URBAN OUTFITTERS, INC.

Third Quarter, FY'21 Conference Call
November 23, 2020

Participants

Richard A. Hayne, Chief Executive Officer
Frank Conforti, Co-President, COO & CFO
Margaret Hayne, Co-President & CCO
Trish Donnelly, Global CEO, Urban Outfitters Group
Hillary Super, Global CEO, Anthropologie Group
Sheila Harrington, CEO, Free People Group
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, Director of Investor Relations

Good afternoon, and welcome to the URBN third quarter fiscal 2021 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three and nine-month periods ending October 31, 2020.

The following discussions may include forward-looking statements. It's important to note at this time, the global COVID-19 pandemic has had and continues to have a significant material impact on URBN's business. Given an extremely high level of uncertainty about the duration and extent of the virus' near and long-term impact to the global retail environment, content discussed on today's call could change materially at any time. Accordingly, future results could differ materially from historical practices and results or current descriptions, estimates and suggestions. 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 Frank Conforti, Co-President, URBN, Trish Donnelly, Global CEO, Urban Outfitters Group and Richard Hayne, Chief Executive Officer, URBN. 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 Frank.

Frank Conforti

Thank you, and good afternoon everyone.

It continues to be a year full of challenges, and I believe we continue to meet them head on. All three brands delivered sales improvement from Q2 and recorded lower Q3 markdown rates versus last year. We produced a new record low markdown rate for the third quarter which helped to drive nearly $100M of operating profit and an op profit rate above 10%. Our balance sheet remains strong as we paid down the remaining $120M on our outstanding line of credit and ended the quarter with $634 million in cash and marketable securities. Each brand controlled inventories well and ended the quarter with inventory below their sales performance. I have said it before and I don't mind saying it again, during an incredibly difficult environment, we could not be more proud of the teams and their exceptional execution.

Before I speak about our upcoming quarter, please note, there remains a high level of external uncertainty. The number of COVID cases are spiking at home and around the globe, resulting in more government restrictions. So, as you can imagine, our current views could change at any time.

Now, as we enter the fourth quarter of fiscal year 2021, it may be helpful for you to consider the following:

Quarter-to-date, our sales are reasonably in line with where we finished the third quarter. Store sales have slowed slightly, while the digital demand has accelerated slightly. As already noted, there is a ton of uncertainty in the consumer behavior for the holiday season, therefore, we are not forecasting where we believe sales will land for the quarter.

If sales performance for Q4 were to remain fairly consistent with the third quarter, we believe URBN's gross margin rate for the fourth quarter would deleverage. Please note that I am referencing Q4 gross profit margin versus last year excluding the store impairment charges recorded in the fourth quarter in the prior year. The decrease in Q4 margin versus the prior year would primarily be due to increased delivery and logistics expense. This deleverage in delivery and logistics expense rate would be due, in part, to the increased penetration of the digital channel, as well as increased costs to meet the strong digital consumer demand. This deleverage will not be fully offset by the digital penetration benefit in store occupancy due to negative store 'comps' persisting and possibly getting worse than the third quarter result.

Many of you may question how our gross profit rate could decline in the fourth quarter given our strong margin performance in the third quarter. First and foremost, this is about delivery expense. We anticipate delivery expense will deleverage significantly more in the fourth quarter than it did in Q3. Three items would cause the deleverage: first, the increase in penetration of the digital channel; second, an increase in carrier rates; and third the need for an increased amount of expedited shipping to ensure packages arrive on time. As many of you are aware, the delivery demand is at or above network capacity in the United States. Knowing that our existing carriers will be unable to fully meet our demand, we have added additional regional carriers in an attempt to get shipments to our consumers on time.

Besides delivery, the other item that could contribute to a lower gross profit margin in Q4 is the markdown rate. In the third quarter, all three brands had favorable year-over-year markdown rates with Urban Outfitters and Free People delivering exceptionally low rates. This helped to drive a record low Q3 rate for URBN. With the uncertainty around holiday, especially in the store channel, we are anticipating markdowns in the fourth quarter to be less exceptional.

