URBAN OUTFITTERS, INC.

Second Quarter, FY'23 Conference Call
August 23, 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 second quarter fiscal 2023 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the six and three-month period ending July 31, 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 second 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, URBN delivered positive revenue growth in the second quarter against our especially strong, record-breaking quarterly print last year. Total Retail segment 'comp' sales increased by 1% versus Q2 last year and 24% against the same period in FY20. Anthropologie and Free People both posted robust Retail segment 'comps' against last year, increasing by 7% and 8%, respectively. The Urban brand saw Retail segment 'comps' decline by 9%. Sales gains for Urban Europe partially offset significant weakness in North America. We believe much of the weakness was due to three factors: first is brand execution issues. These included inaccurate product distortion and over-assortment that led to inventory problems. Second is severe inflation which caused the Urban customer to have less money for discretionary spending, and last is an exaggerated prior year comparison that included stimulus-money that fueled demand.

Although URBN sales grew in Q2, the operating environment remained challenging, and weighed on profitability. Continued high inbound freight and transportation costs drove IMU lower while higher markdowns versus the historic low rates we achieved last year hurt MMU. The combination of these two factors produced a year-over-year decline in gross margins and operating profits even though SG&A expenses were well controlled and returned to a more normalized rate. Second quarter operating income was $86 million a 48% drop from last year's record profits, but a 10% increase versus FY20.

Customer shopping behavior at our brands has bifurcated with affluence being the differentiator. Those brands with higher price points and serving a more affluent customer – in our case Anthropologie and Free People – have a customer who is able and willing to continue spending despite the current inflation level. She's demanding fashion newness and shopping to accommodate her social calendar, choosing products tailored for 'going-out'.

Demand at these two brands did moderate slightly from their robust pace in Q1, but both continued to record nicely positive sales throughout Q2. To date in August, both brands continue to perform well with Anthro posting low-teen, and Free People high single-digit 'comps'.

For the Urban brand customer who is younger and less affluent, the current inflation, especially around the necessities like food, rent, and energy, is not a mere inconvenience, it's economically crippling. As a result, we see this customer spending much more cautiously on discretionary items and often waiting for promotions before buying. This is in stark contrast to the Anthropologie and Free People customers who are driving strong full-price sales. If the current macro-economic situation doesn't deteriorate further, we believe the customer bifurcation will continue through the entire second half. As a result, the Urban brand performance is likely to suffer versus last year and produce negative 'comps' while the other two brands could remain nicely positive.

Finally, I'm pleased to report that Nuuly, URBN's apparel rental service, continued to experience a strong, positive response to its business concept and product offering in Q2. Active subscribers now exceed 90,000, a 15% increase from Q1, and a 200+% jump from Q2 last year. In addition, Nuuly was able to nicely leverage the increase in revenue from these additional 'subs' and make excellent progress towards profitability. We look forward to welcoming our 100,000th subscriber later this year and, hopefully, celebrating Nuuly's first profitable quarter sometime in FY24.

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 Q2 results vs. the prior comparable quarter, followed by some more detailed notes by brand.

Total Company sales grew by 2% to a second quarter record of $1.2 billion, driven by a total Retail segment 'comp' sales increase of 1%, a Wholesale segment sales increase of 1%, and a Nuuly segment sales increase of $19 million.

The growth in Retail segment 'comp' sales was driven by low single-digit digital channel 'comp' sales while store 'comp' sales were flat. Wholesale segment sales growth was due to a 4% increase at Free People. Nuuly's robust increase in sales was due to a significant increase in subscribers from the prior year.

As Dick noted, although sales were positive, the operating environment during the quarter was challenging. Those challenges coupled with exceptional performance in the prior year contributed to lower operating profits versus a year ago.

The decline in operating profits was due to higher markdowns, lower initial mark ups and deleverage in delivery expense. Markdowns were higher than last year mainly because the markdown rates last year at all brands were exceptionally low and because each brand had excess inventory in certain categories.

Total inventory remains elevated at the end of Q2. This increase is due in part 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. We will have to deploy incremental markdowns throughout the third quarter to sell through this excess inventory. The Urban Outfitters brand in North America has the largest overage. We are working towards our inventory position being meaningfully improved at the end of the third quarter and in line with sales performance by the end of the fiscal year.

IMU was lower vs. last year due to the continued impact of elevated supply chain costs. The good news is that not only do comparisons get easier in the back half of the year, we are also starting to deliver on our initiatives to improve our IMU, both of which, have resulted in an improving IMU trend. Additionally, transit times and pricing in the market are beginning to gradually improve. While it is still very early, and our transit times and costs are still significantly increased versus pre-pandemic levels, if this overall improvement continues, it could benefit not only IMU but markdowns as well. As many of you know, our fashion model is built in part on speed and the faster and more reliable our supply chain is, the greater the opportunity it gives our merchants to deliver the right fashion.

