URBAN OUTFITTERS, INC.

First Quarter, FY'23 Conference Call
May 24, 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 first quarter fiscal 2023 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three-month period ending April 30, 2022.

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 impact on URBN's business. Given the uncertainty about the duration and extent of the virus' 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 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 first quarter sales and make a few macro consumer observations. I will then turn the call over to Frank and Melanie who will provide more details by along with our thoughts about future performance.

URBN produced strong sales gains in the first quarter with total Retail segment 'comp' sales increasing by 11% versus Q1 last year. Each brand posted positive Retail segment 'comps', led by Anthropologie with a powerful 18% gain, and Free People with a 15% increase. The Urban brand Retail segment 'comp' was 1% driven by strong sales in Europe partially offset by weakness in North America. The Urban brand in North America saw a deceleration in 'comp' sales throughout the quarter as it faced progressively more difficult comparisons against sales in the first quarter last year.

When we last spoke with you in March, we were optimistic that strong consumer demand would continue through the spring season. We believe this remains true for the Anthropologie and Free People brands. These customers are excited for a return to normal. They're shopping in stores again and are out and about with family and friends, traveling, dining-out, and going to many, many events. Customers are shopping to accommodate their social calendars and the products they're choosing are those tailored specifically for 'going-out' moments. The Anthropologie brand prioritized dresses for the spring/summer season and that is paying off nicely. The customer has reacted favorably to their offerings and the fabulous marketing materials the brand created. We believe both Anthropologie and Free People will continue to see nicely positive sales in Q2.

Most Urban North America brand customers received stimulus windfalls in March and April last year which quickly swelled their disposable income. Many spent it just as quickly and helped drive a surge in demand in the first half of last year. As a result, Urban Outfitters North America has very difficult comparisons this year during the first half. Furthermore, this customer is the most sensitive to inflation as they are typically younger and earn less than their Anthro or Free People counterparts. Adding to these powerful headwinds, the brand in North America did not execute to the level we would have liked. Taken together, we believe Urban Outfitters North America will likely underperform in the second quarter.

Q2 comparable Retail segment sales to date for the Anthropologie and Free People brands are running nicely positive. We believe total URBN 'comp' sales for the second quarter could be in the low single-digit positive range even though Q2 comparisons versus LY are a full 1200 basis points more difficult than Q1.

With that, I will now turn the call over to Frank to provide more detail on our performance.

Frank Conforti

Thank you, Dick, and good afternoon, everyone.

I will begin my commentary discussing our total Company Q1 results vs. the prior comparable quarter, followed by additional notes by brand.

Total Company sales grew by 13% to a first quarter record of $1.1 billion, driven by a total Retail segment 'comp' sales increase of 11%, a 6% increase in Wholesale segment sales and a Nuuly segment sales increase of $15 million.

The growth in the Retail segment sales was driven by outperformance in the store channel versus the digital channel. Please remember, during the first quarter of last year North American stores faced capacity constraints and our European stores were largely closed due to government restrictions related to the COVID-19 pandemic. This resulted in poor store performance and incredibly strong digital performance a year ago. This year, across both the stores and digital channels we saw increases in AUR, decreases in conversion rate while traffic was up in stores and down in digital. By product category, demand for women's apparel and accessories were the strongest with home decelerating from their recent healthy trends.

The growth in our Wholesale segment was due to strong full price channel sales at Free People which more than offset a slight decline at Urban Outfitters.

Although we delivered double-digit sales growth, the operating environment remained challenging and weighed on profits. The decline in gross and operating profit margins in the quarter were largely due to supply chain disruptions resulting in continued increased inbound freight costs deleveraging product margins. Additionally, as stores faced capacity restrictions last year, we held staffing well under normal levels. Now that stores have opened-up again and traffic is rebounding nicely our store staffing levels are closer to historical averages and resulted in increased 'SG&A' spend. As supply chain costs remain high and our 'SG&A' comparisons remain historically low, we believe our profit margin will remain challenged in the second quarter vs. the prior year.

I will now provide more details by brand, starting with the Anthropologie group. The group delivered an impressive 18% Retail segment 'comp' in Q1 vs. the prior year. The double-digit 'comps' were driven by exceptionally strong full price 'comps' in apparel which increased by more than 50%. This led to over 100 basis points of improvement in the brands markdown rate. Anthropologie started the season by strategically bringing in early receipts of an expanded dress assortment in anticipation of the consumers desire to return to events in the spring season. Dresses led the apparel category with outsized growth and BHLDN recorded the highest Q1 revenue on record. The brand pushed the boundaries on newness and style and the customer is responding. To support this strategy, the brand marketing team produced a compelling integrated dress marketing strategy refocusing on the original intended age demographic for the brand. Superior product execution and marketing in the quarter led to double-digit growth in new apparel customers to the brand. During the quarter, the home category was positive driven by strength in furniture and a positive 'comp' in gift and entertaining. We believe gift and entertaining could moderate some as the customer is spending less time in her home than the previous two years. Overall, with current strength of apparel and accessories we believe the Anthropologie group could drive a nicely positive 'comp' in Q2.

