URBAN OUTFITTERS, INC.

First Quarter, FY’24 Conference Call
May 23, 2023

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 2024 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, 2023.

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.

As usual, I'll begin the call with some brief remarks regarding our first quarter results and then make a few observations concerning the consumer and the macro-environment. After that, I'll turn the call over to Frank and Melanie who will provide more details about our Q1 results along with thoughts about the future.

A quick note, starting this quarter we are breaking out FP Movement retail segment sales and 'comps' to provide you with better insight into our rapidly growing athletic brand. Now, on to a review of Q1.

We are delighted to report an excellent start to fiscal 2024. First-quarter results topped our expectations discussed on the February call. Four of our five brands posted record first quarter revenues and total URBN delivered 6% revenue growth against a strong first quarter last year. Double-digit 'comp' sales growth in both the store and digital channels at the Anthropologie, Free People and FP Movement brands more than offset a negative 'comp' at the Urban Outfitters brand and drove total Retail segment 'comp' sales up by 5%. Nuuly, our apparel rental service continued to enjoy strong, positive response to its business concept and product offering. Nuuly's year-over-year revenues grew by 125% driven by a triple-digit gain in active subscribers which totaled 167,000 at quarters end. Nuuly contributed $29 million in additional revenue versus last year's first quarter. Wholesale revenue in the quarter declined by 11% as some of our larger partners sought to operate with leaner inventory levels and wrote smaller orders.

Customer demand for fashion at the Anthropologie, Free People and FP Movement brands accelerated in Q1 versus last year and remained elevated throughout the quarter. This strength was driven by better fashion execution and stronger marketing which created more customer traffic, including a double-digit increase in new customers in North America. Clearly these brands are pleasing existing customers and capturing additional market share.

We currently see no signs of change in customer behavior; no indication that customers are shopping less frequently, buying fewer items or trading down. Indeed, so far in May, total Retail segment 'comps' are in line with first quarter results, and we believe total Retail segment 'comps' in Q2 could look very similar to Q1's print.

Sales 'comps' at the Urban Outfitters brand remained disappointing in Q1. That weakness has largely continued into May. We are planning for better women's apparel 'comps' during the Back-to-School selling season beginning in July. Our recently re-established speed to market capabilities that allows us to react faster to customer preferences, plus an adjustment in our pricing architecture that offers more opening price point items could help drive and maintain this improvement.

Let me now turn your attention away from top line performance and focus on profitability. Here, the URBN achievement in Q1 was dramatic. The hostile operating environment of the last few years has finally abated: freight rates have normalized, supply chain speed and reliability have returned, our IMU improvement initiatives have begun to bear fruit, and total inventories are down to last year and are once again growing at a slower rate than sales. All of this resulted in a 260-basis points improvement in gross margins in Q1. In addition, Nuuly came within a whisker of reaching profitability in the quarter, and we remain confident it will achieve that milestone in a future FY24 quarter. In all, first quarter operating income soared 54% versus the prior year to $71.4 million and earnings per share jumped 70% to a record $0.56.

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.

As Dick noted, the first quarter performed ahead of our expectations that we discussed on the February call. Total Company sales grew by 6% to a first quarter record of $1.1 billion, driven by a total Retail segment 'comp' increase of 5% and a Nuuly segment revenue increase of $29 million. These increases were partially offset by a 11% decline in Wholesale segment sales and close to 100 basis points of unfavorable foreign currency translation.

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

Now moving to gross profit. Gross Profit dollars increased by 15% while gross profit rate improved by 260 basis points. The improvement in gross profit rate was primarily due to significantly improved initial margins. Each brand delivered improved initial margins in the quarter largely driven by lower inbound freight costs as well as several of our URBN cross functional initiatives. Merchandise markdowns also improved in the quarter driven by the strong performance at the Anthropologie and Free People brands. As Melanie will discuss in more detail, we believe we can continue to drive improved IMU as well as lower markdown rates for the remainder of the year.

As a result of our Q1 record sales, as well as significant improvement in gross margin, our operating profit increased 54% from the previous year to $71 million, while earnings per share increasing by 70% to a record Q1 of $0.56 per share.

