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Under Armour, Inc. (UA)

Q1 2016 Earnings Call

CORPORATE PARTICIPANTS

Thomas D. Shaw
Director-Investor Relations

Kevin A. Plank
Chairman & Chief Executive Officer

Chip Molloy
Chief Financial Officer

David Bergman
Senior Vice President, Corporate Finance, Under Armour, Inc.

OTHER PARTICIPANTS

Camilo Lyon
Canaccord Genuity, Inc.

Michael Binetti
UBS Securities LLC

Eric Tracy
Brean Capital LLC

Omar Saad
Evercore ISI

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Under Armour, Inc. First Quarter 2016 Earnings Conference Call and Webcast. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time. As a reminder, this conference is being recorded.

I would now like to hand the meeting over to Tom Shaw, Director of Investor Relations. Please go ahead.

Thomas D. Shaw
Director-Investor Relations

Thanks, and good morning to everyone joining us for today's first quarter conference call. During the course of this call we will be making projections or other forward-looking statements regarding future events or the future financial performance of the company. We wish to caution that such statements are subject to risk and uncertainties that could cause actual events or results to differ materially. These risk and uncertainties are described in our press release and in the risk factor section of our filings with the SEC. The company assumes no obligation to update forward-looking statements to reflect events, or circumstances after the date on which a statement is made, or to reflect the occurrence of unanticipated events.

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 the earnings release and in the electronic version of portions of the script from today's call. Both of which are available on our website at uabiz.com.

Joining us on today's call will be Kevin Plank, Chairman and CEO; followed by Chip Molloy, our CFO, who will discuss the company's financial performance for the first quarter and provide an update to our 2016 outlook. After the prepared remarks, Kevin and Chip, along with our Senior Vice President of Corporate Finance, Dave Bergman,

will be available for a Q&A session that will end at approximately 9:30 a.m. Finally, a replay of this teleconference will be available at our website at approximately 11:00 a.m. Eastern Time today.

With that, I will turn it over to Kevin Plank.

Kevin A. Plank

Chairman & Chief Executive Officer

Thank you, Tom, and good morning, everyone. Transformation – in 2016 the ability to adapt to the changing needs of the consumer is a defining metric of success. For Under Armour that willingness to transform comes from our understanding that when the map differs from the terrain we go with the terrain. Those words of advice came from former Navy Seal, an Under Armour Director, Admiral Eric T. Olson, Retired. And they aptly describe how we are navigating our company as we enter our 20th year in business.

I want to focus this morning on our transformation, the evolution that is manifesting itself across multiple product categories, channels and geographies, but first, our scoreboard.

We have started off our 20th year in business with impressive results. Our first quarter revenues grew 30%, with the growth coming from every facet of our business. And to be clear, that 30% number was no accident. When Stephen Curry decided to average 30 points this season to take the scoring title while wearing the number 30, we thought that putting up 30% growth on our end was the best way for us to demonstrate our pride and support of Stephen and the Warriors.

This means our top-line growth exceeded 20% for the 24th consecutive quarter, that's six straight years above 20%. And we saw continued acceleration in both our Footwear and International businesses. These results are a great example of what happens when we execute at a high level and deliver compelling head-to-toe product for the consumer.

Last year, we achieved our first \$1 billion quarter. This year, we expect every quarter to top \$1 billion in revenues based on our updated outlook of \$5 billion U.S., an important milestone for our brand.

So, let's focus on how and where we are transforming and driving our brand. The first example is in China, where we have patiently built the foundation we know is needed to capture the enormous growth opportunity in that market. In this past quarter, we earned more revenue in China in 90 days than we did in the full year of 2014. We have grown judiciously in this critical market, building a solid foundation of core product, with plans to add an additional 120 owned and partner brand health stores in Greater China throughout 2016.

Last summer we brought the NBA's best player, Stephen Curry, to China, and its impact on the consumer there has been phenomenal. Driven by sales of the Curry Two, Footwear accounted for nearly one-third of our overall business in China compared to the rest of the world, which was less than 20% in 2015. Later this year, we will once again travel to China and Southeast Asia with Stephen, as we continue to drive brand awareness and consumer engagement all over the world.

