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Under Armour, Inc. (UA)

Q3 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Carrie Gillard
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NON-GAAP FINANCIAL MEASURES

- In addition, as required by Regulation G, we need to make you aware that during the call we will reference certain non-GAAP financial information
- We provide a reconciliation of non-GAAP financial information in our earnings release and in the electronic version of portions of the script from today's call, both of which are available our website at uabiz.com

Kevin A. Plank
Chairman & Chief Executive Officer

BUSINESS HIGHLIGHTS

Opening Remarks

- We are a growth company
- And with our 26th consecutive quarter of 20%-plus revenue growth, we continue to demonstrate our ability to drive a bigger and better company quarter-after-quarter
- Our financial results are an incredible accomplishment for any brand and something that we believe separates us from others in our business
- Today, I'd like to start by giving some perspective on our industry and articulate what that means for Under Armour in this moment in time

Athletic Apparel and Footwear Business

- I believe we operate in a truly resilient industry
- The athletic apparel and footwear business and in broader-context sports has been one of the most dynamic and strongest growing industries in our lifetime
- As we continue to immerse ourselves in strategic and long-term growth, we ensure that we will continue to drive in an industry with barriers of entry today that are much higher than 1996 when I drove my old Ford Explorer door-to-door to teams selling T-shirts out of the bag
- Our industry's collective ability to continue to evolve and make better products that improves an athlete's performance, bring the passion of the sports experience to consumers through our brand storytelling, and to do so with increasing profitability on a global basis is a reflection of what has been an ever-growing demand from consumers that our industry has met with outstanding financial results
    - Those measures of success are not as commonplace in other industries that are sometimes viewed as more stable or secure investments
- Today, brands that five years ago were viewed as leaders in our field are in danger of being commoditized, disrupted, or worse, becoming extinct as technology and the way we live changes the way consumers need and value them

GROWTH OPPORTUNITIES

- Our industry of sport is different
- Our industry's growth opportunities are global with consumers around the world embracing athletic apparel and footwear at its historic levels
- It's not about what people are conveniently referring to as athleisure is the simple truth that consumers all over the world are raising expectations about what to expect from their apparel and footwear and it's a shift that is not going to be reversed

MACRO TRENDS

- The macro trends favorite not just us but all the premium brands in our business, which is part of the reason I believe our industry will continue to gain new and loyal consumers across the globe
- In the sports industry, we represent something truly attainable, measurable and sought after by most consumers: to live a better, healthier life
- Under Armour's mission is to make all athletes better and we are fortunate enough to be in an industry that will withstand and maintain its relevancy over time because our value proposition enriches consumers' lives and helps them reach their personal health and fitness goals
- But our track record of growth and the power of the UA brand provides us with the confidence that we can do more
    - That track record is one of which we are extremely proud

REVENUE

- Over the past three years, Under Armour is the only consumer brand in the top 10 fastest-growing companies in the S&P 500, with total revenue increasing 116% through 2015
- We have the capacity to lead our industry over the next 10 years by continuing to take our consumer someplace new with our constant flow of product and innovation, while at the same time improving their lives through our Connected Fitness platform, which will pass our 2016 goal of reaching over 190mm registered users by the end of this week

- For UA, we have punched above our weight for a long time and that has been a central theme of our success
- That's not going to change
- We compete in an industry that is measured by a few very high standards

INNOVATIVE PRODUCT

- We're measured by the innovative product we bring to consumers, by the strength and relevancy of our brand, by the talent of our team, and of course, by the financial results we deliver
- While our business is in constant evolution, we know those standards won't change
- We also know that we can't look to old models of success that have helped establish some of our competitors in their existing positions

Footwear and International

- So, I want to spend some time this morning talking about how we will operate as the world evolves around us and ensure we are investing to continue to drive forward industry leadership on every front
- As I've stated numerous times on these calls, footwear and international will be key drivers of our revenue growth

REVENUES

- Our footwear business went from $239mm in 2012 to approaching $1B in revenue this year
- And our international revenues grew from $108mm in 2012 to more than $700mm this year
- That's clear evidence that our investments in footwear and international have driven strong revenue growth to date and fuels our confidence that we are just getting started in each of these areas

North America

- I'll talk about our focus there in just a minute, but first I want to talk about the core of our business, North America
- We built our brand and our business with the best wholesale partners in the industry and we're incredibly proud of both our growth and our partnerships across the market
  - There's no doubt that the landscape globally, and certainly in our North American backyard, is shifting

NEW DISTRIBUTION

- As we navigate this dynamic environment, our intention is to continue to evolve and grow in the places that have built our brand, while we simultaneously reach a broader set of consumers through new avenues of distribution
- We believe consumers expect excellence at every touchpoint with our brand and you will see us invest to ensure that we drive growth with our long-term partners at the same time that we invest in new distribution through our own direct-to-consumer experiences

OPPORTUNITIES

- As we think about the many dimensions of growth for our company, we're incredibly confident in the opportunity we see for our North America business

- Consider this, our two largest competitors generated approximately $18B in revenue in North America over just the past 12 months
- So, while we recognize that our trailing 12 month North American revenues of $3.95B is 85% of our business, it is just a fraction of the opportunity that we believe exists for our brand
- Whether it's through share gains, market growth, new distribution or sheer brand heat, we know we have tremendous runway in our home market

