URBAN OUTFITTERS, INC.

Third Quarter, FY'18 Conference Call
November 20, 2017

Participants

Richard A. Hayne, Chief Executive Officer
Frank Conforti, Chief Financial Officer
David McCreight, President, URBN & CEO, Anthropologie Group
Margaret Hayne, CCO, URBN & CEO, Free People Brand
Trish Donnelly, Global CEO, Urban Outfitters Group
Azeez Hayne, General Counsel
Barbara Rozsas, Chief Sourcing Officer
Calvin Hollinger, Chief Operating Officer
David Ziel, Chief Development Officer
Dave Hayne, Chief Digital Officer
Sheila Harrington, President, Free People Brand
Oona McCullough, Director of Investor Relations

Good afternoon, and welcome to the URBN third quarter fiscal 2018 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three-month and nine period ending October 31, 2017.

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.

We will begin today's call with Frank Conforti, our Chief Financial Officer, who will provide financial highlights for the quarter. Sheila Harrington, President, Free People Brand, David McCreight, President of URBN and CEO of the Anthropologie Group and Trish Donnelly, Global CEO, Urban Outfitters Group will provide an update on their respective brands and Richard Hayne, our Chief Executive Officer, will then comment on our broader strategic initiatives. Following that, we will be pleased to address your questions.

As usual, the text of today's conference call will be posted to our corporate website at www.urbn.com. I'll now turn the call over to Frank.

Thank you, Oona, and good afternoon everyone.

I will start my prepared commentary discussing our recently completed fiscal year 2018 third quarter results versus the prior comparable quarter. Then I will share some of our thoughts concerning the fourth quarter of fiscal year 2018.

Total Company or URBN sales for the third quarter of fiscal 2018 increased 4% vs. the prior year. The increase in sales resulted from a 1% URBN Retail segment 'comp', a 9% increase in Free People wholesale sales, and a $14 million increase in 'non-comp' sales. URBN Retail segment 'comp' for the quarter, adjusted for the impact of the hurricanes was 2%.

Within our URBN Retail segment 'comp,' the direct-to-consumer channel continued to outperform our store channel, driven by increases in sessions and conversion rate, which more than offset a small decrease in average order value. Negative 'comp' store sales resulted from declines in transactions, average unit selling price and units per transaction. Store traffic for the quarter was up, with strong growth in our European market.

By brand, our Retail segment adjusted 'comp' rate was positive at all three brands with increases of 5% at Free People, 2% at Anthropologie and 1% at Urban Outfitters. These 'comps' have been adjusted for the two hurricanes experienced in the quarter; the adjustment represents approximately two-thirds of a point at each of our brands. Our URBN Retail segment 'comp' improved sequentially throughout the quarter with both September and October being 'comp' positive months.

During the third quarter, we opened four new store locations: two Anthropologie locations in North America and two Free People locations in North America.

Moving on to the wholesale segment. The Free People wholesale segment sales increase of 9% for the quarter was driven by domestic and international growth, in departments stores, specialty stores and direct-to-consumer. We believe Free People wholesale has the opportunity to continue to grow domestically through category expansion and internationally within all categories. We are planning for similar growth in the fourth quarter of 2018.

Additionally, we delivered our first Anthropologie home wholesale order in the UK. We believe Anthropologie wholesale of the home category has strong opportunities to grow with key partners in Europe as well as North America and we are excited to have completed their launch into this new channel of distribution for the brand.

Now moving on to URBN gross profit for the quarter. Gross profit decreased 1% to $298 million versus the prior comparable quarter. Gross profit rate declined by 142 basis points to 33.4%. The decline in gross profit rate was primarily driven by deleverage in delivery and logistics expense due to increased penetration of the direct-to-consumer channel, higher international penetration and increased furniture penetration.

Total ‘SG&A’ expenses for the quarter were down 2% to $225 million versus the prior comparable quarter. Total ‘SG&A’ as a percentage of sales, leveraged by 143 basis points to 25.2%. The leverage in ‘SG&A’ rate was primarily due to savings associated with our store organization project and lower share based compensation expense. These reductions were partially offset by increased investments in marketing expenditures to drive sales.

Operating income for the quarter increased by 4% to $73 million, with operating profit margin flat at 8.2%.

