terms of revenue size and profitability.

Our third growth initiative is opening 30 new stores in North America this year. Over the past five years, we slowed domestic store openings to a trickle because occupancy costs were too high especially in the primary markets. The leasing environment has now changed radically and is once again economically favorable. We have negotiated advantageous leases, many of which are percentage rent only with substantial build-out contributions. Furthermore, most of the leases are in non-redundant, secondary markets which tend to be our most profitable locations on a rate basis. An additional benefit is that opening a store in a new metro area typically drives additional digital sales, too.

Finally, one of our goals for FY21 is to stem the gross margin erosion at our two larger brands. To do this, we plan to increase the penetration of internally designed product. This means investing more in design and creativity. More and better internal product should increase IMU and lower the markdown rate. In addition, we plan to invest more in marketing and gently increase AUR.
So, as we think about the current year, we believe the customer is optimistic, consumer sentiment is strong, and our brands are resonating well. She's currently pleased with our fashion offering and our marketing messages. We realize there's elevated risk to our business and to global economic activity due to the new virus but believe any panic-like reaction will likely be reasonably short-lived. Finally, we're excited by our growth and business initiatives and the investments we're making in our new and existing brands.

In closing, I thank all brand and shared service leaders, their teams and our 24,000 associates world-wide for their hard work, dedication and creativity. I also recognize and thank our many partners around the world, and finally, I thank our shareholders for their continued support. That concludes my prepared remarks.

Thank you, and now for your questions.