MARKET SHARE

- We'll drive growth by the measures you'd expect: innovative product, brand strength and relevance and the best team in the industry to drive market-leading results
- A large part of that growth in North America will come from footwear as we firmly believe that we are at a tipping point in terms of opportunities to gain market share
- In the back-to-school window of July through September, our overall footwear market share nearly doubled according to industry data
- So, while we've always understood that the size of the prize in footwear was massive, we knew coming into this year that there were a lot of consumers in the U.S. who didn't know us as a footwear brand

FOOTWEAR CAMPAIGN

- So this summer, we launched our, It Came From Below, Footwear campaign which focused on the importance of footwork as athletes trained
- We started with Bryce Harper in baseball and for running we hosted a UA run camp, where we took experienced men and women from urban run crews and put them and their Under Armour footwear to the ultimate test in the world's toughest conditions
- With the start of the NFL season in early September, we incorporated NFL MVP, Cam Newton with the prince of a thousand enemies spot and the launch of a game on Snapchat with Cam that drove incredible engagement
- The final piece of our footwear campaign debuts today with the launch of the Curry 3 the TV spot debuts tonight on TNT during opening night of the NBA season combined with our second tour of Asia where we took Stephen to four cities in early September we are continuing to build our relationship with the basketball consumer and driving awareness and UA as a footwear brand by partnering with the two-time NBA MVP

FOOTBALL CLEAT

- So, while Stephen has been a big part of building our footwear story, we're also having success in other areas that are contributing to the growth
- The highlight is the number one Football cleat in the market four years running now and continues to showcase our ability to elevate and drive premium footwear in every category we choose to be in
- We made our first football cleat in 2006 and since then have changed the look of the entire category while elevating the price
    - This type of market evolution and positioning in cleated underscores our opportunity in other footwear categories as we gain awareness, credibility, capabilities and scale

China

BANDIT 2

- We are focused on the exploding running market in China and we saw greater success there with the Bandit 2 running shoe
- An example of how we are building key footwear platforms that will continue to scale and extend
- We are improving our ability to leverage our global assets and help drive business in local markets
- And we continue to focus on being a premium brand in footwear with a goal of having more than 50% of our volume in running footwear over $100 by just spring of next year

SLINGRIDE PRODUCT OFFERING

- We saw incredible demand for our Slingride product offering during Q3
- Slingride is our second running shoe utilizing a full knit upper to deliver comfort and fit where you need it
- Priced at $100, it did extremely well in the market and we believe there is great opportunity in what knit can mean for Under Armour running

INVESTMENTS

- So, we'll continue to invest meaningfully in our footwear business with a focus on talent as well as infrastructure that will help improve the profitability in our business as we scale
- We believe we are at a moment in time where we can gain share in footwear and we are prepared to make investments that will drive long-term profitable growth
    - That same focus on the long-term opportunity holds true for our investments as we build out our international business
- We continue to post strong growth across all our geographies

EMEA

- While our business in EMEA continues to be strong, it's our Greater China market that remains the biggest growth story for our international business
- Posting revenue in Q3 equal to the entire H1 the year and firmly on a path to more than double their business from $80mm just a year ago

China

- We are making incredible inroads in China that we believe will drive our position in this critical market
- With sports and fitness being promoted strongly by the government, we continue to be viewed by the Chinese consumer as the Performance Brand or referred to often as the Professional Brand
- Some of the things we're doing in China include focusing on building premium Brand Houses with a controlled retail environment and a sustainable full-priced business model where we have already opened over 100 doors this year
- Driving a strong e-commerce channel presence and utilizing an Asia for China and local-for-local model to reduce costs and improve fill-rate and on-time delivery
- But we are just getting started in China
- Much like we are in new markets around the world

Mexico, Australia, New Zealand and Chile

- We've rolled out e-commerce platforms in four new markets this year including Mexico, Australia, New Zealand and Chile
- And that's after doing the same in 14 new markets in 2015
- Bringing our total global e-commerce sites to 30
- We're building a global organization for the long-haul, as I said earlier funding these growing international markets may require additional investment in the short-term
    - However, we believe they are essential to our long-term goal of market leadership

Retail

- In addition to footwear and international, we're making investments in other key growth areas that will contribute and drive our ability to become a bigger and better company
- Including; retail, where we're ensuring that we deliver a great presentation of brand wherever our consumer decides to transact
- With SAP, we're creating efficiencies in our systems as we continue to grow in scale

Category Management and Merchandising

- In category management, where we are organizing around nine sport categories and executive leadership to create focus and alignment across our business
- And finally, merchandising, which enables us to differentiate our product to create unique experiences for our consumers across our points of distribution and now gives us the ability to reach more athletes than ever before

Connected Fitness

- The third key where we will continue to overinvest in the near-term is Connected Fitness
- We're doing so because we believe strongly that it will prove an important differentiator in our relationship with the consumer
- With nearly 190mm registered users in our community, we continue to gather critical information to help us change the way athletes live