Our effective tax rate for the quarter came in at 37.4% vs. 33.5% in Q3 last year. The variance in quarterly rates is primarily due to the ratio of certain foreign profits and losses to global tax profits in those periods.

Net income for the quarter was $45 million or $0.41 cents per diluted share.

Now turning to the balance sheet. URBN inventory was down 1% versus the prior year to $450 million. Retail segment ‘comp’ inventory decreased by 1% at cost.

We ended the quarter with $369 million in cash and marketable securities and have zero drawn down on our asset backed line of credit facility. During the quarter, the Company repurchased and retired 3 million common shares for $66 million. This brings our fiscal year 2018 buyback totals to 8 million shares for $157 million. Capital expenditures came in at $20 million for the quarter, $63 million year-to-date, and we are planning for $90 million in total ‘cap ex’ for fiscal year 2018. The capital spend for fiscal 2018 is primarily driven by new, relocated and expanded stores followed by investments in direct-to-consumer related technology.

As we enter the fourth quarter of fiscal year 2018, it may be helpful for you to consider the following:

We are planning on opening one net new store during the fourth quarter. This will result in 19 new stores opened for the year and 8 store closures. For brand level store information, please see our financial metrics sheet posted to our URBN website.

Now moving on to gross profit. We believe that gross margin rate for the fourth quarter could decline on a year-over-year basis primarily due to deleverage in delivery and logistics expenses primarily due to the increased penetration of the direct-to-consumer channel. However, we believe the decline in gross margin rate could be lower than what we saw in the third quarter due to store occupancy leverage and lower markdowns, if our positive sales performance continues throughout the quarter. Additionally, we believe gross profit dollars could increase on a year-over-year basis if sales growth from the third quarter continued to improve throughout the fourth quarter. Please keep in mind, the holiday selling period has been difficult to predict over the past several years, this is only our current view.

Based on our current plan, we believe 'SG&A' could increase by approximately 4% for the fourth quarter. This increase could relate primarily to increased digital marketing investments to drive stronger topline sales growth. As we believe the brands product offerings are improving, we believe there is an opportunity to increase our marketing investments to hopefully help drive an improving sales growth rate in the fourth quarter.

Finally, our fourth quarter effective tax rate is planned to be approximately 32.3%, which would result in our annual effective tax rate at approximately 36%.

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 it is my pleasure to pass the call over to Sheila Harrington, Free People Brand President.

Sheila Harrington

Thank you, Frank, and good afternoon. I am thrilled to report the Free People brand delivered 8% sales growth in the third quarter. This topline sales growth was coupled with expanded margins leading to stronger growth in operating income for the brand.

By channel, wholesale delivered 9% growth driven by strong increases in specialty accounts. I would like to thank Krissy and her team for their continued strong performance. The retail segment increased by 7% in total with a 5% adjusted retail segment 'comp', Free People's strongest retail segment 'comp' this year. The retail segment 'comp' benefitted from strong, double-digit increase in digital. This marks the fourth consecutive quarter the brand has achieved a positive retail segment 'comp' and reflects even more distortion by channel with over 50% of our retail segment revenue now coming from digital. Due to our recent re-platform and centralized digital teams, we are excited by the new opportunities to continue to evolve her online experience. Additionally, during the quarter we opened 2 new stores and ended the quarter with 132 doors. The brand is well positioned to continue to learn and react to our omni-channel opportunity as consumer behavior continues to evolve.

In both the retail segment and wholesale, the brand continued to experience strong total and regular price growth in apparel, particularly in our bottoms classifications. Also, worth noting, our intimates and shoes business showed strong growth within wholesale and tremendous improvement in the retail segment compared to the trend earlier this year.

In September, the brand creative teams partnered with Vogue to develop the "Coat Check" video marketing campaign, combining strong product, imagery and cleverness associated with both brands. This collaboration was the first of its kind for the brand, and we are committed to continuing to find new and creative ways to speak with our customer and reach new customers.

While we are pleased with the current results, the progress achieved on our long-term initiatives is even more exciting.