Now moving on to SG&A. Based on our current sales performance and our current plan, we believe SG&A could decline for the fourth quarter resulting in SG&A leverage versus last year. We continue to manage our expenses tightly while closely monitoring our topline performance.

We are currently planning our effective tax rate for the fourth quarter to be fairly consistent with the third quarter.

Capital expenditures for the fiscal year are planned at approximately $195 million. The spend is primarily related to expanded distribution facilities, including the completion of our new omnichannel distribution facility in the UK and the start of construction on a new facility in the U.S.

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 over to Trish Donnelly, Global CEO of the Urban Outfitters brand.

Trish Donnelly

Thank you, Frank, and good afternoon everyone.

I am excited to report the Urban Outfitters brand delivered a positive 4% global retail segment ‘comp’ for the third quarter. These ‘comps’ were driven by exceptional growth in the digital channels in North America and Europe, partially offset by more challenging ‘comps’ in the store channel. Well-controlled inventory management enabled historically low markdown rates and fast inventory turns. This, coupled with disciplined expense management, lead to operating income double that of last year.

As I mentioned, the positive global retail ‘comp’ was driven by our digital channel. All global KPIs – sessions, conversion, and average order value – saw impressive increases over last year. All geographical sectors – Americas, Europe, APAC, Middle East and AU/NZ – saw positive double-digit ‘comps.’ In addition, every marketing channel – paid and unpaid – positive comped to last year. Most impressive was ‘new’ customer growth in the digital channel. Globally, we gained 36% more customers over last year with both North America and Europe picking up hundreds of thousands of new customers during the quarter. In addition, we launched a new Urban Outfitters website in Mexico and the early results are very exciting.

Turning to the retail store channel, despite the obvious COVID-related challenges, the field teams drove impressive increases in both conversion and average transaction value which helped offset some of the traffic declines. Our retail stores optimized their pick, pack, and ship capabilities and were able to fill close to one million direct-to-consumer units out of store inventories, globally. In addition, we launched 'UO to GO' – our curbside pick-up capability, which continues to gain traction as we move into holiday. Other bright spots within the retail channel this quarter included the opening of our Urban Outfitters flagship store in Munich, as well as an iets Frans… pop-up shop on Carnaby Street in London. On the North America side, we opened a new store in Sarasota, FL, and relocated our store in Omaha, NE.

Strong topline sales were driven by positive customer response to our product assortment and allowed for historic, full price selling rates across a number of categories. While the women's businesses were key to the success of the quarter, the Home business experienced the highest growth rates. Our speed-to-customer/chase model allowed the teams to react to reads from Q2, pivot quickly, and distort into trending categories for Q3. At the beginning of Q2, we started to see notable shifts in customer behavior. On the apparel side, structured product gave way to comfort and the teams quickly chased and distorted buys for Q3 into casual and cozy tops, bottoms, and third pieces in both men's and women's. We also saw our customer shift their attention to our Home areas. Whether they needed furniture and storage to set up work from home spaces; new bedding or textiles with which to decorate their apartments or houses; bakeware and drinkware to support a newfound love of kitchen and DIY; games and puzzles – both tech and non-tech – as entertainment; or music, listening to or playing, our complex merchandising model catered to needs in all facets of our 18- to 26-year old core customers' evolving interests. The efforts from the merchants, planners and designers on the product side were buoyed by relevant and compelling marketing campaigns.

The marketing teams immediately channeled our customers 'mindsets' and created meaningful marketing messages to support our product strategies. Our 'UO at Home' campaign drove growth and excitement to the business. By featuring over 200 global influencers and creators, from Paris to Copenhagen and Los Angeles to Miami, these diverse individuals photographed themselves in Urban Outfitters product within their local environments, capturing their lifestyles, their interests, and creative expressions. This wide range of creative assets, reinforcing UO's 'big ideas' and 'key product categories' felt authentic, familiar and it resonated with our customers. We not only saw this in increased engagement and following on our social platforms – particularly Instagram, Pinterest, and TikTok – but we also saw increases in sales within the categories and the items we highlighted.

