URBAN OUTFITTERS, INC.

Third Quarter, FY'23 Conference Call
November 21, 2022

Participants

Richard A. Hayne, Chief Executive Officer
Frank Conforti, Co-President & COO
Margaret Hayne, Co-President & CCO
Sheila Harrington, Global CEO, Urban Outfitters & Free People Groups
Tricia D. Smith, Global CEO, Anthropologie Group
Melanie Marein-Efron, CFO
Azeez Hayne, Chief Administrative Officer and General Counsel
Dave Hayne, Chief Technology Officer, URBN and President, Nuuly
Barbara Rozsas, Chief Sourcing Officer
David Ziel, Chief Development Officer
Oona McCullough, Executive Director of Investor Relations

Good afternoon, and welcome to the URBN third quarter fiscal 2023 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the nine and three-month period ending October 31, 2022.

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.

On today's call you will hear from Richard Hayne, Chief Executive Officer, Frank Conforti, Co-President and COO, and Melanie Marein-Efron, Chief Financial Officer. Following that, we will be pleased to address your questions. For more detailed commentary on our quarterly performance and the text of today's conference call, please refer to our investor relations website at www.urbn.com.

I will now turn the call over to Dick.

Dick Hayne

Thank you, Oona, and good afternoon, everyone.

Today I'll begin the call with some brief remarks regarding our third quarter results and make a few observations concerning the consumer and the macro-environment. I will then turn the call over to Frank and Melanie who will provide more brand details along with our thoughts about future performance.

Overall, third quarter business performed in line with our expectations as discussed on the August call. URBN delivered 4% total revenue growth in the quarter against a strong third quarter last year. Retail segment 'comp' sales also grew by 4%. Higher AOV and AUR were the principal drivers of positive 'comps'. Nuuly also contributed to total revenue growth with an exceptional quarter that delivered revenues 178% above the prior year. Positive sales gains from the retail segment and Nuuly were partially offset by a wholesale revenue decline of 3% and a 200-basis point adjustment to total revenues due to currency exchange rates.

On our August call, we noted a bifurcation in our customers' shopping behavior with brands offering higher price points and serving a more affluent customer posting better results. The Anthropologie, Free People, FP Movement, and Nuuly brands all have customers who have been able and willing to spend despite the inflationary environment. In the third quarter, the customers of each of these brands drove strong demand. To date in November, we have seen a slight softening in demand. We attribute this to the unusually strong build in demand during early November last year when many shoppers felt supply chain problems would lead to empty shelves during the traditional holiday period and thus made purchases early. Overall, sales in November are on track to achieve our Q4 goal of delivering a Total Company 'comp' in the low single-digits.

Not all our brands, however, serve an affluent customer. Urban Outfitters customers are younger with less discretionary income and accumulated assets, and the current elevated inflation around necessities like rent, food and energy has had a greater impact on them. These customers are transacting less often and when they do shop, they're looking for a deal. The UO brand in North America began the quarter with heavy inventory left over from the 'bullwhip' effect brought on by Covid-induced supply chain issues. The brand is working through this excess inventory and is planning to be much cleaner by the end of Q4. The brand also faces some operational issues like product over-assortment. In Europe, the UO brand performed much better, benefitting from extra-strong store traffic, positive AUR and excellent marketing efforts.

Urban Europe, Anthropologie and Free People all drove strong full-price sales in Q3. If the current macro-economic situation doesn't deteriorate further, we believe the customer bifurcation will continue at least through the holiday season. As a result, we believe the Anthropologie and Free People brands could continue to post nicely positive results while the Urban brand might continue to underperform.

Looking forward to Q1 next year, the health of the economy remains highly uncertain, but assuming we avoid a major recession, we believe there are several reasons for us to be optimistic. Supply chain costs have dropped precipitously over the last six months and our speed to market capabilities are almost back to FY'20 levels. These improvements combined with other actions we launched to build margins like reducing our choice count by eliminating many smaller buys, and placing deeper buys of alpha product, should result in favorable IMU compared to last year. We also remain committed to entering the spring selling season with leaner inventories which would give us the opportunity to deliver lower markdown rates especially at the Urban Outfitters brand. Lastly, and maybe most importantly, we believe strong fashion trends remain in place for all our brands.

Finally, I'm pleased to report that response to Nuuly, our apparel rental business, continued to excel in Q3. On a quarter-over-quarter basis, active subscribers grew by 37%, surpassing the 100,000 'sub' milestone in early October and now posting in excess of 120,000 active 'subs'. Strong subscriber growth is allowing the brand to leverage expenses and make solid progress toward profitability. We look forward to celebrating Nuuly's first quarterly profit sometime in FY'24. With that, I will now turn the call over to Frank to provide more detail on our third quarter performance by brand.