First amongst these is the expansion of FP Movement which represented over 11% of the brands growth for the quarter. FP Movement grew 36% on a year-over-year basis. The growth is supported by 21 physical locations, 19 within existing Free People stores and 2 free standing pop-up shops. In ‘comp’ stores with a FP Movement assortment, the category delivered double-digit increases, and the stores total ‘comp’ exceeded the fleet average by over 300 basis points, reflecting the healthy development of this concept. We continue to invest in initiatives to boost FP brand awareness, such as collaborations with strong partners like Well and Good. We believe FP Movement has continued opportunity to help the brand grow and will continue to invest.

Moving on to international expansion. Free People delivered 26% growth in the brands international business, driven by both wholesale and digital. Wholesale experienced strong growth in Europe with existing accounts, as well as a new partnership with a French distributor. In the fourth quarter, the teams have secured additional partnerships in both Spain and Italy, and we expect these to benefit sales next year. International digital growth was driven by strength in Europe and China. In Europe, the brand began fulfilling orders to our UK customers from our Rushden fulfillment center for the first time. This will enable us to shorten delivery times and provide better communication to our local customers. We do expect this will further enhance the customers experience and loyalty to the brand over time.

I am extremely proud of the team’s results, and the current momentum entering the fourth quarter, as well as the progress we have made on our longer term strategic initiatives. We are optimistic that the strength of the brand experienced in the third quarter will continue throughout the fourth quarter, but remain aware of the unpredictability of the holiday season over the last several years. I would like to thank Meg and the entire Free People team for a great quarter.

Thank you. I will now turn the call over to David McCreight.

David McCreight

Thank you, Sheila, and good evening everyone.

I am pleased to provide you with an update on our progress within the Anthropologie Group. As we mentioned on our last call in August, we were seeing early signs of improvement in North America in our fall product reads. I am happy to report that during the quarter we did indeed see a change in our business trajectory. Anthro Group retail segment ‘comp’ sales improved in the third quarter to a +2% ‘comp’, a 600 bps improvement from Q2’s -4% ‘comp’. The trend improvement in North America was broadly based across the expanded categories and apparel divisions, in both selling channels, and importantly, ‘comp’ sales quality also improved with regular price ‘comps’ outpacing markdowns.

The direct-to-consumer channel had another strong quarter of double-digit growth. Momentum in this channel was driven by improved digital marketing effectiveness, a broader assortment that we continue to expand, and creative assets that increasingly market the lifestyle experience. The Anthro Loyalty member path to free shipping significantly increased new signups and overall digital customer counts, also lifting average transaction value with more units in Her basket. We continue to invest in our digital shopping brand experience and the data analytics that power best-in-class digital merchants.

Last August, we mentioned seeing traffic in our North American stores stabilizing. Store sales did indeed improve across the quarter, with a majority of our stores delivering a positive 'comp' in the month of October. This was the first full quarter with our new field structure. The structure was designed to improve back-of-house and scheduling efficiencies while protecting the customers' experience and delivering more consistent merchandising messages. We continue to evolve the omni-channel shopping experience through buy-online and pick-up in store, as well as mobile ordering of items in store that are not in stock. With new efficiencies and the aid of technology, Anthropologie continues to provide one of the more unique and compelling retail shopping experiences and this is never more proudly on display than in the holiday season.

From a product perspective, our expanded categories continued their strong 'comp' growth rate in Q3 led by home décor, as well as women's accessories and beauty. Anthropologie home delivered their first wholesale assortment in the UK, where it far exceeded expectations. While we have become accustomed to Andrew's successes in home décor, the exciting news within the Anthro group's Q3 'comp' growth was the change in our apparel trajectory. As we have spoken of previously, the majority of our revenue decline in recent periods was due to execution of apparel. In a short period of time, Hillary and the apparel team focused the offer on the separates trend that echoes much of what is happening across the fashion industry. They also concentrated on delivering more color, pattern, and special details with a touch of hand for which Anthro is known. In addition to the improved sales trajectory, feedback from listening posts in the field, social channel chatter, and online commentary indicate that customers and associates are increasingly enthusiastic about our offer.

This revenue momentum has continued into November, and when combined with a shift in fashion, could create conditions for a promising holiday season.

Turning to product margins, Q3 merchandise margin rates were flat to last year, and were comprised of a reduction in markdowns offset by lower initial margins due to both lower penetration of own-brand apparel and category sales mix. We anticipate higher market penetration in apparel to continue into Q4 and early spring, as the newer merchant and design teams gain a better understanding of how to interpret the new fashion trends for our customer. However, we expect own-brand apparel penetration to begin rebuilding by early summer of next year.

