URBAN OUTFITTERS, INC.

Third Quarter, FY'22 Conference Call
November 22, 2021

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 third quarter fiscal 2022 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, 2021.

The following discussions may include forward-looking statements. In today's commentary, unless otherwise noted, all comparisons will be made to the third quarter of fiscal 2020, referred to as LLY. 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 Frank Conforti, Co-President and COO, Melanie Marein-Efron, Chief Financial Officer and Richard Hayne, Chief Executive 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 Frank.

Frank Conforti

Thank you, Oona, and good afternoon, everyone. Today we announced another record-breaking quarter. Before discussing the results, I first want to congratulate and thank all URBN team members. The record results we produced this quarter, and this year, are a tribute to your hard work, perseverance, and above all, your ability to successfully navigate a rapidly changing landscape. Thank you.

I will now give a high-level view of our Q3 results followed by a more detailed analysis by brand.

Total Company sales grew by 15% to a third quarter record of $1.13 billion, driven by a total retail segment 'comp' sales increase of 14%. Strong consumer demand across most categories, plus skilled execution by our teams, drove nicely positive retail segment 'comps' at all brands. Total sales were driven by robust strength in full-priced selling which resulted in a record low URBN third quarter markdown rate. This helped to generate outstanding merchandise and gross profit margins despite inflationary pressures from freight, raw materials, and wages. The combination of strong gross profits with well-controlled SG&A expenses led to all three larger brands recording double-digit operating profit margins. Overall, URBN produced record third quarter results for total sales, operating income, and earnings per share.

Although we're certainly pleased with record results, we are confident that a myriad supply chain problems throughout the quarter held back both top and bottom-line results. Lack of new receipts depressed sales most in August and September. As receipt flow improved somewhat in October, we saw a commensurate improvement in our 'comp' trends as well, with October delivering the strongest 'comps' of the quarter. That trend has continued into the fourth quarter with quarter-to-date URBN retail segment 'comps' exceeding their third quarter print. As of today, we believe we have sufficient inventory on hand and receipts coming in to support fourth quarter sales growth.

Now moving on to detail by segment, starting with the retail segment. Retail segment sales increased by 16%. 'Comp' store sales declined in the mid-single-digit range but improved throughout the quarter with October coming in only slightly negative. As mentioned, lack of inventory in the first half of the quarter negatively impacted stores sales. Total store traffic versus LLY was mid-teens negative but healthy AUR gains partially offset that deficit. By region, traffic in the Southeast, Southwest and Midwest continued to outperform the major metro markets in New York, California, and Canada. In Europe, traffic levels were stronger than the trends seen in North America.

The digital channel continued its rapid growth registering mid-double-digit sales gains in North America and even larger gains in Europe. Overall, the strong digital performance was driven by increased sessions and improved conversion and higher AOV. Digital customer growth also remained strong with year-to-date total customers up 50% to LLY and 3% to LY.

Shifting to the wholesale segment, total wholesale sales decreased by 15% versus LLY. Lower sales at Free People wholesale were partially offset by an increase in UO wholesale sales. As we have discussed previously, Free People wholesale has adjusted its customer mix, cutting back some accounts to better align with its go-forward strategy of concentrating on full-price selling. While this strategy reduced sales in the short term, we believe it has benefitted the brand overall and resulted in improved profitability in the quarter and less discounted product in the market.

I will now provide more details by brand, starting with the Urban Outfitters brand. The Urban brand delivered a 7% retail segment 'comp' vs. LLY. Double-digit direct sales more than offset negative store 'comps'. The brand drove increased sales despite a significant decrease in promotional activity during the quarter. Focus shifted from offering frequent dollar and percentage-off promotions two years ago to highlighting everyday accessible opening price points in key categories. This strategy resulted in nearly 400bps improvement in merchandise markdowns, healthy improvement in gross profit margins and low double-digit operating profit margins. In North America, UO entered the quarter with tight inventory levels, especially in apparel, accessories, and shoes, and thus was highly impacted by supply chain driven late receipts. Light apparel inventory and fewer promotions led to a deceleration in overall 'comps' from Q2 but fueled strong double-digit regular price 'comps' and a historically low markdown rate. In Europe, the brand experienced fewer delays in inventory receipts, better store traffic and delivered better 'comps' than its North American counterpart also along with a very low markdown rate.