Investments

- We firmly believe that going forward, brands without substantive communities will be at a deficit when it comes to building a relationship with our consumer
- We are investing in our single view of the consumer through our partnership with SAP as we look to continuously drive a better business as we scale, knowing that much of the benefit will not be seen immediately
    - That said, we expect to see return on these investments starting in the near-term with tools like self-service consumer comparison reporting where we can quickly compare the demographic profiles, workout habits and purchase behavior of any group of consumers
- We are growing our analytics capabilities and moving from backward-looking reporting to predictive and prescriptive analytics which allow us to establish and drive growth in a more meaningful way
- We will be able to personalize our e-commerce homepage driving off your geographic profiles, which sport categories are important to you, your exercise, how frequently you exercise, sleep, weight, diet, and the make-up of your household

DATA AND LEVERAGE

- Going forward, we will continue to dive into the data and leverage the insights to deepen and expand our relationship with athletes as their needs change
- Our brand continues to evolve and shift with the changing demands and needs of the consumer
- And as I said earlier, we are an incredible industry where sports and health and fitness are driving forces in our success
- Our investments, the ones we have made in the past and we'll continue to make in the years to come, are critical for us to realize the true potential of the UA brand
- We are confident we are making the right investments and our track record of investing for growth is exceptional
- Our investments are all about expansion of brand, about opening the aperture of what we are capable of and never being satisfied with our past successes

Strategic Growth

- So recently I pulled together the top leaders in the company and discussed the strategic growth and direction of Under Armour
- We came away with three key areas of focus that I want to share with you today
    - First, getting big fast
    - Second, making retail a core competency
    - And third, getting more shoes on feet
- To be clear; get big fast does not mean at all costs, it means prioritizing our growth and making the right decisions for the brand
    - It means growing the right way
- As I said earlier, we have succeeded over the past 20 years by consistently punching above our weight and that will not change

OPPORTUNITIES

- But our growth now gives us opportunities to move up in weight class and we find ourselves well-positioned at this moment in time to compete for long-term relationships with athletes, teams and league affiliations that we previously could not justify
- Now with the flexibility to lock in 10-year to 15-year deals, we can make investments on a global scale that will help drive authenticity, awareness and revenues for our brand
- It is not going to be easy
- The mix of our business is evolving and so must we, which is why making retail a core competency is critical to our future success
    - We'll do that by answering the call to consumer who is asking us to give them more in the place that they expect to find our product
- We are no longer just a North American apparel company
- We are a retail company across multiple consumer touch points and we'll look to be best-in-class and when we know how to be a great retailer, we can leverage that expertise to help us be a better wholesale partner and therefore continue to elevate and meet our consumer where and how they want to engage with us

Summary

- So to summarize where this nets out, both international and footwear are growing faster in the near-term than we had originally planned; and as a result, we remain confident in reaching our 2018 revenue target of $7.5B
- While this mix shift will create margin pressure, we have a significant opportunity to offset the sales mix impact by continuing to improve our footwear product margins over time and we will
- But the market share opportunity cannot wait
- We will remain focused on getting more shoes on feet, because we see footwear being as big, if not bigger than apparel one day
- And as we drive footwear revenue, the dynamics of the business do change, but that's a good thing because we are truly just getting started in footwear

OUTLOOK

- So before I pass to Chip, I just want to reiterate my confidence in the future of our industry and more specifically how Under Armour with the right investment and incredible brand momentum will continue to lead and outpace the competition
- As I said during my opening, I believe we operate in a resilient industry with strong competitors who have built global businesses over the course of many years
  - And while their sheer size poses consistent challenges for us, and challenges we have consistently met and beaten, we believe that the monumental shift that is taking place in both the manufacturing of shoes and apparel and the way consumers buy our products is leveling the playing field and will enable us to build a bigger and better global brand

Revenue Growth

- We've delivered great results on the path that has led us to this moment in time. 26 consecutive quarters of 20-plus percent revenue growth
- During that stretch, we've established a culture of growth that equips us for this next chapter in our story
- And today, we are reiterating our target of $7.5B in revenue for 2018
- Our challenge is that we need to continue investing on multiple fronts, in categories, geographies, and the talent and infrastructure required to capture those growth opportunities and that's why the dollars we are committing reflect a broader investment strategy
  - In the short-term, these investments will impact our operating income growth, which Chip will walk you through in a moment

Industry Leadership

- We understand that the path to industry leadership grows more complex as we expand in categories, channels and geographies
- And I am confident we will remain the market leader in growth by delivering innovation at every touchpoint a consumer has with our brand

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Chip Molloy
Chief Financial Officer

FINANCIAL HIGHLIGHTS

Revenue Performance

- I would now like to spend some time on reviewing our third quarter 2016 financial results followed by our updated outlook for the remainder of the year as well as our long-term outlook and initial guidance for next year
- Our revenues for Q3 2016 increased 22% to $1.47B

CURRENCY-NEUTRAL BASIS

- On a currency-neutral basis, net revenues increased 23% compared with the prior-year's period
- Our ability to deliver another quarter of consistent growth is a direct result of continued investments we have made in the business to meet consumer expectations through categories, channels, and geographies
- As we continue to navigate through the changing dynamics of the North American retail landscape, we remain focused on solving problems for athletes all over the world and meeting the consumer with premium compelling product wherever they are interacting with our brand