The other example that illustrates our ability to adapt is in our e-commerce business, where we now operate 26 global sites and for the first time more than half of our U.S. traffic this quarter came through mobile devices. The rapid transformation in how people access our brand has been astounding. It's critically important that we reach our consumer where and how they shop, and our focus is on improving our e-commerce consumer experience, on both our own sites as well as our retail partner sites.

These dynamic shifts are creating valuable diversification for our business. Today, that diversification in our portfolio, whether it's wholesale versus DTC, or North America versus International, is a key factor in our ability to deliver 30% revenue growth even in a quarter where one of our largest partners, the Sports Authority, filed for bankruptcy.

China and e-commerce are just two small examples of how quickly our business is transforming. We consider ourselves extremely fortunate to be in such a dynamic industry, one where our consumer is in a constant state of change, from new ways to think about your fitness, new fashion trends or new athlete icons coming onto the scene. It's those changing dynamics that create opportunities to bring new consumers into our brand and to deepen the relationships with those already familiar with us.

These two examples are also compelling statements about the speed of change in our world. We are running a much different business than we were last year and the change is perpetual. So, while others may measure our growth prospects solely by more myopic metrics, we look to our ability to adapt as an equally strong indicator of our continued pace of growth. A growth we have consistently delivered above 20% plus in top-line revenue for the past six years, whether it's evolving to where athletes like Stephen Curry, Misty Copeland, Bryce Harper, Cam Newton and Jordan Spieth are some of the young faces of our brand, or having our Footwear and International businesses leading our growth, we are transforming our company and are doing so every 90 days. This is a velocity that growth companies need to maintain to be competitive [ph] in 2016 (10:04).

For Under Armour, it's the cadence at which we have competed since we started this race 20 years ago and the pace where our team is most comfortable. That pace of growth is most evident in our Footwear business, with revenues for the first quarter up 64%. And the Footwear MVP for Under Armour, just like he is in the NBA, is Stephen Curry.

Our strong momentum in the fourth quarter of 2015 carried through into the new year with the Curry Two topping the signature shoe charts consistently week after week. Stephen's phenomenal season has brought unprecedented attention to our overall Footwear business, and especially basketball Footwear, and is driving both door expansion with our key mall partners and credibility with the hard-core basketball kid.

With the NBA playoffs underway next month, we will be releasing the Curry 2.5 through Foot Locker and our own e-commerce channel. It's the shoe that Stephen wore when his team accomplished its historic 73rd NBA win, and it's the shoe he is now going to be wearing in the playoffs. The Curry 2.5 will launch globally on July 1, and then we will come back this fall with the Curry Three.

We recognize that Stephen's ascent to the top of the basketball world creates a once-in-a-generation opportunity for our brand, and our team is laser focused on delivering against that potential.

As strong as basketball footwear has been for Under Armour, this past quarter we saw more premium footwear introductions entering into the marketplace than all of last year combined. First up was the Under Armour Gemini 2 RE, the first UA Record Equipped running shoe that interfaces with our Connected Fitness platform. This shoe tracks your every step and uploads data including time, date, duration and distance directly into your chosen Under Armour digital dashboard, one of our four apps. This untethered experience allows the athlete to run, device-free, with no start or no stop button.

So whether it's the Gemini 2 RE at \$150 or its traditional counterpart at \$130, when you build compelling, innovative products at a variety of price points, the consumer can select the product that is right for their needs, staying within our brand.

Next up was the UA Architect, our first shoe with a 3-D printed midsole made right here in Baltimore, Maryland. The shoe sold out in 19 minutes on our e-commerce site at a suggested retail of \$300. We will continue to test and learn with this technology and customization, and you can expect new 3-D printed iterations later this year.

And earlier this month, we launched our line of golf footwear just ahead of Masters Week, with three styles: the Tempo Tour at \$220, the Drive One at \$200, and the Tempo Tour Hybrid at \$160, driving premium as we introduce ourselves to this market. Jordan Spieth has energized the game of golf and continues to drive incredible brand heat for us. We are well-positioned to become the authentic performance alternative for today's passionate golfer. Our entry into golf-specific footwear enables us to provide a head-to-toe solution. The Drive One is already one of the top five selling items on our website, despite the presale launching just a few weeks ago.

