URBAN OUTFITTERS, INC.

Second Quarter, FY'24 Conference Call
August 22, 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
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Barbara Rozsas, Chief Sourcing Officer
David Ziel, Chief Development Officer
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Good afternoon, and welcome to the URBN second quarter fiscal 2024 conference call. Earlier this afternoon, the Company issued a press release outlining the financial and operating results for the three and six-month period ending July 31, 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, URBN, Tricia Smith, Global CEO Anthropologie Group, Frank Conforti, Co-President and COO, URBN, and Melanie Marein-Efron, Chief Financial Officer, URBN. 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.

I'll begin with some brief remarks regarding our second quarter results and then make a few observations concerning our view of the consumer and the macro-environment. After that, I'll turn the call over to Tricia Smith, who will provide greater detail about Anthropologie's stellar second quarter results. Then, Frank and Melanie will add to the analysis of our Q2 results along with thoughts about our future business.

Simply put, URBN's Q2 results were outstanding. In total, they topped our optimistic expectations. Four of our five brands posted record second-quarter revenues. The Anthropologie, Free People and FP Movement brands produced double-digit sales growth in stores and on-line with FP Movement leading the way with 'comp' sales of plus 57%. This more than offset a negative 'comp' at the Urban Outfitters brand. Total URBN delivered 8% revenue growth while total Retail segment 'comp' sales increased by 5%.

The Nuuly brand, our apparel rental service, continued to enjoy strong, positive response to its business concept and product offering with year-over-year revenues almost doubling in Q2 driven by an 85% increase in active subscribers. Nuuly contributed $27 million in additional revenue versus last years' second quarter. Total Wholesale segment revenues declined by 5% as some of our larger partners continued to write smaller orders as they seek to operate with leaner inventory levels and grow their penetration of internally generated product.

Customer demand for fashion at the Anthropologie, Free People and FP Movement brands remained strong throughout Q2. The customer continued to respond positively to fashion newness within the women's apparel, accessories, and shoe categories. Effective brand marketing drove robust traffic increases to our websites and stores, including strong growth in new customers. Clearly these brands were pleasing existing customers and capturing additional market share. So far in August, total Retail Segment 'comps' are in line with first half results, and we believe total Retail Segment 'comps' in Q3 could look very similar to both previous quarters.

During the July and August back-to-school period, the Urban Outfitters teams in North America succeeded in improving women's and men's apparel 'comps', especially in stores, but unfortunately the 'comp' improvement fell short of our goals. In Q2, the apparel teams also improved full-price sales, lowered mark-down rates, and enhanced IMU and MMU, but total brand 'comp' sales remained disappointingly weak. We've made some progress, but the teams know there is still much work to be done to right the Urban ship. That work is underway but could take longer than we originally expected.

Let me now focus your attention on URBN's bottom line results. In Q2, we enjoyed the continued benefit of a pre-Covid-like operating environment. Supply chain speed and reliability returned to pre-Covid levels. A speedier supply chain allowed the merchants to keep inventories tight, thus lowering markdowns. At the same time, our IMU improvement initiatives, especially the reduction in inbound freight costs, exceeded expectations. Combining better IMU with lower mark-down rates resulted in a 400+ basis points improvement in gross margins and led to the Anthropologie, Free People and FP Movement brands posting very strong second quarter operating results. Total URBN operating income soared 54% versus the prior year to $132 million and earnings jumped 72% to $1.10 per share.

All indicators currently point to a continuation of the robust business we've seen in the first half. Our customer is favoring fashion over price and she's responding nicely to our brand concepts, our assortments and our marketing.

With that, I will now turn the call over to Tricia to discuss Anthropologies' record setting quarter, Tricia.

Tricia Smith

Thank you, Dick, and good afternoon, everyone. I am pleased to speak to you today about the Anthropologie Group's strong second quarter performance and our ongoing strategic growth initiatives. First, I will start with the quarter. The Anthropologie Group delivered an 11% retail segment 'comp', marking our 10^{th} consecutive quarter of positive sales 'comps'. The quarter's 'comps' were driven by double-digit growth in both stores and digital. We exceeded pre-pandemic traffic, conversion, and 'comps' in stores and online. By product category the team delivered exceptional growth in the apparel, accessories and shoes categories delivering sales 'comps' over 20%.

Our top line performance was accompanied by an even more impressive growth in profit driven by significant improvement in IMU and continued reductions in markdowns versus last year. This year the brand is running significantly fewer promotional days than we have in the past, allowing us to deliver an impressive 22% growth in our regular-price business and a 30% year-over-year increase in operating income.

The strength across all apparel and accessory categories has continued into the month of August which has us optimistic that Anthropologie can continue to drive strong 'comps' in the third quarter.