WHOLESALE AND DIRECT-TO-CONSUMER

- During Q3, our wholesale revenues grew 19% to $1.01B
- Our direct-to-consumer revenues grew 29% to $408mm, representing approximately 28% of total revenues for the quarter
- During the quarter, licensing revenues grew 21% to $29mm and Connected Fitness revenues grew 40% to $20mm

PRODUCT CATEGORY

- On the product category front, apparel revenues increased 18% to $1.02B compared to $866mm in the prior year's quarter, led by consistent growth in our sport categories, including men's training, women's training, golf and team sports
- Third quarter footwear revenues increased 42% to $279mm from $196mm in the prior year's quarter
- Within running, we saw strong global demand for the brand, led by two of our new $100 price-point product offerings, the Bandit 2 and Slingride, showcasing our continued focus and investment in this key category of long-term growth
- In basketball, the Curry signature line continues to drive strong growth for the Under Armour brand
- Our accessories revenues during Q3 increased 18% to $122mm from $104mm in the prior year's quarter, primarily driven by bags and headwear

REGIONAL BASIS

- On a regional basis, North American revenues in Q3 increased 16% to $1.23B compared to $1.06B during the same period last year
- Within our direct-to-consumer channel, our North American store count at the end of the quarter included 162 company-owned stores, comprised of 145 factory stores and 17 Brand House stores
- With the opening of three new Brand Houses in the quarter, including Philadelphia, New York City World Trade Center and Madison, Wisconsin, we continue to invest in building and creating the best premium retail expression of our brand

INTERNATIONAL REVENUES

- International revenues increased 74% to $226mm in Q3 to reach 15% of total revenues
- On a currency-neutral basis, international revenues increased 80%
- Within our international wholesale channel, the store count at the end of the quarter included 282 partner stores
- Within our direct-to-consumer channel, our company-owned international store count at the end of the quarter included 63 stores, comprised of 32 Factory Houses and 31 Brand House stores

EMEA AND ASIA-PACIFIC REGION

- Looking at our international regions, starting with EMEA, we continue to post strong growth in the region as we expand our presence with key wholesale partners and distributors while building out our direct-to-consumer business
- In the Asia-Pacific region, our premium performance brand strategy continues to resonate with the consumer driving strong growth in the quarter
- As Kevin mentioned, we continue to see strong growth in basketball led by the Stephen Curry signature line and believe we are well positioned to capitalize and scale the business in our fastest-growing region

LATIN AMERICA

- And in Latin America, we drove incredible brand awareness in the region and around the globe with the strong performances of our Olympic athletes
- We remain focused on the long-term growth opportunity of this region as we continue to build and expand our distribution

Margins

- Moving on to margins, third quarter gross margins decreased 130BPS to 47.5% compared to 48.8% in the prior year's period
- The following items contributed the majority of the margin contraction this quarter:
  - First, liquidations negatively impacted the quarter by approximately 80BPS vs. the prior year
  - Second, product margins negatively impacted gross margin by approximately 30BPS vs. the prior year, driven by product mix, higher discounts and promotions, partially offset by continued improvement in product input cost
  - And finally, foreign currency exchange rates negatively impacted gross margin by approximately 30BPS.
- In the quarter, gross margin declined more than planned, driven predominantly by higher-than-expected promotions both the volume and rate of liquidations and foreign exchange rates
- Despite liquidations having been a headwind on margin rates for most of this year, we now believe that our inventory position is healthier and that liquidation should not have the same negative impact moving forward

SG&A Expenses

- Selling, general and administrative expenses grew 20% to $499mm, compared to $416mm during Q3 last year

- Growth was predominantly driven by investments in our direct-to-consumer businesses both retail and e-commerce along with the infrastructure and people necessary to support our growth and strategic initiatives such as product creation, innovation and sport-category management
- Selling, general and administrative expenses were less than planned in the quarter due to lower incentive compensation and the timing of marketing activations
    - A portion of the expected marketing spend shifted from Q3 to Q4 to better align with key initiatives including the launch of Curry 3 that Kevin mentioned earlier

Operating Income, Interest Expense and Tax Rate

- Operating income for Q3 increased 16% to $199mm compared with $171mm in the prior year period
- Interest expense for Q3 increased to approximately $8mm compared to $4mm in the prior year's period
- Within other income and expense, we recorded a loss of $1mm in the current year vs. a loss of $3mm in the prior year
- In addition, the tax rate in Q3 was 32.6% compared to 38.8% in the prior year, largely due to improved international profitability in the current-year period and a tax benefit related to our prior-year acquisitions
- Our third quarter net income increased 28% to $128mm compared to $100mm in the prior year period

BALANCE SHEET

- On the balance sheet, total cash and cash equivalents for the quarter was $180mm compared with $159mm at September 30, 2015
- Inventory for the quarter increased 12% to $971mm compared to $867mm, while total debt increased to $1.07B as compared to $902mm

Cash Flows

- Looking at our cash flows, our investment in CapEx was $73mm for Q3 compared to $71mm in the prior year's period
- We now expect to spend approximately $450mm for the full-year, including investments in our global offices around the world including our headquarters in Baltimore, our distribution centers, our SAP platform and global direct-to-consumer