With the Curry shoes consistently leading the signature basketball market this season, and the introduction of multiple running footwear shoes above \$100, we are beginning to see meaningful growth in our Footwear ASPs. On a global basis, our Footwear ASPs grew in the high single digits in the first quarter, and we expect them to continue to grow throughout the year, including in our largest Footwear category, running.

I spoke earlier about the strength of our business in China, and it was clearly a key contributor to our overall International growth of 56% in the first quarter. During the quarter, we also saw continued growth in the U.K. market. Last week, we announced our new relationship with Southampton Football Club, starting in the 2016 and 2017 season, giving us our second UA team in the English Premiership, the world's most popular global football league. With Tottenham Hotspur currently in second place in the EPL, we'll have a strong presence in the league next year, and if things fall right, Champions League play for the Spurs next season as well.

We continue to expand our wholesale presence in the U.K. by accelerating our business with key partners like Sports Direct and JD Sports. Throughout the Europe, Middle East, and African region, we are seeing solid growth through our expanded direct-to-consumer business, the addition of 250 shop-in-shops with partners throughout Europe, and this past quarter the introductions of our brand in Turkey and North and South Africa through distributors. Throughout other key markets around the globe, the UA brand continues to outperform and drive brand momentum.

And of course, with the Olympics coming up this summer, we are seeing an increase in global brand awareness as our 'Rule Yourself' campaign kicked off this past February, with memorable spots featuring the United States women's gymnastics teams, Manchester United's Memphis Depay, and in preparation for what will likely be his own Olympic goodbye, the most decorated Olympic athlete of all time, the great Michael Phelps.

So while core apparel products like training are driving the growth globally, our category focus in the U.S. is already helping drive strong results across multiple businesses, including basketball, golf and running. As we move into the balance of the year, we'll start to see a greater impact from some of our apparel product innovations, like CoolSwitch that combines three active ingredients in a print technology that keeps you cool and performing at your best.

We are also bringing to market something called Microthread, a new elastomeric thread that dries 30% faster and is 70% more breathable than similar lycra. We are focused on innovating at the yarn level and expect to drive even bigger innovations in the years to come in all of our product categories.

In addition to the statistic I gave earlier about more than half of our e-commerce traffic coming through mobile devices, our e-commerce business provides us great visibility directly into our consumer and brings quantitative insights to how we measure our business.

Specifically, our women's e-commerce growth rate continues to outpace the growth on the men's side, a direct indicator of the strength of demand for our women's product where we deliver upon her expectations for performance and style. This year, our women's business will surpass \$1 billion, US\$1 billion, that's a \$1 billion women's business, a milestone we are proud of, that puts us among very select company in the space that continues to attract a lot of interest and competition.

However, much like our Footwear and International businesses, we are focused on our long-term prospects in women's. We believe the continued investments we are making to create beautiful women's performance product and deliver it to them where they shop are the key drivers of that long-term opportunity.

In the Connected Fitness space, we saw strong activity on our website for the UA HealthBox launch as it came in as our second best-selling item on e-commerce behind the Curry Two for the quarter. This great initial consumer reaction to a \$400 Connected Fitness bundle and broader retail rollout through spring has us excited about the opportunities in Connected Fitness.

Beyond our opportunities in products like HealthBox, we are seeing meaningful improvements in direct revenue to e-commerce coming from our Connected Fitness community. Monetizing our Connected Fitness space in a synergistic way that enhances consumer engagement and drives value to our community and the Under Armour brand remains a key initiative for us, and in this quarter alone we nearly matched the revenue from people interacting on our platforms compared to what we did for all of 2015.

With the community now of over 160 million registered users that continues to grow by well over 100,000 new users logging on every day and registering, we recognize the opportunity that we have through products, as well as enriching consumer lives by helping them make better decisions about their health.

While we are still in investment mode, we believe that the future of Connected Fitness is very bright for our brand. In 2016, we will continue to move our digital strategy forward as we focus on driving even better consumer engagement while also building our math house to drive insights to make better decisions and ultimately build better products for our consumer.

Last week, we released creative for UA HealthBox, starring our newest brand ambassador, Dwayne "The Rock" Johnson. It's been a great start to the relationship as he is not only the voice for our HealthBox, but his initial launch of Project Rock Backpack has already sold out.