Frank Conforti

Thank you, Dick, and good afternoon, everyone.

I will begin my commentary discussing our total Company third quarter results versus the prior comparable quarter, followed by some more detailed notes by brand.

Total Company sales grew by 4% to a third quarter record of $1.2 billion, driven by a total Retail segment 'comp' increase of 4% and a Nuuly segment sales increase of $23 million. These increases were partially offset by a 3% decline in Wholesale segment sales and foreign currency translation that reduced sales by approximately 200bps.

The growth in Retail segment 'comp' sales was driven by a mid-single-digit digital channel 'comp' sales increase and a low single digit positive store 'comp'. Nuuly's robust increase in sales was due to a significant increase in subscribers from the prior year. Wholesale segment sales decline was due to a decrease at Free People.

Although sales were positive, operating profits declined in the quarter. The decline in operating profits was largely due to increased markdowns during the quarter. Markdowns were higher than last year because the markdown rates last year at all brands were exceptionally low and because each brand had excess inventory in certain categories. Although each brands' markdown rate increased versus the low prior year rate, when compared with FY'20 this performance differed. The Urban Outfitters brand markdown rate increased the most significantly versus FY'20, due to elevated inventory levels, a miss in execution and a highly promotional environment. The Free People brand recorded only a slight increase in markdown rate versus FY'20, and the Anthropologie brand delivered a strong improvement in their markdown rate. I will discuss more on each brand performance later in my commentary.

Total inventory increased 19% versus the prior year. This represents a 25-point reduction from the year-over-year increase of 44% in the second quarter. Each brand has worked hard to improve its inventory to sales alignment, and we believe inventory will show a further reduction by the end of Q4.

The 19% third quarter inventory increase is due mostly, to higher inventory costs, earlier receipts than originally planned, and excess slower selling product in certain categories. The Urban Outfitters brand in North America has the most inventory to clear and will continue to deploy incremental markdowns throughout the holiday season to improve their inventory to sales relationship. We are working towards our inventory position being in line with sales performance by the end of the fiscal year.

In Q3 the IMU variance to last year was slightly positive. As the quarter progressed, we began to see the benefits of lower inbound transportation expenses, a more reliable sourcing and supply chain network, and the impact of internal initiatives. As a result, we currently believe that IMU could be nicely favorable in the fourth quarter compared to the prior year. We also believe there is still much more opportunity for further improvement in FY'24 and beyond.

I will now provide more details by brand, starting with the Anthropologie Group. The Anthropologie team delivered an impressive 13% Retail segment 'comp' in Q3. This increase was driven by double-digit positive store and digital 'comps'. By category, apparel, home and accessories delivered positive 'comps' in the quarter. The brand delivered nicely positive 'comps' in each month during the quarter. When compared to FY'20, Q3 'comps' remained mostly consistent with the first and second quarter results. Fourth quarter comparisons against last year continue to get more difficult, but we believe the brand 'comp' sales versus FY'20 could remain consistent. This would produce retail segment 'comps' in the mid to high single-digit range for Q4.

The Anthropologie consumer remains optimistic and is choosing fashion newness that is versatile across multiple parts of her lifestyle, whether it's going out or returning to the office. They are responding well to more dressed up categories like dresses, pants, jackets, and shoes with heels. The brand distorted into these trends as they have seen customer interest wane in more casual fashion. Anthropologie intentionally brought holiday receipts in early to cater to the consumers' desire to dress up and celebrate all the occasions in their life. This is true for both apparel and home. Home categories that lean into decorating for guests and entertaining are outperforming other items in the home assortment. The team's execution of the brand strategy to target a slightly younger customer, under the age of 40, is gaining traction. Marketing and creative teams worked collaboratively to create and deliver incredibly compelling campaigns that have successfully attracted new, younger customers. New customers in the quarter increased by an impressive 24%. We remain optimistic about the brand's performance for the holiday season.

Now I will call your attention to the Free People Group. Once again, the Free People team produced a strong quarter with Retail segment ‘comp’ achieving an 8% gain versus last year. Retail segment ‘comp’ was driven by double-digit growth in the digital channel while store ‘comps’ were flat. Retail segment ‘comp’ sales by month were fairly consistent in the quarter. During the quarter, the brand achieved growth across all major categories, with particular strength in accessories, apparel and FP Movement. The FP Movement brand delivered another outstanding quarter, delivering 28% retail segment growth on top of a very strong multi-year comparison. New and existing FP Movement stores continue to exceed expectations which bodes well for continued growth of the brand. Early holiday trends remain positive for the Free People Group, and we believe the brand’s retail segment performance could look similar in Q4 to the third quarter.