GUIDANCE

Revenues, Operating Income and Gross Margins

- Now, moving on to our guidance for the remainder of the year
- Based on our current visibility, we continue to expect full-year 2016 net revenues of approximately $4.925B, representing growth of 24%
- And operating income in the range of approximately $440mm to $445mm, representing growth of 8% to 9%
- Gross margins for the full-year are expected to decline approximately 80BPS compared to last year driven by the same factors that we have experienced through the year
- Based on our outlook of $4.925B in revenues, SG&A is now expected to grow approximately 26%, as we remain focused on making the right investments today to drive our long-term global success

Interest Expense and Tax Rate

- Below the operating line, we expect interest expense to increase to approximately $30mm in 2016
- In addition, we now expect a full-year tax rate of approximately 35.5% and fully-diluted weighted average shares outstanding of approximately 446mm

Q4 Results

REVENUES AND GROSS MARGIN

- I would also like to provide additional color on Q4
- For Q4, we expect revenues to grow approximately 20%
- We believe the strength of our brand and increased breadth of head-to-toe product offerings position us for another quarter of strong growth in what has been a challenging North American retail environment
- With strong momentum in footwear and international, we remain focused on delivering key products and assortments for the holiday season
- Gross margin is expected to be relatively flat vs. prior year

SG&A AND OPERATING INCOME

- Within SG&A, as I mentioned earlier, the timing of certain marketing activations along with continued investment in long-term growth opportunities like Connected Fitness, international and direct-to-consumer will drive the growth in the quarter
- For Q4, we expect operating income in the range of $186mm to $191mm, representing growth of 5% to 8% over the prior year

OUTLOOK

- Before we turn it over to Q&A, we'd like to briefly discuss our long-term outlook and associated guidance for next year
- At our 2015 Investor Day, we announced our goals of achieving $7.5B of revenues and $800mm of operating income by 2018
- We are on track to achieve our 2018 revenue goal of $7.5B and expect to grow full-year revenues consistently in the low 20%s in both 2017 and 2018
- At the same time, we expect annual operating income growth in the mid-teens each of the next two years as we focus on investing to get big fast

Growth Rate

- As Kevin highlighted earlier, the landscape for our business and our industry continues to evolve and in a fast-paced world we must be willing to adapt make game-time decisions and drive our brand forward
- North America apparel growth is slowing across the industry
- While we expect to continue to significantly outpace the apparel industry, the growth rate going forward will be less than expected from our Investor Day in 2015
    - This is a moment in time
- We could choose to optimize for more near-term profits, but we believe it is more prudent to invest to maintain superior growth rates, while gaining both share and scale
- Growth, share and scale are the priorities for our brand

Investments

- That said, we will invest more heavily in areas that we can grow faster such as footwear, direct-to-consumer and international as well as more aggressively enter sport fashion like UAS and the much-broader sports lifestyle category
- In footwear, that means doubling down on creating great product through innovation and design, scaling and extending our pinnacle footwear franchises and investing in the complete market strategy from merchandising to in-store marketing
- In direct-to-consumer, we are driving investment in mobile, the optimization of the Factory House store footprint and building our premium Brand House expressions to help us drive market share
- International growth includes being more aggressive in key markets where we are gaining significant awareness such as Asia
- In the sports lifestyle category, we are accelerating investment in the people necessary to design relevant and brand-right product
- And finally, we will continue to make key investments in assets that promote the brand

Opportunities

- Beyond 2018, we believe we have opportunities across categories, channels and geographies to consistently deliver superior revenue growth relative to our industry
- We also believe that as we approach $10B in revenues, the scale it provides along with the investments we have made in people, infrastructure and systems will begin to pay off in the form of increasing operating margin rates
- As Kevin stated earlier, we've delivered great results on the path that has led us to this moment in time
- The dollars we are committing reflect a broader investment strategy that will enable us to build a company as big as our brand

QUESTION AND ANSWER SECTION

Michael Binetti
UBS Securities LLC

Q

Kevin, let me – I'm going to start with a question for you Kevin. Can you just help us better understand within the context of the longer-term guidance, why you don't think you'll be able to hit the $800mm in operating profit income, and maybe what has changed that gives you confidence in hitting the $7.5B in revenues, wow, but not the $800mm in operating income?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Yeah. Thank you, Michael, and this is obviously an area that I want to spend a little time on and go deep, so give me a few minutes to craft this for you.

Michael Binetti
UBS Securities LLC

Q

Sure.

Kevin A. Plank
Chairman & Chief Executive Officer

A

So, as Chip just said in his commentary, we talked about building a business as big as our brand. We've had our eye on $10B, that's the way that we see our company, I think it's the way that people view and judge us with $7.5B being our next milestone to be hit by 2018. And again, we want to reiterate that we're on track to hitting that goal. But there are a few factors that led to the decision to modify the operating income for us, since Investor Day September 2015. So what's happening and what's different?

First of all, in North America, it's a place that provided incredible air cover for our brand for a very long time and I think like we're seeing in a lot of places that, that is modifying, it's changing. In the investments that we've made over the past 11 years as a public company, we've seen that our business, thankfully, has evolved from being strictly a North American wholesale apparel brand into a global sports brand that also has the ability to claim international and footwear as probably two of our largest and greatest opportunities for growth.