Next, I want to briefly touch on inventory. Over the second half of last year, we meaningfully improved our inventory to sales ratios, and we targeted FY'24 Q1 inventory levels at or below our sales growth rates. I am proud to say that is exactly what we delivered. I want to thank the brands, the sourcing team and shared partners for their fantastic execution. Total inventory vs. last year is down 6% as of Q1, with Retail segment 'comp' inventory up 4% and Wholesale segment inventory down 23%. Total Company, along with both segments, are below our sales variances. For the remainder of the year, we believe we can continue to manage inventory at or below sales growth, which should give us the opportunity to lower our overall markdown rate, increase our open to buy and allow us to chase into outperforming product.

I will now provide more details by brand, starting with the Anthropologie Group. The Anthropologie team delivered an exceptionally strong 13% Retail segment 'comp' in Q1. This increase was driven by double-digit positive store and digital 'comps'. Both store and digital 'comps' were driven by increased traffic, strong regular price sales and less promotions. Strong sales, improvements in IMU, and record low first quarter mark down rates all led to a record first quarter in profit dollars for Anthropologie.

The impressive quarterly performance was largely driven by apparel and accessories. Within apparel, the Anthropologie customer continues to respond favorably to fashion newness with strength across the brands more dressed up categories such as pants, dresses, jackets, and shoes with heels. As mentioned on the February call, the brand had started to see complementary growth of more casual and versatile product categories perform alongside the dressier occasion product. This trend continued throughout the quarter with all major apparel and accessory categories producing double-digit reg price 'comps'.

In the quarter, new customer acquisition in North America increased by an impressive 11% resulting in part from well received marketing campaigns, great store experiences and of course strong product execution. The strength across all apparel and accessory categories, along with new customer acquisition has resulted in a nicely positive start to the second quarter, which has us optimistic that Anthropologie can continue to drive strong 'comps' in the second quarter.

Now I will call your attention to the Free People Group. Free People continued to deliver exceptional results, achieving record sales and profit dollars in the first quarter. Retail segment 'comps' at the Free People Group were extraordinarily strong at 17% versus last year. Within the group, the Free People brand produced a 14% 'comp' and FP Movement brand produced a robust 48% 'comp'. Total Retail segment 'comp' was driven by double-digit 'comps' in the store and digital channels. These double-digit 'comps' were driven by strong traffic growth in both channels due in part to excellent marketing execution as well as average unit retail growth fueled by increased full price selling across all major product categories. Total customer growth also reached double-digit increases for the quarter at both the Free People and FP Movement brands.

The customer response to the Free People group spring & summer product trends, marketing campaigns and store experience have continued into May, and we believe the Free People's Group Retail segment performance could be nicely positive in Q2.

Free People wholesale segment sales decreased 14% during the first quarter, which was in line with what we discussed on our last conference call in February. The decrease in sales was a result of weakness in department and specialty store accounts partially offset by growth in close out account partners. Wholesale segment profitability rebounded nicely from the lows recorded in the fourth quarter but remained below the first quarter last year. With Q1 inventory levels now down 22% to last year, we believe we are in a much better position to further improve profitability as compared to the second half of last year. We believe Wholesale segment sales will decline for the remainder of the year due to continued focus on the right balance of account partners and doors for the brand while the rate of profit could remain in a healthy low double-digit range.

Now moving on to the Urban Outfitters brand. Urban recorded a negative 13% Retail segment 'comp' in Q1. UO's negative 'comp' was the result of disappointing performance in North America and a deceleration in the Urban business in Europe that had previously been delivering positive 'comps'. In North America both the stores and digital channel recorded negative double-digit 'comp' sales. In Europe, the weakness was concentrated in the UK while the rest of Europe continued to see positive 'comps'. As noted previously, we believe the macro environment in North America is having an outsized impact on the Urban Outfitters customer and has begun to weigh on the UK customer as well. While we know the macro environment for the Urban customer is not ideal, we also know we can execute better. The brand has done a good job in improving their inventory position. Total inventory is down 19% while Retail segment 'comp' inventory is down 15%. We believe the improved inventory to sales ratio will give the brand a better opportunity to chase into outperforming products as well as reduce their markdown rate.