From The Rock to Missy Copeland, we bring together diverse athletes that truly speak to our willingness of adapting to new terrain. And for Under Armour, partnerships like the ones we have with Misty, The Rock, Cam Newton, Stephen Curry, Tom Brady, Jordan Spieth, Bryce Harper, so many more, all combined to make a powerful statement about how we operate as a company.

In the specific cases of Stephen and Jordan, we can internalize the challenge of repeating, the challenge of breaking a record, of setting a standard, then finding the will to do it again. This is what drives us every day, and when those streaks are eclipsed, we will start a new one. Whether it's in one of our regions, product categories or something not even yet created, we will deliver against a different set of metrics that inspire us to outperform our competition, because today's record becomes tomorrow's benchmark.

And with that, I will pass it over to Chip.

Chip Molloy

Chief Financial Officer

Thanks, Kevin. Before I begin, I want to quickly express my gratitude to the entire Under Armour team for this opportunity to be part of such a powerful growth story. Approaching 100 days in the role, I have been extremely impressed by the unwavering drive of this culture and the strength and depth of the team across the board.

Now I'd like to turn our focus to the details of our first quarter 2016 financial results, followed by our updated outlook for the remainder of the year.

Our revenues for the first quarter of 2016 increased 30% to \$1.05 billion. On a currency-neutral basis, first quarter revenues increased 32%. While we are experiencing some changing dynamics among our domestic wholesale partner base, the increased diversity of our global channels and product lines continues to drive strong results.

During the first quarter, our wholesale revenues grew 28% to \$744 million. Our direct-to-consumer revenues grew 33% to \$266 million holding steady year-over-year at approximately 25% of revenues in what has been our lowest quarter from a mix perspective the past two years.

In direct-to-consumer, our store count at the end of the quarter included 198 company-owned stores globally, comprised of 162 Factory House stores and 36 Brand House stores. We also increased our total number of in-country websites to 26, with the opening of our site in Mexico.

During the quarter, licensing revenues grew 15% to \$19 million and Connected Fitness revenues grew 119% to \$19 million.

On the product category front, Apparel revenues increased 20% to \$667 million compared to \$555 million in the prior year's quarter, led by growth in training, golf and new innovation platforms such as Microthread and CoolSwitch.

First-quarter Footwear revenues increased 64% to \$264 million from \$161 million in the prior year's quarter. The Curry Two signature basketball shoe continues to be a clear leader in the category. And we are also excited about the reaction to some of our new pinnacle running styles, including our updated SpeedForm Gemini 2, as well as our first smart shoe, the SpeedForm Gemini 2 Record Equipped.

Our accessories revenues during the first quarter increased 26% to \$80 million from \$63 million in the prior year's quarter, primarily driven by our new lines of headwear and bags.

On a regional basis, North American revenues in the first quarter increased 26% to \$881 million compared to \$701 million during the same period last year. On a currency-neutral basis, North American revenues increased 27%.

One of our key stories domestically continues to be the strategic initiatives we embarked upon early last year to improve service levels for our wholesale customers. Although these initiatives carried an associated investment in inventory beginning in the second quarter last year, we have seen significant improvement in our customer fulfillment rates supporting growth in North American sales.

International revenues increased 56% to \$149 million in the first quarter to reach 14% of total revenues, representing a 200 basis point increase from the year-ago period, and on pace to reach our Investor Day target of 18% of revenues by 2018. On a currency-neutral basis, International revenues increased 65%.

Starting with Asia-Pacific, China emerged as our largest International country, nearly tripling the year ago revenue base. Our positioning as the premium performance brand in the market is resonating with consumers and we are particularly encouraged by the relatively higher mix of Footwear and women's.

In the EMEA region, as Kevin mentioned, we are strengthening our partnerships with key sporting goods accounts and continuing to invest in controlled retail space to elevate our positioning and brand awareness. We are also extending our brand reach by building some of our newer distributor relationships in areas such as the Middle East, Turkey and North Africa and South Africa. And in Latin America, we remain in early stages of our growth story as we build our distribution and product mix in our primary markets of Mexico, Chile and Brazil.