With apparel showing new signs of health and continued momentum in the expanded categories, we can begin leveraging product strength to fuel strategic digital and international expansion initiatives and re-accelerate Anthropologie's growth.

In advance of the busy holiday season, I would like to thank the many Anthropologie brand fans and associates working tirelessly to delight Her every day.

Thank you, and I would now like to turn the call over to Trish Donnelly.

Trish Donnelly

Thank you, David, and good afternoon everyone.

Fourteen weeks ago, on our last earnings call, I delivered the news that the Urban Outfitters brand had posted a negative eight percent global comparable sales rate for the quarter. I recognized product misses, particularly in our women's category, as well as some styling and brand marketing issues, which had not resonated with our core customer. I also noted that we implemented a new speed-to-customer model during the quarter. This new model was designed to shorten our product lead times in order to get the right product in the right place at the right time. The creation, rollout and implementation of the speed-to-customer model during the quarter was distracting and disruptive to the business and another factor in the top line softness we saw in Q2.

What a difference fourteen weeks make. I am proud to report Urban Outfitters' positive one percent adjusted comparable sales achievement for the third quarter. In a short time, with our new business model as the foundation, the team was able to react to shifts in trends and categories to dramatically swing the business nine 'comp' points in one quarter. Of course, a business can't shift so drastically on a new business architecture alone. The design and merchant teams are once again creating relevant product that our customer is loving, and our brand marketing team is supporting the business with compelling and creative campaigns.

For Q3, Urban Outfitters delivered positive comp performance in both the women's and men's apparel categories, globally. Apparel is having a very exciting moment, given the shifts in proportion, resurgence in prints and a strong cycle in bottoms. Customer reaction to newness and emerging ideas is strong and almost every sensibility is showing product opportunity. Early signs point to this trend continuing in both women's and men's as we move through Q4.

In Q3, the total global business saw a 24% increase in new customers over last year, with new Men's customers outpacing the total. Our UO Rewards membership picked up 60% and engagement continues to grow. Direct-to-consumer demand posted strong comparable sales in both North America and Europe, with both geographies seeing impressive year-over-year conversion rates. Although the retail store channel in North America remained negative in the quarter, it did show very nice comparable sales improvement versus the second quarter performance and the stores in Europe continued to drive high, single-digit increases in traffic 'comps' and positive sales 'comps' to last year.

Social engagement was another highlight this past quarter. Our global Instagram following was just shy of 8 million and our 95 Instagram stories had over 30 million views. One of our most successful campaigns of the quarter was our "What Do You Champion?" partnership with the Champion brand, where we featured five up-and-coming celebrities and musicians. We saw more than half a million social engagements tied to the video and 2.3 million views. We also partnered with the ride-sharing app Lyft to provide free rides to UO Home shoppers during the critical back-to-school shopping period. This partnership received 1.1 million organic Twitter impressions. And finally, within UO Community Cares, we partnered with girl group Fifth Harmony on VH-1's "Save the Music" foundation. According to Listen First Media tracker, the tweet announcing the UO x Fifth Harmony collaboration was deemed the #1 post on Twitter during the campaign window.

The improvement in the business from Q2 to Q3 was exceptional. The nine-point ‘comp’ swing would not have happened without the incredible talent, energy and commitment of the UO Leadership Team, as well as the entire field team, home office organization, and shared services partners. Meg and I would particularly like to recognize Sue, Gaby, Lauren, Colby and Keith on the North America side of the business, and Emma and Claire on the European side. We truly value you and your teams’ impressive contributions, your passionate work ethic and love for our customer. Thank you.

I will now turn the call over to Dick.

Dick Hayne

Thank you, Trish, and good afternoon everyone.

Congratulations to our brand leaders, to Meg and to their teams for delivering exceptional improvement in third quarter ‘comp’ sales. When I spoke on this call three months ago, I voiced my disappointment in our second quarter results and stated the sales shortfall came primarily from our lack of execution rather than macro headwinds. I expressed confidence there was sufficient fashion newness to drive positive ‘comp’ sales. Today, I am pleased to report that all brands executed well in Q3. They exceeded the expectations I had when entering the quarter, with each delivering positive Retail segment ‘comps’ and in North America, sequential month-over-month ‘comp’ sales improvement. In addition to the Retail segments, Free People wholesale produced another fabulous quarter.