The Free People wholesale segment delivered a 4% decrease during the third quarter driven by weakness in the department store accounts partially offset by strength in specialty account partners. We believe the Wholesale segment sales will decline in the fourth quarter and into next year as our department store partners are planning future orders more conservatively. Additionally, FP wholesale inventory levels remain higher than we would like, and we are planning on meaningfully reducing our inventory through closeout channels. The planned increase in close out sales will significantly weigh on the wholesale profit rate in the fourth quarter.

Now moving on to the Urban Outfitters brand which delivered a negative 9% Retail segment ‘comp’ in Q3. UO’s negative ‘comp’ was the result of disappointing performance in North America due to double-digit negative store and digital ‘comp’ sales. We believe the macro environment in North America is having an outsized impact on the Urban Outfitters customer. This customer’s shopping behaviors have changed due to reduced discretionary income. They are shopping less frequently, and when they do visit, they are converting at a lower rate. While we know the macro environment for the Urban customer may remain challenging for some period, we also know we can execute better. We believe our product distortion, presentation, inventory management and marketing all have room for improvement. Lastly, as noted, inventory levels in North America are higher than we would like. As a result, the brand in North America will need to be more promotional to clear through excess inventory in Q4.

In contrast, UO Europe continues to perform remarkably well, delivering a 13% Retail segment ‘comp’ for the quarter. Customer traffic was exceptionally strong in stores, inventory levels are in a better position than Q2, and we believe the brand is gaining market share. Regular price and total sales ‘comps’ were positive for the quarter in all major categories. We believe UO EU can continue to deliver positive Retail segment ‘comps’ in the fourth quarter, although we do note that the macro environment is getting more difficult due to record levels of inflation.

As we look at Q4 for the Urban Outfitters brand, if North America’s performance remains consistent with Q3 and with the increased inflation potentially negatively impacting the EU consumer the Global Urban Outfitters brand could deliver results below Q3’s results.

I will now turn the call to Melanie, our Chief Financial Officer.

Melanie Marein-Efron

Thank you, Frank and good afternoon, everyone.

I will discuss our thoughts on the fourth quarter and full fiscal year 23 financial performance.

Based on current sales plans, we believe our URBN Retail segment 'comp' sales could register low single digit positive for the fourth quarter. Our growth in the retail and Nuuly segments is likely to be partially offset by lower sales in our Wholesale segment. Additionally, similar to the third quarter, we believe foreign exchange could negatively impact total sales growth by approximately 200 basis points. Together, this would result in total company sales growth in the low single-digit range.

Moving on to gross profit margin. Based on our current sales plan, we believe that fourth quarter gross profit margins could decline by approximately 50 basis points compared to the prior year. We believe merchandise margins could be flat in the fourth quarter as the favorability in IMU due in part to lower supply chain costs versus prior year could be offset by higher markdowns needed to reduce inventory levels, particularly at the Urban Outfitters brand. Higher carrier rates primarily resulting from higher fuel and peak surcharges than last year could deleverage delivery expenses and contribute to a decline in fourth quarter gross profit margin rates.

Moving to SG&A. We believe SG&A growth for the fourth quarter will increase at a similar rate as our sales growth of low single-digit range.

Inventory has remained elevated for the past year due to higher inventory costs resulting from increased inbound freight costs, planned earlier receipts to protect sales against a volatile supply chain, and excess slower selling product in certain categories. Based on our current sales plans and receipt expectations, we believe that our inventory growth versus prior year will end the quarter in line with sales performance of the fourth quarter.

We are currently planning our effective tax rate to be approximately 25% for the fourth quarter and 28% for full year fiscal 23. Capital expenditures for the fiscal year are planned at approximately $225 million. The spending is primarily related to providing increased distribution and fulfillment capacity and new store openings.

Lastly, we are planning to open 10 new stores for the quarter while closing 11 stores. Our new store number includes four new FP Movement stores this quarter.

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, I am pleased to turn the call back to Dick.

Dick Hayne

Thank you, Frank, and Melanie. That concludes our prepared remarks. I thank our brand, creative and shared service leaders. I also thank our 23,000 associates worldwide for their hard work, dedication, and amazing creativity. I thank our many partners around the world for their extra effort in helping us overcome the numerous supply chain disruptions we faced over the past two years. And, finally, I thank our shareholders for their continued interest and support. I will now turn the call over for your questions.