Our outstanding second quarter performance reflects the strategy we developed two and a half years ago when I arrived at the brand. At that time, sales growth had slowed, particularly in apparel and accessories and the brand had become too dependent on promotional activity. We knew we had an opportunity to attract more new and younger customers to the brand and offer them a wider range of products, enabling us to gain market share.

The first course of action was aligning and empowering our leadership team around our strategy and goals to best serve our customers. Next, the team set four strategic priorities to recapture market share. These four priorities are to modernize our product, enhance our selling environments both in stores and online, provide inspirational creative content and grow our customer base across multiple age demographics.

First, modernizing our product. It was essential that we develop the right mix of own brand fashion, customer favorites and premium brands to help us return to full price growth and offer more fashion forward product. Our focus has been to distort into core categories such as dresses and denim, introduce new concepts that appeal to different end uses such as an assortment that satisfies her vacation and casual needs, and elevate the edit of market brands to modernize the assortment to appeal to a younger customer. We began by improving and expanding the own brand assortment, concentrating on our Pilcro, Maeve and By Anthropologie labels. Today our own brand product makes up over 60% of the apparel assortment. We elevated our market brand assortment with a selection of premium brands that are aspirational for the younger customer such as Reformation, Favorite Daughter, Good American and On Running, and we are becoming a go-to destination for these premium brands. Additionally, we expanded apparel adjacent categories such as intimates, accessories, and shoes to cater to the different end uses of our customer's life we were not fully servicing.

Moving on to the second and third priorities of enhancing our selling environments and creating inspirational creative content, with the goal of becoming an aspirational brand for new and existing customers. We knew the customer wanted to be inspired by complete looks through digitally enabled experiences and in-store styling. As the product teams distorted into key categories and pushed new fashion trends the creative teams elevated the imagery and enhanced the store visual experience to properly support the brand message with an omni experience in mind. Today our teams create some of the most aspirational imagery in our industry. We have invested in creating exceptional omnichannel experiences and this has translated into the strong traffic and 'comp' sales the brand is experiencing today.

Our last priority was to grow our customer base. We wanted to introduce the brand to a new generation of customers while strengthening our relationship with our existing customer. We have invested in marketing to drive customer acquisition, conversion, and retention. In North America during the second quarter, new customer growth surpassed 10%, while active customer spend increased high single digits. We designed New to Next marketing strategies that drive repeat purchases by new customers. In the past year, over 30% of new customers have returned to the brand to make a second purchase. Over 60% of the women's new customer growth enter via our enhanced owned brand product available only at Anthropologie. These customers are 2.5 years younger than our existing core customer.

I'll shift gears now to touch on our home performance. Much of today's call has centered on the opportunities the brand has in apparel and accessories. When I entered the business, these categories had the most opportunity to reignite growth while Home had just delivered multiple years of outsized growth. Although Home was slightly negative this quarter, we see customers pivot from pandemic-driven furniture purchases to more hosting and entertaining-focused categories. Customers are improving their homes with decorative layers focusing on tabletop, glassware, decorative objects, and textiles. As they refresh their spaces and prepare to entertain more, we have seen robust growth within our regular price business in gift and entertaining categories. We have hired a new president of Anthropologie Home and will be deploying strategic priorities to drive outsized growth and brand awareness in our home business. I am confident in our growth opportunities and the team's ability to execute and look forward to sharing more on upcoming calls.

In conclusion, the team's focus on our four priorities has transformed our business. Looking forward, our strategy is consistent with the work we have done to get here, and our focus remains on top-line growth and bottom-line expansion. We have plans to increase our apparel and accessories business to $2B while building the foundation to double our home business to $1B and will be strategically increasing our global store count to 270 over the next several years.

We look forward to providing you with more updates in the future. I will now turn the call over to Frank.

Frank Conforti

Thank you, Tricia, and congratulations to you and the team on a truly outstanding quarter. We are excited to support the brand's continued growth and help the team reach their goals.

Now I will discuss URBN's total company results and then give some additional details on our brands. As Dick noted, the second quarter for URBN performed nicely ahead of our expectations from when we spoke on the May conference call. Total Company sales grew by 8% to a second quarter record of $1.3 billion, driven by a total Retail segment 'comp' increase of 5% and a Nuuly segment revenue increase of $27 million. These increases were partially offset by a 5% decline in the Wholesale segment.

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

Now moving to gross profit. Gross Profit dollars increased by 22% while gross profit rate improved by 416 basis points. The improvement in gross profit rate was primarily due to significantly improved initial margins and lower markdown rates at all brands. Improved initial margins in the quarter were driven by lower inbound freight costs as well as the early benefits on several of our URBN cross functional initiatives. 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. I cannot thank the teams enough for their continued focus and results in driving improved IMU and lower markdown rates.