Another new marketing method we quickly adopted was hosting virtual experiences for our customers. Virtual dance and workout classes, DIY workshops, live performance concerts, and beauty tutorials were some of our most successful, with thousands of customer sign-ups. And lastly, to further our customer connection, we partnered with the 'I AM A VOTER' campaign to help our customers navigate the 2020 election and inspire all to get involved, stay aware, and to vote. We created exclusive Ballot Box Tee kits and emerged as a brand leader in encouraging the youth vote.

In closing, the third quarter was an exciting one for the Urban Outfitters brand. We will continue our focus on the customer from a product standpoint and will continue our fiscal diligence around inventory control. The last eight months have forced our team to re-evaluate how we operate and how we continue to please the customer. The operational competencies we've developed this past quarter in the retail channel around DTC order fulfillment will certainly prove beneficial this holiday season. The team's ability to quickly pivot and give our customers relevant product; best in class marketing; innovative digital experiences; and personalized service in stores were critical in driving these results. I would like to thank Meg, the Urban Outfitters leadership team, our home office and our field teams.

Thank you.

I will now turn the call over to Dick.

Dick Hayne

Thanks Trish. Wow, what a phenomenal quarter. Strong 'comps', lean inventories, low mark-downs, and well-controlled expenses…all leading to a 100% jump in operating profits. Truly a great, great effort. Thanks, and congratulations to you, Meg and the entire Urban team.

Good afternoon everyone. Today, I will discuss our overall results for the third quarter, talk about performance by channel, then by brand, and give my thoughts on the holiday season, before turning the call over for your questions.

I am pleased to report URBN produced healthy revenues and excellent operating profits for Q3 versus the same quarter last year. Total 'comp' sales were flat, but operating profits soared 31%. In addition, all large brands were profitable and together they delivered the lowest Q3 markdown rate and best full price selling in URBN history. This is a tremendous accomplishment given the environment we faced.

Let me now recap performance by channel, beginning with stores. Not surprisingly, the store channel at all brands struggled again in the third quarter. Compared to the previous quarter, 'comps' did improve, but stores still faced punishing traffic declines particularly our high-volume stores in large cities like New York, London and San Francisco. All stores were open for business, but most were either forced to obey crippling occupancy caps or observe restrictions in hours of operation – and sometimes both. The impact of low traffic on sales was partially offset by strong conversion increases as the shoppers that did visit, came with intent.

In August, when we last spoke, store traffic had improved slightly from July, and we saw that improvement continue, at a frustratingly slow pace through the middle of October. Since the third week in October, we've seen a slight reversal with lighter traffic as viral caseloads spiked and restrictions were reinstalled.

Fortunately, store channel weakness in Q3 was offset by outsized strength in digital demand. Our overall digital business posted robust mid-double-digit 'comp' sales in each month of the quarter and that strength has continued in the fourth quarter, to date. Sessions, orders, and conversion all saw powerful increases across all three brands and total new digital customers in the quarter jumped by 45%. Since May of this year, our fulfillment centers have experienced non-stop holiday level workloads and have done an exceptional job of maintaining customer service levels.

Turning to a review by brand, beginning with Anthropologie. Of our three main brands, Anthropologie has been most harshly impacted by the pandemic. Anthro is known for offering more structured apparel appropriate for social interactions outside the home. Obviously, the virus has curtailed those interactions and thus the need for apparel that supports them.

The apparel team has seen some success in adjusting the assortments to have a higher penetration of casual 'at home' clothing. While this led to better 'comps' in the third quarter versus the second quarter, when compared to Q3 last year, apparel remains negative for two primary reasons: first, the average price of a casual item is significantly less than most structured items, and second, more markdowns were needed to clear less desirable products. We believe the Anthro apparel category will likely remain challenged through the remainder of FY21.

Conversely, the AnthroLiving home category enjoyed one of its most productive quarters ever, generating strong, double-digit 'comp' sales, largely at regular price. As apparel sales suffer from a lack of social interaction, the home category benefits from 'stay at home' regulations. Holiday gift giving typically boosts the penetration of home sales during Q4, and since home product is performing well, we believe Anthropologie could produce better retail segment 'comps' despite continued softness in apparel sales.

Even though total sales were disappointing, Anthropologie engineered a very respectable operating profit for the quarter, driven by tight expense management and well-controlled inventory levels. The brand entered Q4 with total inventory down 14% at cost.