Now I will call your attention to the Free People brand. Once again, the Free People team produced an extraordinary quarter with Retail segment 'comps' achieving a 15% gain vs. last year driven by strength in apparel and accessories. The brand continued their strong customer growth due in part to some of the best marketing campaigns in the industry. The wholesale channel returned to growth this quarter driven by strength in the full price channel along with many specialty stores operating at full capacity again. The FP Movement brand also delivered another outstanding quarter, delivering 42% total Retail segment growth. We believe Free People will continue to drive healthy sales growth in the Retail segment as well as continue to grow the Wholesale segment in the second quarter.

Now moving on to the Urban brand which delivered a 1% Retail segment 'comp' vs. the prior year. UO Europe delivered a robust 44% 'comp' which was largely offset by a negative 8% 'comp' at UO North America. As Dick previously mentioned, we believe the macro environment, especially in North America is having an outsized impact on the UO brand and consumer. With inflation rates not seen in over 40 years in addition to lapping trillions of dollars in stimulus funding from the prior year it presents a unique challenge for the UO North America customer. While we know the macro environment for the Urban customer may remain challenging for some period, we also know we can execute better. The brands inventory is higher than where we would like it to be, and we are focused on correcting those inventory levels throughout the second quarter. As a result of difficult Q2 comparison, macro environment headwinds and execution opportunities, we believe UO could deliver a negative 'comp' in Q2.

Lastly, I will speak to Nuuly. The first quarter was a very strong one for Nuuly Rent. Nuuly finally experienced a period with limited COVID interruptions, and the business was well positioned to capitalize on the customer's interest in fashion and going out. Marketing campaigns continued to build brand and concept awareness in addition to driving robust customer growth. Active subscribers ended Q1 up nearly 200% versus Q1 last year, and up nearly 50% from the end of Q4. The brand outperformed our expectations with stronger growth in new subscribers, more reactivated subscribers and greater subscriber retention than planned. Momentum built through the quarter, and as of today, the brand has over 82,000 active paying subscribers. We are looking forward to continuing to grow the Nuuly customer base and our learnings over the coming year.

I will now turn the call to Melanie, our CFO.

Melanie Marein-Efron

Thank you, Frank and good afternoon, everyone.

Now I will discuss our thoughts on our second quarter and full fiscal year 23 financial performance.

As you think about sales growth for the second quarter, it is important to keep the prior period comparisons in mind. As a reminder, we had exceptional 'comp' sales improvement in Q2 last year as COVID restrictions lifted and the consumer purchasing accelerated. Last year, we reported comparable Retail segment growth of 10% in Q1 with Q2 accelerating 12 full 'comp' points to a robust 22%. While we still believe that we can grow sales in Q2 this year vs. last year's impressive number, we believe our Retail segment 'comp' sales growth could land in the low single-digit range and Wholesale segment sales could grow in the mid-single digits. Together this would result in total Company sales growth in the low single-digit range.

Now on to gross profit margin. As a reminder, second quarter gross margin last year significantly benefitted from unsustainably record low mark down rates as demand exploded and inventory levels could not keep pace. Due to last year's exceptionally low markdown rates at all brands, we are planning for increased rates in Q2 this year. Additionally, our current inventory levels, mostly at the Urban Outfitters brand in North America, are higher than we would like and could lead to higher markdowns versus last year's low levels. Also, as the supply chain challenges continue to drive higher freight costs, our initial product margins will continue to be negatively impacted. The combination of higher markdown rates and lower initial product margins could result in an approximate 500 basis point decline in gross profit margins for the second quarter based on today's current sales performance and plan.

Now moving on to 'SG&A'. Based on our current sales performance and plan, we believe 'SG&A' growth for the second quarter will increase in the low double-digits. Our planned growth in 'SG&A' is primarily due to increased store labor costs versus the prior year. This could result in 'SG&A' rate deleverage versus last year, but we would expect 'SG&A' rate as a percent of net sales to come more in line with previous years.

We are currently planning our effective tax rate to be approximately 24% for the second quarter and 25% for full year FY'23.

Now moving onto inventory. Our inventory is elevated in the first quarter due to several factors. First, inventory costs have increased as a result of higher freight and raw material costs. Second, last year's inventory was significantly constrained due to supply chain disruptions. Third, as supply chain disruptions have persisted, we have extended our inventory lead times and are holding more inventory earlier than normal to ensure that we have adequate inventory to protect sales. Lastly, Urban Outfitters brand sales came in lower than plan in Q1 resulting in their inventory being higher than where we want it to be. Due to all those factors just discussed, we believe that overall inventory levels in the second quarter will continue to be elevated, although we are planning for Urban's inventory to show meaningful improvement.

Capital expenditures for the fiscal year are planned at approximately $225 million. While lower than last year, the level of spend is still elevated due to installation of our automation equipment in our new North America distribution facility just outside of Kansas City, Kansas. This facility will support the growth and expansion of our Retail segment business in North America by providing more efficient and faster logistics.

Lastly, we will be opening approximately 38 new stores and closing approximately 16 stores during fiscal year 23. Our new store number includes 12 new FP Movement stores this year.

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, Melanie, and thank you, Frank. That concludes our prepared remarks. I want to thank our brand, creative and shared service leaders. I also want to thank our 23,000 associates worldwide for their hard work, their dedication, and amazing creativity. I thank our many partners around the world for their extra efforts in helping us overcome numerous supply chain disruptions, and finally, I thank our shareholders for their continued interest and support. I will now turn the call over for your questions. As a reminder, please limit your questions to one per caller.