Delivery expense deleveraged in the quarter vs. the prior year primarily due to fuel surcharges related to the significant fuel inflation in all of our markets. We have been able to offset a portion of these surcharges with initiatives that reduce our out of market shipments and split shipments.

I will now provide more details by brand, starting with the Anthropologie group. The Anthropologie team delivered an impressive 7% Retail segment 'comp' in Q2 vs. the prior year. The increase in 'comps' was driven by nicely positive store and digital 'comps'. By category both apparel and home delivered positive 'comps' in the quarter. The Anthropologie brand delivered positive 'comps' in all three months with May and July being the strongest. The Anthropologie consumer is still shopping and is responding well to more dressed up categories like dresses, pants, jackets, and shoes with heels. The execution of the team's brand strategy is having a positive impact on the women's business, as they are attracting and acquiring new younger customers. Within the home category, the strength in furniture and décor demand offset weakness in gift and entertainment. Although it is early, fall product is performing well across major categories, and we remain optimistic about the brand's performance for the back half of the year.

Now I will call your attention to the Free People group. Once again, the Free People team produced a strong quarter with Retail segment 'comps' achieving an 8% gain vs. last year. Retail segment 'comps' were driven by double-digit growth in the digital channel which was partially offset by a low single-digit decline in stores. Retail segment 'comp' sales moderated as the quarter progressed, but August has accelerated from July's results. During the quarter, the brand achieved growth across several categories with strength in accessories and apparel. The FP Movement brand delivered another outstanding quarter, growing their customer base by 34% vs. last year and delivering 30% 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 fall receipts have been well received by Free People's customer and we believe the brand's retail segment performance could look similar in the third quarter to the second quarter.

The Free People wholesale segment delivered a 4% increase during the second quarter driven by strength in specialty store partners which was partially offset by weakness in the department store accounts. We believe the wholesale segment may see declines in the back half of the year due to lower sales to department store accounts. This change in sales performance coupled with increased inventory levels could weigh on the wholesale profit rate in the second half of the year.

Now moving on to the Urban Outfitters brand which delivered a negative 9% Retail segment 'comp' vs. the prior year. UO's negative 'comp' was the result of disappointing performance in North America due to double-digit negative store and digital 'comp' sales. As Dick previously mentioned, we believe the macro environment in North America is having an outsized impact on the Urban Outfitters customer. 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 American 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 brand has fashion that is working but did not distort their buys appropriately. As a result, the brand in North America will need to be more promotional to attract and convert this customer. Additionally, inventory levels in North America are higher than we would like. We are focused on correcting those inventory levels which will lead to higher markdowns for the third quarter compared to the prior year.

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, and we believe the brand is gaining market share. As long as the economy does not get materially worse, we believe UO EU can continue to deliver positive Retail segment ‘comps’ in the third quarter while the total Urban Outfitters brand could deliver results similar to Q2’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 third quarter and full fiscal year 23 financial performance.

Our URBN ‘comp’ sales growth trends have started out the quarter similar to our Q2 ‘comp’ sales performance with low single-digit positive Retail segment ‘comps’. Based on our quarter-to-date performance and sales plans, we believe our URBN Retail segment ‘comp’ sales could register low single-digit positive for the third quarter. Our Retail segments growth is likely to be partially offset by lower sales in our Wholesale segment. Together, this would result in total Company sales growth in the low single-digit range.

Now on to gross profit margin. Based on today’s current sales performance and plan, we believe that that gross profit margins could decline by more than 400 basis points for the third quarter. The decline in third quarter gross profit margins could largely be driven by higher markdown rates vs. last year’s exceptionally low markdown rates at all brands as well as elevated inventory levels this year. As a reminder, last year’s third quarter gross margin significantly benefitted from unsustainably low record markdown rates. In Q3 last year, demand was very strong, and our inventory levels could not keep pace when we experienced significant receipt shortfalls due to severe supply chain interruptions.

Moving to SG&A. We believe SG&A growth for the third quarter will increase in the high single-digits. Our planned growth in SG&A is primarily due to increased store labor costs and customer marketing acquisition 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 pre-pandemic levels.

We are currently planning our effective tax rate to be approximately 24% for the third quarter and 27% for full year FY’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 on opening approximately 37 new stores and closing approximately 15 stores during the fiscal year. 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, Frank, and thank you, 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, their dedication, and amazing creativity. I thank our many partners around the world for their extra efforts in helping us overcome the numerous supply chain disruptions we've faced, and finally, I thank our shareholders for their continued interest and support. I will now turn the call over to you for your questions. As a reminder, please limit your questions to one per caller.