Moving on to margins, first quarter gross margins decreased 100 basis points to 45.9% compared to 46.9% in the prior year's period. As we forecasted on our last quarterly call, higher liquidations to clear through excess inventory and foreign currency exchange rates negatively impacted gross margin by approximately 100 basis points and 70 basis points respectively. These negative impacts were partially offset by favorable product margins, led primarily by cost improvements benefiting gross margin by approximately 60 basis points.

Selling, general and administrative expenses grew 27% to \$446 million compared to \$350 million during the first quarter of last year. Growth was predominantly driven by investments in our direct-to-consumer businesses, both retail and e-commerce, and overall head count that support our growth and strategic initiatives such as Connected Fitness and sport category management. Marketing expenses grew 14% for the quarter.

Operating income for the first quarter increased 26% to \$35 million compared with \$28 million in the prior -year period. Interest expense increased approximately \$2 million compared to the prior-year period, driven by higher debt levels from our Connected Fitness acquisitions in 2015, and other working capital needs.

Within our other income and expense line, we recorded a gain of \$3 million versus a \$2 million loss in the prior -year period. The gain was driven by an improvement in foreign currency exchange rates towards the end of the quarter, which favorably impacted our required period-end balance sheet adjustments. In addition, the company tax rate in the first quarter was 42.0% compared to 50.3% in the prior year, primarily driven by International losses decreasing as a percentage of our overall pre-tax income.

Our first quarter net income increased 63% to \$19 million compared to \$12 million in the prior -year period while our diluted earnings per share increased 62% to \$0.04. As a reminder, diluted earnings per share calculations for both periods reflect the company's Class C stock dividend, effective April 7, 2016, which has the same effect as a two-for-one stock split. On a pre-split basis, EPS would've been \$0.09 for the first quarter this year compared to \$0.05 in the prior-year period.

On the balance sheet, total cash and cash equivalents for the quarter decreased to \$157 million compared with \$225 million at March 31, 2015. Inventory for the quarter increased 44% to \$834 million compared to \$578 million at March 31, 2015. As previously mentioned, the strategy to improve wholesale customer service levels resulted in elevated inventory investments beginning in the second quarter of last year. We expect the growth in inventory will be more in line with sales as we begin to anniversary this strategy during the second quarter of this year.

Accounts receivable grew 43% to \$566 million compared to \$396 million at the end of the first quarter of last year, while total debt increased to \$935 million as compared to \$669 million at March 31, 2015.

Looking at our cash flows, our investment in capital expenditures was \$91 million for the first quarter compared to \$68 million in the prior year's period. We continue to expect to spend between \$450 million and \$475 million for the full year, including investments in our global headquarters in Baltimore, our SAP platform and global direct-to-consumer.

Now, moving on to our guidance for the remainder of 2016, based on our current visibility, we are slightly raising both our revenue expectations to approximately \$5.0 billion, representing growth of 26%, and our operating income expectations to a range of approximately \$503 million to \$507 million, representing growth of 23% to 24%. Gross margins for the full year are expected to be relatively flat when compared to last year, and based on our outlook of \$5.0 billion in revenues, SG&A is expected to grow approximately 27%. The anticipated leverage in expenses is the result of our continued focus on making the right investments to drive our long-term global success.

Below the operating line, we expect interest expense to increase to approximately \$35 million in 2016 from the higher debt levels to support our business. In addition, we continue to expect a full year tax rate of approximately 38.5% and fully diluted weighted average shares outstanding of approximately 446 million, adjusted for the Class C stock dividend.

For the second quarter, we expect revenues to grow at a rate in the high-20%, led by many of the same factors from our first quarter, including strength in Footwear and International, and continued strategies to better service our customers. In addition, we expect our gross margin percentage to be relatively flat and operating income of \$40 million to \$42 million, representing 25% to 32% growth.

Before we turn it over to Q&A, I wanted to reiterate how excited I am to be working with Kevin and the entire Under Armour team. This is an incredible brand and I look forward to promoting and protecting our growth ahead. One of the key members of this team, Dave Bergman, our SVP of Corporate Finance, will be joining us this morning to provide assistance with your questions. Dave brings nearly 12 years of finance and accounting leadership at Under Armour to the table and he will continue to assist me as I seek to understand all aspects of our global business. Finally, I look forward to beginning a dialogue with many of you on this call in the upcoming months.

Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Camilo Lyon with Canaccord Annuity.

Camilo Lyon

Canaccord Genuity, Inc.

Q

Thanks. Good morning, guys. Great quarter.

Kevin A. Plank

Chairman & Chief Executive Officer

A

Thanks, Camilo.

Camilo Lyon

Canaccord Genuity, Inc.

Q

Kevin, I wanted to get your thoughts on just the health of the North America wholesale channel. There's a lot of moving parts and some of our bigger customers have been shutting doors, some of the tertiary players are going away. Can you talk about the health of that channel and what that could lead to from the channel expansion opportunities and how do you think about segmentation, but within that strategy?

Kevin A. Plank

Chairman & Chief Executive Officer

A

Yeah, thanks. So, it was obviously a tough quarter for some of our partners in sporting goods, as we saw Sports Authority and just recently Sport Chalet with some of the filings that have come out. And I guess, if there's anything as we think about our business, the good news is that we're not strictly a North American story anymore as this is a global company, and it's becoming more and more important to us as we'll be closing on 13% of our revenues and possibly north of that as we think about what the 2016 play will ultimately look like.

But again, and I'm going to put this through the lens of Under Armour which is incredibly proud of what we've done, I mean, posting 30% growth in a quarter where one of our largest customers, one of our top two or three customers just a few years ago, filed for bankruptcy. I think putting that kind of number up is something that just continues to demonstrate the strength of the brand, and how strong our portfolio ultimately is.

I want to reiterate as well is that, there is definitely the things that happen in these types of situations is that it separates sort of where the best are, and I want to be clear that we do not believe that retail is dead. We do believe that there is still an underlying very strong wholesale market out there and we expect to continue to be iconic, to be a destination. But in order to compete in today's market with what's happening on the digital side, it needs to be experiential. And one of the things we pride ourselves on is being terrific storytellers, and we've got some amazing partners out there that you'll see us continue to invest, and frankly reinvest in the places we're already doing business today.

That starts with our largest customer, which is DICK'S Sporting Goods, and I think one of the best in the market and in the field. And as I say that, I also – I look and say, I don't know if we've been as great as we can be there, and while we've posted fine results we think that there's an enormous amount of opportunity for us to do a better job. And so with Ed Stack and myself I want you to know that we've both taken a personal interest in how we can

drive and build a better business today, and that will come through in some of our collaborations on premium footwear, as well as things as getting the details like Elevated golfshops. But we certainly see more opportunity there.

From the mall channel, partners like Champs expanding The ARMOURY concept, we've got five large format Champs right now, and something we've seen success and we'll be expanding that to over 150 doors, the Takedowns this year. Foot Locker, we've effectively doubled our store base that we've had at Foot Locker because of the success, really driven of course by Steph Curry. But frankly, what we're doing in Footwear is extraordinary. That's giving us – one thing Dick Johnson said to me a long time ago is that the word foot is what's on the door, and so while we can lead with our apparel, it's important that we have that balance. And so I think you're seeing us drive toward that really across the board as we have a better even balance between both Apparel and Footwear. And then as we look at distribution from the department stores, we've added 275 women's departments this year across some of our department stores channels like Macy's, Bon-Ton and Bloomingdale's. So we think that the key to all this is going to be merchandising efforts.

As we think about distribution in North America, I just want to put in perspective sort of where we are, is we think that we have been incredibly tight, I think it was one of the assets and strengths of the Under Armour brand, is how narrow we have been with our distribution. And we're not looking to make any drastic changes, and I want to be clear, but to sort of set the table. Under Armour has roughly 11,000 points of retail distribution, shop-in-shops, our own stores, et cetera in North America. One of our competitors has over 24,000 points of distribution. So we just want to be really clear, is that there is a tremendous runway for us as we think about the opportunity in front of us, and so it gives us the luxury and the ability to really be able to pick and choose.

And probably the thing that drives that for us more than anything else is just merchandising. Line segmentation is that we haven't had the sophistication, and frankly needed it, until the last several years. We were a company that built a great shirt for athletes to wear beneath their uniforms, and then they – all of a sudden they had bottoms, they had cold weather, and they had women's, and we sort of added this as the consumers demanded and asked for more.