Now turning to Anthropologie. The brand delivered a 9% retail segment 'comp' vs. LLY. Like the Urban brand, Anthropologie entered the quarter with tight apparel inventory levels and like Urban, supply chain disruptions stunted apparel sales. Retail segment 'comp' sales accelerated each month in the quarter fueled by strong double-digit digital sales which more than offset negative 'comp' store sales. Sales were driven solely by full price selling with regular price 'comps' jumping by more than 50%. This led to a reduction in markdowns, almost 300bps improvement in MMU and low teens operating profit margins. The brand proactively planned to receive holiday home product early this year leading to elevated home inventory throughout the quarter. As a result, the home category produced the strongest 'comps' in Q3.

Improved inflows of apparel and accessories inventory at Anthropologie beginning in October have boosted sales trends in these categories. Within the apparel category, denim produced the highest 'comp' growth fueled by the Pilcro marketing campaign in early September. Sales of occasion and party dresses surged toward the end of the quarter as new receipts finally arrived. Momentum in that class has continued into November. We believe Anthropologie is well positioned to deliver exciting fourth quarter results as October's double-digit 'comps' have accelerated in November with the customer shopping early for holiday trim, décor, home, and apparel.

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 staggering 55% gain vs. LLY. Every product category recorded at least a strong double-digit regular price 'comp', while the total Free People brand generated powerful triple-digit direct 'comps' which easily offset the slightly negative store 'comps'. Store sales showed sequential improvement in the quarter with October store 'comps' turning positive. Free People's extremely low markdown rate for the quarter led to over 350 basis points improvement in merchandise markdown rate. Strong sales and gross margin growth all led to an impressive high teens retail segment operating profit rate for the brand. The FP Movement brand also delivered an outstanding quarter. Retail segment sales grew by close to 300% versus LLY and they opened 6 additional stand-alone Movement stores, bringing the total number to 15 at quarter's end.

November is off to a strong start at both Free People and Movement, so we believe both brands could produce stellar results again in Q4.

Lastly, I will speak to Nuuly. As noted on our last call, our subscription rental business has seen a positive shift in customer behavior as COVID wanes and customers have returned to more normal behaviors. The brand is also in a better inventory position, which helped fuel subscriber count growth of 55% vs. last quarter to 44,000 active subscribers. We believe we are on target to reach our goal of 50,000 subscribers by year's end. In October, the Nuuly brand launched Nuuly Thrift, a new resale app. The 'app' offers users a peer-to-peer resale platform where sellers can sell products and receive either a cash payment or choose Nuuly cash with a 'kicker' that can be then redeemed for purchases at any URBN brand. We are still in the early innings of these rental and resale businesses, and we are looking forward to continuing to grow the Nuuly customer base 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 fourth quarter financial performance. As Frank noted, we remain optimistic about the opportunity ahead of us. Of course, there are always challenges to overcome and risks to our plans. The impact of COVID-19 is still driving numerous disruptions and costs pressures in many areas of the business. Logistics, sourcing, fulfillment, the overall labor market, and product input costs remain constant areas of focus right now and the foreseeable future.

We have several strategies in place to try to mitigate the everchanging cost and operational challenges in these areas.

We believe the fourth quarter could continue to show healthy sales improvement vs. FY'20. We believe our retail segment 'comp' sales growth could land in the mid-teens range, while the wholesale segment sales could decrease at a rate similar to the third quarter. Together this would result in total Company sales growth in the mid-teens range.