And all the while, I want to be clear, with apparel remaining incredibly profitable and still growing at the tune of 18% in just Q3 for us. So, there's not an end to the North American apparel story. That continues to march on for us as well. We just have other opportunities that are outpacing some of that growth.

So some of those opportunities, like footwear and international, they are exceeding what we're putting up, in 24-plus percent top line growth as a company and that change in mix is modifying our gross margin story in the short-term. That means while we're doing better in footwear and international than we thought we were capable of doing, that we're fortunate to have these levers to pull and, frankly, attack as we maintain our industry-leading growth on the top line as well as continue to drive what we can in making the right investments in the right parts of our business.

So it also changes our distribution. The fact that we've had three bankruptcies that have occurred in just the last 12 months in sporting goods that account for more than $4B in lost revenue for the sporting goods industry in

North America, and compare that relatively speaking that going all the way back to 2008/2009 there was just $170mm of bankruptcies, of lost revenue in our industry. So we saw something pretty big happen that we'd thought about, but it definitely has been eye-opening for us, especially recently.

We want to be clear, like our demand is still there, like this doesn't mean that the demand for the Under Armour brand has disappeared, but it certainly hasn't reappeared dollar-for-dollar in our immediate distribution. We believe that the opportunity is also still there. We just have to be more thoughtful about how to capture the consumers and their dollars including replacing with our own direct-to-consumer controlled retail as well as expanded distribution by doing things like Kohl's, which will carry the Under Armour product beginning in 2017.

We also plan to make additional investments in the places where we know that we can win. So right now, that moment in time is a very important message I think for, obviously, our shareholders but, frankly, for our team and our consumer.

Footwear and international are going to continue to be staples of our investment strategy, because we think the opportunity for us now is to strike and strike hard. And we take the momentum of things like Curry, with what is launching tonight, and I think you'll be pretty excited by what you see and, most importantly, the consumer is going to be pretty excited about what they see.

We also have opportunities like lifestyle that, as we've talked about before on these calls, represents roughly a third of the revenues of our two largest competitors and today less than 5% of the business for Under Armour. Thirdly, Connected Fitness is continue going to be an area that we'll invest in, where we believe that redefining the expectation the consumer has of a sports brand with our data will give us perspective on our consumer that will be truly unmatched in our industry.

Another factor that we've seen recently has been the escalation in the price and, frankly, the duration of sports marketing assets. The length of these deals has gone from standard 5-year deals arrangements to now 10 to 15-year deals.

UCLA, one that we just wrapped up recently this past spring, was the largest collegiate deal in history, but it's a 15-year partnership. And at the same time, we also locked up Cal Berkeley and giving us a true position in California which, frankly, prior to that, we really didn't have.

If we deem them strategic, the ability that what's happening in the sports marketing as these assets are being wrapped up, it's either act now, or lose them for frankly the mid to long-term. This, of course, does not mean every deal and I want to be clear, is that the shift in operating income for us is not about creating a bigger marketing budget so we can go buy more stuff. It is about truly investing in our brand, our systems, our infrastructure and especially our team.

I'll give you another example of that in just a minute. So all those things are just some of the tactical but not to be ignored long-term strategic issues, new issues that we're facing since September of 2015. And when you grow a business 20-plus percent a quarter for 6.5 years, it builds a unique profile that we find ourselves today, which means adding $1B and growing a year in revenue and it requires significant resources and investment. But I want to be clear, is that the growth remains intact, it just costs more short-term investment dollars to achieve and the belief is that greater efficiency can come later and that the growth that we have over the short-term EPS is a priority for our long-term goal of becoming the number one sports brand in the world.

And I want to reiterate that, like we are in this for the long haul and the opportunity that we see is to be the best in the world. And that does require investment and we know that people aren't going to like the way it sounds, but this is – I don't know if there's ever been another model like ours at 6.5 years with the growth that we've seen, particularly in consumer. And so the book isn't written anywhere and if it were, we'd have read it. But this is what we're telling you is that from our purview of 11 years public and what I've seen in our business, that now is the time for us to strike because I think the upside is so much greater on the other side.

So on a relative basis, we believe the short-term dollars are better spent building our infrastructure, ensuring that we capture that 2018 goal of $7.5B, especially once we achieve the scale of $10B growth company, which will be when we can truly begin to leverage our model to optimize expanding gross margins, our SG&A investment and ultimately shareholder value.

So one of the issues that I just – I know people notice but I think it's worthy of us to say, that you face as a superior growth company, which Under Armour has always demonstrated its ability to be, is that operating growth of 15% for virtually any S&P or Fortune 500 business would be outstanding. But because our business is growing in the 20%s, a profile that only a very few rare companies in either the S&P or Fortune 500 and frankly not from our industry from either pharma or tech share and where we still expect to deliver more than $0.5B of operating income profit in 2017 alone.

So we're not saying we're losing money. We are moving and marching forward or in growth terms that more than $0.5B is more than nearly two times the total revenue we delivered in our IPO year of 2005 proving that our investments in things like footwear, women's, and international have all paid off.

But at the end of day, look, we believe that by making these investments, the ability for us is to mature into a business as big as our brand. And we want to drive best-in-class profitability as our business hits scale, our growth rates become more measured and we've got the people, distribution, systems and infrastructure to optimize. Today, we have pieces of it, but frankly it's just incomplete and that's why we must continue to invest.