Next, I want to briefly touch on inventory. Total inventory was down 16% with retail segment 'comp' inventory down 2% and Wholesale segment inventory down 32%. We have remained committed to managing inventory variances below our sales growth rates and we are delivering on our commitment. We believe our improved inventory to sales ratio is one of the primary drivers of our lower markdown rates.

As a result of our Q2 record sales, as well as significant improvement in gross margin, our operating profit increased 54% from the previous year to $132 million, with earnings per share increasing by 72% to $1.10 per share. Earnings per share growth was primarily driven by healthy operating profit growth and additionally benefitted from a lower effective tax rate versus last year.

Since Tricia has already provided an update on Anthropologie, I will now provide more details for the remaining brands, starting with the Free People Group. This quarter, Free People delivered historically exceptional results, once again achieving record sales and profits in the second quarter. Retail segment ‘comps’ at the Free People Group accelerated from the first quarter and finished the quarter at a robust 27% retail segment ‘comp’ increase. Within the group, the Free People brand produced a strong 22% ‘comp’ and FP Movement brand produced an impressive 57% ‘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 for both the Free People and FP Movement brands. The Free People’s Group improvement in sales was only outdone by their impressive surge in profitability for the quarter.

The strength of the Free People Group assortments, marketing campaigns and store experience have continued into early fall. We believe the Free People’s Group Retail segment performance will continue to be nicely positive in the third quarter.

Free People wholesale segment sales decreased 7% during the second quarter. The decrease in sales was a result of weakness in department store accounts partially offset by growth in specialty store accounts. Although wholesale sales remain challenged, profitability has returned to a healthy level. We believe Wholesale segment sales could 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 Urban Outfitters. Urban recorded a negative 14% Retail segment ‘comp’ in Q2. UO’s negative ‘comp’ was the result of disappointing performance in North America and a slightly negative ‘comp’ in Europe. In North America ‘comp’ store sales were high single-digit negative while the digital channel ‘comp’ sales were double-digit negative. In Europe, the weakness was concentrated in the UK while the rest of Europe continued to see positive retail segment ‘comps’. As Dick noted earlier, we did see some improvement in North America’s women’s and men’s apparel in the back-to-school season versus last year, but we still know we can execute better and will need more time to drive the overall improvement we want.

Next, I will touch on the Nuuly business. The brand continued to deliver strong year-over-year subscriber growth with active ‘subs’ increasing 84% to last year. 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, and we continue to believe Nuuly will record its first profitable quarter later this year.

Lastly, I want to congratulate the teams on the opening of our new state-of-the-art distribution and fulfillment facility in Kansas City, Kansas. We believe this facility will improve our overall operating efficiency, reduce our average cost of consumer delivery expense as well as increase our delivery speed to our customers.

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 third quarter and fiscal year 24 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 third quarter. Right now, we believe third quarter total Company sales growth could be high-single digits. Sales growth in Q3 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.

Now on to gross profit margin. We believe URBN's gross margin rate for the third quarter could improve by more than 400 basis points compared to the prior year third quarter, similar to the improvement which we realized in Q2. The increase in gross profit margin could be driven by higher initial product margins from lower inbound freight costs as well lower merchandise markdowns. An improved supply chain is allowing us to bring in product 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 third quarter compared to the prior year third quarter.

Now moving on to SG&A expenses. Based on our current sales performance and plan, we believe SG&A growth for the third 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 intend to increase marketing expenses to drive incremental customer growth at Free People and Anthropologie. 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 Q3, we also believe that SG&A expense growth in the fourth quarter will be more closely aligned with sales growth.

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

Now moving onto inventory. We have made significant progress this year controlling our inventory to sales ratio. We believe that inventory levels in the third quarter could grow at a rate below sales growth. The teams continue to make progress speeding up inventory turns and are targeting product turns close to pre-pandemic levels at most of our brands by the end of fiscal year 24.

Capital expenditures for the fiscal year are planned at approximately $230 million. The spend is primarily related to investments in additional distribution facilities. Earlier this month, we opened our highly automated omni fulfillment facility in Kansas City, Kansas. In addition, we are investing in a new rental fulfillment facility in Missouri within the Kansas City region. We are targeting to open this facility at the beginning of fiscal year 25.

Lastly, we will be opening approximately 28 new stores and closing approximately 21 stores during fiscal year 24.

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. In conclusion, as you've heard from Mel and Frank, we're confident about our prospects for the remainder 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 as demonstrated by our performance in the first two quarters.

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. With their amazing dedication and creativity they 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.