Based on current sales performance and forecast, we believe our gross profit margins for the fourth quarter could show approximately 100 basis points of improvement to FY'20. Much like our third quarter, this improvement could be largely driven by lower markdown rates as a result of strong consumer demand and solid product performance. We believe favorable markdowns could offset lower initial mark-ups and deleverage in delivery and logistics expenses. Lower initial mark-ups are likely to be due to increased freight and commodity price increases. Deleverage in delivery and logistics expense are likely to be driven by the increased penetration of the digital channel as well as increased delivery and labor costs. We would also anticipate store occupancy to leverage nicely due to the increased penetration of the digital channel.

Now moving on to SG&A. Based on our current sales performance and plan, we believe SG&A for the fourth quarter could grow at a rate just below our sales growth rate while still leveraging. Our planned growth in SG&A is primarily due to greater marketing and creative spend to support our robust digital channel growth. Additionally, our SG&A growth is a result of planned incentive-based compensation which was largely not achieved in FY'20. Similar to the past few quarters, our teams will manage SG&A relative to actual sales.

We are currently planning our effective tax rate to be approximately 24% for the fourth quarter.

Capital expenditures for the fiscal year are planned at approximately $285 million. The spend is primarily related to providing increased distribution and fulfillment capacity to support our growing digital business and secondarily, to opening new stores.

We are planning on opening approximately 56 new stores and closing 21 stores for the entire fiscal year. Our new store opening number does not include franchise partner locations in international markets.

Lastly, I wanted to add that the current supply chain challenges brought on by disruptions in production and the global transportation network have resulted in delayed inventory receipt flow. As a result, we are continuing to strategically place earlier inventory positions in areas with lower fashion risk such as the home category. We believe these factors may elevate our inventory position at the end of the fourth quarter versus two years ago.

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.

I am pleased to turn the call now to Dick.

Dick Hayne

Thank you, Mel and good afternoon, everyone. Well, the Holiday season is upon us, and we're optimistic about our prospects. Consumer demand remains powerful despite the various sentiment reports that would suggest otherwise. The customer is shopping early and often selecting both apparel and home products. Sweaters, dresses, and denim seem to be the apparel items of choice this year, while candles, trim and holiday décor top the home list. Fashion newness remains more important than price, and though promotional activity is normally higher in Q4, we are still planning for a favorable markdown rate compared to LLY. As for inventory, receipt flows have improved over the past four weeks, so we are confident our inventory will be sufficient to meet our sales goals. Total retail segment 'comps' are currently running nicely ahead of Q3's rate, so in sum, we believe we are well positioned to capitalize on the fashion trends and strong customer demand and deliver another record quarter.

On our last conference call, I focused on two important URBN growth initiatives – FP Movement and Nuuly. We believe both hold significant promise and as Frank relayed earlier, both are performing well. Today, I would like to discuss a third initiative – AnthroLiving. AnthroLiving is the gift and home furnishings division of the Anthropologie Group. The brand selected this division to deliver outsized growth several years back and has not been disappointed. In the current year, AnthroLiving is on-track to deliver almost $150 million in incremental sales versus LLY. Our consumer research indicates that the average Anthropologie customer spends more on home products each year than on apparel. Given the size of Anthro's apparel business, we believe AnthroLiving has an opportunity to be at least a $1B business. To capture that opportunity, the brand, over the past few years, has invested in infrastructure, delivery capabilities, systems, marketing, and people, including additional design, merchant, and marketing talent. Those investments have paid off nicely, with total sales this year projected to advance by 44% against LLY. The brand's ambition is to add another $150 million in sales over the next three years. To achieve this the brand plans to expand their assortment using a mix of internal design and artist and designer collaborations, concentrate on certain iconic product categories like home fragrance and accelerate new customer acquisition by investing more in both digital and traditional marketing.

Rapid growth from initiatives like Movement, Nuuly and AnthroLiving, in combination with core growth at our three brands, should help URBN achieve its goal of driving double-digit sales growth in the years ahead.

That concludes our prepared remarks. I want to thank our brand, creative and shared service leaders. I also thank our 25,000 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.