I want to give some perspective here for a second just on where we are. I mean, Under Armour's – we got dropped into the sporting brand pond about 20 years ago. And we jumped in and there were a lot of players, 20 players, 30 players or brands as many as you want.

Today, we're the third-largest brand in the world. We're the second largest brand in North America. And our two largest competitors have more than 20,000 points of distribution each in North America alone compared to just our 11,000, which speaks to just some of the runway that we still have in front of us right here in our own backyard. They are also six times and four times our size respectively.

So, let me give you a real-time example of what that means. It means in an area like women's footwear where we currently have just six teammates on our women's footwear team based in Portland, who are doing an amazing job for us and is building best-in-class product, our competitors who we get compared to on a one-to-one basis have dozens or even hundreds of people covering the same category. It's our responsibility for our long-term growth objective of being number one in youth, in men's, and of course, women's across all categories to continue to invest to meet that long-term goal.

So, I want to be clear is that, you know, we have a saying around here, it's called, no loser talk. And it's the last thing we would ever do. And I want our shareholders to know how hard this company fights for every single dollar at the bottom line, but how we're looking honestly at this moment in time and saying it's time for us to invest. We have the best team and we've got the best brands and we expect to continue to grow.

John Kernan
Cowen & Co. LLC

Q

It seems like product flows into the retail channel and your wholesale channel are changing pretty dramatically, and we've heard from some of your competitors. And it just seems like there's a need for speed out of the supply chain and the sourcing from all the brands. Can you just talk about the change in product flows and how it's going to affect your business going forward?

Kevin A. Plank
Chairman & Chief Executive Officer

A

I mean, product flows for us, there's a lot of ways for us to think about it. So first of all, we're seeing a tough story that as we look or think about North America, you've heard a couple of people talk about it.

And again, it's nothing's going away, but it's definitely been reflective in just some of the bankruptcies and the other things that we've seen recently. The people we're doing business with, I believe are doing very well. They're getting very smart about the way they're managing and running their business. But it's definitely, you know, you're not finding our accounts that are taking big inventory positions and betting on the cold weather. So, those are the things that are leading for us that's requiring us to run and to drive a better business.

Today, I would define Under Armour as a great brand and as a great brand with a – but probably a good company. The opportunity we have is things like what we see with some of the speed to manufacturing. Things like recently when we announced our partnership at City Garage here in Baltimore and when we talk about a local-for-local strategy, which means bringing manufacturing back to the United States and again that's not a made in the USA initiative as much as it's an initiative for us about making great product anywhere. It's that the people of America want product made in America, the people of Europe want the same, the people of São Paulo want products from Brazil, so we're going to continue to answer that and look to drive on that answer. But there's a lot of investment on the front end. And the good news is that the sad thing about our industry is that a shirt and a shoe are still made the exact same way they were 100 years ago and we see a massive opportunity for that to improve.

So some of the things I talked about in my script and my comments was how that we have the ability, I think, to accelerate the speed at which innovation can happen there. Right now to make a single shoe, for instance, it takes upwards of 300 pairs of hands to make a single shoe. So we think there's a lot of room for innovation, we're finding a lot about ourselves and I think that's continuing to move for us as well.

John Kernan
Cowen & Co. LLC

Q

Okay. And if I can just sneak one more in. I think longer term, what people see as they see one of your big competitors out in Portland with a mid-teens operating margin, they see one of your other competitors in Germany with a mid-single-digit operating margin, where does Under Armour fit in long-term? What's the true driver of margin expansion long-term? Is it really just following more through by better SG&A leverage, or gross margins and product margins can move higher? What pushes the operating margin longer-term when we think beyond just 2018?

Chip Molloy
Chief Financial Officer

A

Hey, John. This is Chip. A couple of things.

John Kernan
Cowen & Co. LLC

Q

Hey. How are you?

Chip Molloy
Chief Financial Officer

A

As we start to get to $10B, there's a couple things that will happen. One, the gross margins, we should start to get expansion on the gross margins and we'll start to get that because we won't be faced with as much of a mix shift that we're faced with today and the improvements we're seeing on the cost side of the house, we are seeing those today and they'll continue; but over time, as we start to gain more and more scale, we'll see that gross margin improvement. And on top of that as we get more into lifestyle, we'll see more gross margin as well. So, once we start to get towards $10B we'll see gross margin.

At the same time, that's when we should really start to be able to leverage our expense structure. We're investing across the world. We're investing in offices, we're investing in IT systems, we're investing in distribution capacity. All of those things are happening today and will continue to happen over the next couple years, but we will start to see that leverage. So, it becomes sort of a perfect storm, once we get to $10B and we'll start to see operating income margin expansion. And I think we'll head towards more the premium level vs. the other person or the other competitor that you're speaking with.

Erinn E. Murphy
Piper Jaffray & Co.

Q

I guess just on that last point Chip, for you, on the gross margin, the analyst that you talked about, 49% gross margin and now it sounds like you're saying that you need to get kind of bigger scale towards that $10B mark to really see that gross margin pick up. I mean, can you just help us think about at least over the next couple of years from a planning horizon perspective how should that gross margin line metric look?