Finally, I will touch on the Nuuly business. Nuuly delivered an exceptionally strong Q1 beating our expectations for both top and bottom-line performance. Strong subscriber growth continued in the quarter with current active 'subs' now topping 167,000. We continue to believe active 'subs' could approach or possibly exceed 200,000 by year end. In addition to strong revenue numbers, Nuuly continues to make fast and steady strides towards profitability, nearly reaching break-even in Q1. We continue to believe Nuuly will record its first profitable quarter later this year.

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

Melanie Marein-Efron

Thank you, Frank and good afternoon, everyone.

Now I will discuss our thoughts on the second quarter and fiscal 2024 financial performance.

We are pleased that overall consumer demand has remained strong to start the quarter, and we are planning for this strength to continue throughout the second quarter. Right now, we believe that second quarter total Company sales growth could be mid-single digits. Sales growth in Q2 could result from mid-single-digit growth in Retail segment 'comp' sales and high double-digit growth of Nuuly segment sales versus last year. Our growth in the Retail and Nuuly segments is likely to be partially offset by sales decline in our Wholesale segment. Additionally, similar to the first quarter, we believe foreign exchange could negatively impact total sales growth by approximately 100 basis points.

Now on to gross profit margin. We believe URBN's gross margin rate for the second quarter could improve by nearly 300 basis points compared to the prior year's second quarter. The increase in gross profit margin could be driven by higher initial product margins from lower inbound freight costs as well lower merchandise markdowns. We have made significant progress over the past few quarters controlling our inventory to sales ratio. In addition, an improved supply chain, with faster speed and reliability versus last year, is allowing us to bring product in closer to demand. As a result of well controlled inventory and a healthier supply chain, we believe that there could be lower markdowns in the second quarter compared to the prior year second quarter.

Now moving on to SG&A expenses 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 could be primarily driven by higher overall payroll due to anticipated higher incentive pay from improved Company performance, lower vacancy rates, and higher payroll rates. In addition, we expect marketing expenses to support growth in customers and sales could be higher versus last year. This could result in SG&A rate deleverage versus last year. As always, if sales performance fluctuates, we maintain a certain level of variable SG&A spending that we can adjust up and down depending on how our business is performing. While we believe SG&A growth could outpace sales growth in Q2, we also believe that SG&A expense growth in the second half of the year will be more closely aligned with sales growth.

We are currently planning our effective tax rate to be approximately 26% for the second quarter and 25% for full year.

Now moving onto inventory. We believe that inventory levels in the second quarter could grow at a rate below sales growth. The teams continue to be focused on speeding up inventory turns and managing inventory growth below sales for the remainder of the year as their target product turns closer to pre-pandemic levels.

Capital expenditures for the fiscal year are planned at approximately $230 million. This spend is primarily related to investments in additional distribution facilities. In the late summer, we will be opening our highly automated omni fulfillment facility in Kansas City, Kansas. In addition, we will be investing in a new rental fulfillment facility in Missouri within the Kansas City region. We are targeting to open this facility by the end of fiscal year 24. The new Missouri facility, along with our existing facility in Bristol, PA, will support the growth and expansion of our Nuuly rental business in North America.

Lastly, we will be opening approximately 33 new stores and closing approximately 24 stores during fiscal year 2024.

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 over to Dick.

Dick Hayne

Thank you, Mel, and thank you Frank.

In conclusion, as you've heard from Mel and Frank, we're confident about our prospects for the second quarter and optimistic for the entirety of fiscal 2024. We have four brands that are executing at rarefied levels and gaining market share. In addition to top line growth, we have significant margin recapture potential this year as demonstrated by our performance in the first quarter. This gives us additional opportunities to deliver improved profitability and EPS.

All of this would not be possible without the hard work of our brand and shared service leaders, their merchant, creative and operating teams, and our 24,000 associates worldwide. Their amazing dedication and creativity produced a truly outstanding quarter, and I thank them. I also recognize and thank our many partners around the world. Finally, I thank our shareholders for their continued support. That concludes our prepared remarks. Before I turn the call over for your questions, I remind you to please keep your questions to one per caller, so we have time to recognize more of your colleagues. Thank you, and now for your questions.