I thank Hillary, Meg, and the Anthropologie team for driving the improvement in third quarter results. The team has done a good job of mitigating the virus-induced impacts and keeping the brand profitable.

Now turning to Free People – what a quarter this brand delivered! Retail segment 'comps' surged 17% driven by exceptional growth in digital demand. Since COVID, Free People has greatly benefitted from having the highest digital penetration in our portfolio of brands. In the third quarter that penetration topped 70%.

For the quarter, all Free People product categories posted positive 'comps' and strong regular price selling. This produced a near-record low Q3 mark-down rate for the brand. Within categories, none was more impressive than FP Movement which delivered triple digit 'comp' increases. Sales of Movement product were even 'comp' positive in the struggling store and wholesale channels.

We are pleased to announce that in mid-October we successfully opened our first stand-alone Movement store in Century City, CA. We are encouraged by early results which have tracked nicely ahead of plan. A second Movement store is slated to open later this month in Boulder, CO. We expect to open additional stores next year and believe Movement has the potential to become a billion-dollar brand and plan to invest in its growth aggressively.

Free People sales in the wholesale channel dropped by 23% against Q3 last year. That represents a strong rebound from Q2's 52% decrease. Each wholesale segment – specialty stores, department stores and closeout outlets registered similar declines. Sales declined, but profits showed strong improvement and were nicely positive as the brand issued far fewer discounts and allowances.

My thanks go to Sheila, Meg, and the Free People team. The powerful quarter you produced is a wonderful tribute to your leadership and the talent and tenacity of your team. Well done.

In Q3, our subscription rental brand Nuuly, passed its one-year mark. After suffering relatively high pauses in customer subscriptions in the early days of COVID, Nuuly has seen a gradual re-engagement from subscribers who were on pause. Overall, Nuuly has seen a 75% increase in active paying subscribers since the lows recorded in mid-May, and subscribers have been purchasing their rented products at almost twice the pre-COVID rate. In all, we remain optimistic about the future of rental post-COVID.

In any other year, coming off such a strong third quarter with exceptional product execution and positive customer response to early holiday assortments, would make us highly confident about holiday results. It goes without saying, 2020 is not like any other year and our confidence is tempered by external risks beyond our control.

In recent weeks, governments in some regions such as the UK have returned to strict lockdowns and an increasing number of states and local municipalities have reimposed draconian store capacity restrictions and stay-at-home orders. These actions insert a significant amount of uncertainty into our business for the weeks leading up to beyond Christmas. We're confident that our brands are executing well. We know our products and marketing messages are compelling. Most importantly in this environment, we're highly confident in our well-developed digital capabilities. These enable us to capture consumer demand even when stores are challenged by external restrictions.

Turning to our current business, total company sales-to-date in Q4 are essentially in-line with our third quarter results. Stores have de-accelerated slightly due to new restrictions, and the digital channel has improved slightly. As with everything else in the year 2020, the situation is highly fluid, so accurately predicting holiday sales is a low-confidence proposition that I'll avoid.

We do anticipate a surge in digital demand in the coming weeks. To address that we have taken extra measures to help scale with demand including: increasing fulfillment center staffing levels versus last holiday, installing more automation equipment in those centers to help boost productivity, staffing stores to allow for more pack and ship processing, and launching curbside pick-up in stores where it's practical. As Frank pointed out, we are also concerned about the capacity constraints of our delivery carriers. To mitigate that risk, we've added more regional firms to our network. Our goal remains to be able to please customers no matter how, when or where they shop with us.

Before turning the call over to your questions, I want to thank our Co-Presidents, all brand and shared service leaders, their teams, and all associates world-wide. It has been a long and difficult year, but I'm incredibly proud of our teams, how hard they've worked, and the amazing results they've produced. They have shown grit and determination and have excelled in what has been the most difficult environment I can remember. Our positive performance is a direct reflection of our teams' will to make it happen. So, thank you. Thanks also to our many partners and their workers around the world who went above and beyond to produce our products, often under the most trying of circumstances. Finally, thanks to our shareholders, especially our longer-term investors, for your continued support.

That concludes my prepared remarks. Now, for your questions.