Chip Molloy
Chief Financial Officer

A

Yeah, Erinn. Well, first off, in any given quarter there will be noise around liquidations or FX. So that can happen in any given quarter, but over the course of the next couple years, we as a company will probably see flat gross margins. We're going to have mix as a headwind as we continue to grow our footwear at two times to 2.5 times our apparel and accessories business and the disparity between those gross margins creates a mix shift for us.

At the same time, we're already seeing improvements in our footwear margins and we'll continue to see those improvements. And so net-net, we think we can overcome that mix shift through the improvements we're seeing on the costing side for the next couple of years; but net-net, it will be flat. Then as we start to approach $10B as I mentioned earlier, that's when we believe that we will have the scale and we will have a much more significant mix at that time of footwear that you'll start to see an expanding gross margin come $10B.

Erinn E. Murphy
Piper Jaffray & Co.

Q

Okay. That helps.

Kevin A. Plank
Chairman & Chief Executive Officer

A

Erinn, we're also – I mean, I think it's just good to drive home the point about footwear and the opportunity we see there. So, Under Armour today, we're in the low to mid-30%s when it comes to our footwear gross margin that nets out compared to our competitors which are 10% or roughly 1,000BPS in front of us. And so, we've made great strides in the last couple of years actually taking hundreds of points of gross margin and calling that back and we see great opportunity as well.

And so there's no secret sauce that someone else has that we don't. It's been time, it's been energy and experience and frankly having just gotten back from a trip from Asia about four weeks or five weeks ago and seeing the investment that our manufacturing partners are making us throughout China but also through Vietnam and the Philippines where you're seeing a lot of these new facilities going up, there is a great belief in a company and a brand like Under Armour that just a couple years ago, I think footwear is important to lay out. Last year, we made 30mm pairs of shoes. 2016, we'll make 40mm pairs of shoes. Obviously, you hear how bullish we are in footwear, so that number is increasing.

And again, that's impressive, but it still compares to the hundreds of millions of pairs of shoes that are made by our competitors. So as we build scale, this will massively come on board as well it will help with people like Colin Browne, who is our new President of Sourcing, in some of the things that we'll do driving some of these initiatives. So, we see there's great opportunity in gross margin and this is nothing that we're laying back in – there's no excuse for what we're doing with operating income as it relates to – or the way that we're attacking gross margin across the board.

Erinn E. Murphy
Piper Jaffray & Co.

Q

Okay. That's helpful. And then just on inventory up 12%, so fairly lean. I mean, do you feel like you have enough inventory if you go into the holiday season? And I think you're still planning for 20% growth in that Q4 and early part of 2017. How should we just think about that at the end of the quarter as well?

Chip Molloy
Chief Financial Officer

A

Hey, Erinn. It's Chip. We feel like we're in really good shape from an inventory perspective. We did have very large growth rates over the course of late last year and then the early part of this year. So that growth rates come down, but the inventory is in great shape, and the inventory we have, we do have availability in the event that we all hope that it gets cold and it'll be nice and we do have the inventory to supply for that.

Erinn E. Murphy
Piper Jaffray & Co.

Q

Okay. And then just last, Kevin, for you on women's. I didn't hear you talk much on this call on the women's opportunity. Can you just flush out where we're at now and kind of where you see that as you think about your 2018, $7.5B goal? Is that still unchanged in terms of the opportunity?

Kevin A. Plank
Chairman & Chief Executive Officer

A

Yeah, completely. So, I want to be clear is that women's remains one of our brightest opportunities for growth in our business. Women's is still growing in the quarter, up 17%, I think 18%. And again that the heart of this is category management. I spoke about it in my prepared remarks and we've done that with women's to specifically call it out and make sure that it gets the emphasis it needs.

Pam Catlett is leading that. She's an industry vet and has been a complete pro in bringing the pieces together, but there's a lot of pieces to bring together. Probably the best thing I could say is, when you talk about our women's business, we have $1B women's brand. It's taken us one heck of a long time to get here, but we're incredibly proud of what that means.

And but, you know what, I think probably looking at women's through the lens of – I gave the example about footwear in one of my earlier answers, and we have six people in our women's footwear team. We just built our first Women's Last, last year for the first time and those are the things from an operating income standpoint. I want to say is that when people say you don't have enough – people dress toe to head. It's the way they start with their shoe, but if the shoe isn't right, if the fit isn't right, if the color isn't right, if we don't have the right team, you know, the reason we didn't build the Women's Last before is because we were focused on the ability that we couldn't afford it.

And so we're making a lot of those small decisions right now that we truly believe that looking at 2017, 2018, making the investment as unfortunately and fortunately because our growth rate is so great, it creates that drag. But making this right investment in footwear is important.

So we go back with women is that one thing we think is incredibly important is that the football cleated opportunity and what we're doing being the number one cleat there isn't doing much for the women's category. But the confidence that we're demonstrating in running from our knit products, this is the – again, this will be the first year in the market that we'll have that Women's Last on people's feet, on women's feet and we also think that as we continue to drive a better product for driving both performance, style, strength and beauty, the focus is we'll have. And so I think we've got a terrific team in place. We are investing in our women's team as well. We think footwear will be one of the catalysts for it, but achieving $1B business in women's is a pretty big feat and it's something we're certainly not stopping or satisfied with