Two major trends drove the improvement, one old and one new. The first was the continuing strength of our digital results where each brand produced an excellent, double-digit sales increase. Digital penetration grew by over 400 bps in the quarter and eclipsed our previous high recorded in Q4, last year. October digital sales were especially robust; each brand produced a year-over-year increase in excess of 20%. As we enter the holiday season this year, we are planning for digital penetration to grow even further.

It should be noted that during the quarter we also saw improvement in North American store traffic and less negative ‘comp’ store sales than in the previous quarter. In Europe, both store traffic and sales remained strongly positive on a ‘comp’ basis.

The second and emerging trend across all brands was a revival in customer interest in fashion apparel. Quite simply, fashion is back and it’s selling. Demand for apparel, driven partially by the shift in silhouette that I’ve alluded to in previous commentaries, finally gained traction in North America during the quarter. Regular price sales of women’s apparel were positive at each brand led by Urban Outfitters with the European group’s sales being especially powerful.

As Trish noted in her commentary, our merchants were able to read and react to the demand because of improvements we've made in our speed-to-customer capabilities. I believe these competencies, which we are still refining and implementing, will become increasingly important as the customer demands more newness and fashion trends have quicker adoption rates and shorter life cycles because of social media use. Based on the positive response to our current fashion offerings combined with our improved ability to execute looks more quickly, I'm optimistic that our merchants will be able to deliver compelling fashion through the holiday season and well into next year.

We're excited by the topline potential created by the confluence of these two trends. To capitalize on this potential, all brands will invest more in digital marketing during the holiday period when on-line traffic peaks. Our primary goal, of course, is to drive sales, but the spend will also target customer acquisition and retention.

While the ascent of digital within the omni-channel retail world can drive increased sales as it did for URBN in Q3, it can also have a negative impact on our financial model, including causing store occupancy de-leverage, increased variable expenses in delivery and marketing, and significantly higher investments in technology. These additional expenditures are necessary to drive sales and grow share but can result in operating margin erosion.

The question then is what can be done to offset some of these additional costs? In the short-term, I believe our biggest opportunity is to reduce markdowns. Our speed-to-customer initiative, coupled with tight inventory control and adoption of new demand and allocation forecasting tools, could afford us the opportunity to reduce total markdowns by several hundred basis points. Furthermore, now that demand for apparel is trending higher, we also have an opportunity to produce better Retail segment 'comps', which would help leverage all fixed and semi-fixed costs.

Longer-term, as our brands continue to expand internationally through a combination of owner-operated, joint-venture, franchise and wholesale operations, I believe we will have the opportunity to leverage larger product buys to negotiate better cost prices, which should allow for increased IMU. I also believe over time, we will see North American store rents adjust to the new omni-channel realities after which, 'comp' store occupancy costs should begin to stabilize. If executed well, these short and longer-term opportunities could help offset the additional expenses listed earlier.

I believe our brands and our Company are very well positioned to adapt to the changing retail environment and succeed in the marketplace. We have no debt, we have expanded cautiously and today, each brand operates a conservatively-sized fleet of stores in North America. Our digital penetration is high and growing quickly, we operate three powerful brands, each of which possesses a proven ability to create unique, compelling products and experiences, and most importantly, I believe we have some of the best talent in the industry.

Before I close I do want to say a few words about the holiday season. We all know this time of year has become highly promotional and somewhat unpredictable. We have no reason to believe this year will be different from a macro perspective. Having said that, we also know our three brands gained momentum as the third quarter progressed and this momentum has continued in November to date. We believe our brands are better positioned for holiday this, versus last year, with fresher inventory, more giftable items, a plan to spend more on marketing and the benefit of renewed consumer interest in apparel. So, as I write these words, our outlook for URBN in Q4 remains cautiously optimistic.

In closing, I thank David, Trish, Sheila, Meg, our shared service leaders, and our 24,000 associates worldwide for their inspiring dedication, drive and creativity. I also recognize and thank our many partners around the world, and finally, I thank our shareholders for their continued support. That concludes my prepared remarks. I now turn the call over for your questions.