And now we've really gotten to a point where understanding that merchandising needs to be a core competency for us. And so bringing back Kevin Eskridge, who's the gentleman that helped us build out and get China rolling for us and really building a merchandising, a key merchandising team, we are incredibly bullish about what that's going to mean. And so we really – we identified it in 2014, and again this sounds, may sound a little pedestrian, but we identified it in 2014, we began building the team in 2015. I think that we're building expertise in 2016, and we think we're really going to begin to see the fruits of that coming in 2017 which is going to leave us a lot of opportunities to look at finding where the best places where we can deliver the right products at the right time, and really meet our consumer where they want us to be.

So we recognize there's opportunities out there, we recognize that there's frankly distribution channels or specific partners that we are currently not doing business with today, that we're basically walking a consumer and not giving them an Under Armour opportunity, which is frankly giving our competition, allowing them to go unchecked, and we believe that when we – when or if we decide to do that, that we can be incredibly competitive, and that ultimately we believe that we can win in that type of mentality.

As I also say that it's hard to understand, as I think some of the data that we've realized is our DTC business is incredibly strong as well. As 30% plus of our business coming from DTC, you can't overlook e-commerce and it's one of the things we don't clearly report on. But we can tell you that our e-commerce business is outpacing our overall growth, and again in a year where we – or a quarter we decided to honor Stephen Curry with posting that 30% number of growth, that's obviously a very big, big statement.

So what we can tell you is that the good news for us is that the growth right now we recognize what a big – how – what a privilege it is to make this statement, but our growth is effectively coming from everywhere. And North America is something that we feel incredibly strong about, we've recognized some of the challenges, but I think, as I mentioned in my written comments is that we are – we have one thing we have developed over the last 10 years and especially the last six years of 20% plus top line revenue growth consistently. Is that I believe that we've assembled a team that is expert in terrain, and the math will continue to change, and it will continue to undulate, but when and as it does, hopefully we've demonstrated our expertise to be able to deliver results for our shareholders, our customers, and ultimately for our end consumers.

Camilo Lyon

Canaccord Genuity, Inc.

Q

That's great. Thanks for the detail, Kevin, and then Chip, I just had one for you. If you could just disaggregate the composition of inventory between planned inventory increases and any sort of excesses that you have given the liquidations they had during the quarter? And coupled with the expectations for flat gross margins in Q2. So if you could just help us understand, it seems like we're shifting more towards that planned increase, if I'm reading that correctly, but just any detail there would be great?

Chip Molloy

Chief Financial Officer

A

Yeah, Camilo. It's great to meet you. Majority of the growth is planned. But we did have slightly excess, slightly higher percentage of total revenues was excess coming out of Q4 and continues to be this quarter relative to last quarter same time. But we are working through that. As you can see we worked through it through liquidation, we're continuing to manage through that, and as you can see through our guidance second quarter we're expecting our gross margins to be flat, and then flat for the year. So it'll start to creep away as we go through the year. So we're working through it, but the majority of it is planned.

Camilo Lyon

Canaccord Genuity, Inc.

Q

Thanks a lot, guys. Great job, and good luck with the rest of the year.

Kevin A. Plank

Chairman & Chief Executive Officer

A

Thanks, Camilo.

Operator: Thank you. And our next question comes from the line of Michael Binetti from UBS.

Michael Binetti

UBS Securities LLC

Q

Hey. Good morning, guys. Congrats on a great quarter.

Kevin A. Plank

Chairman & Chief Executive Officer

A

Thanks, Michael.

Chip Molloy
Chief Financial Officer

A

Hey, Michael.

Michael Binetti
UBS Securities LLC

Q

Just real quick a housecleaning – housekeeping question. Just in very basic terms the operating income increased a little less than the revenue increase for the year, you – Chip, you commented on some of the investments you're looking at which we know you've always got going on in the background. But with the revenues going up a little more, did you guys pull forward some bigger projects that might have otherwise been earmarked for 2017? Or just dial up the marketing? Any comments there to help us with the model?

Chip Molloy
Chief Financial Officer

A

Hey, Michael. Yeah. This is Chip. We're – we did up our guidance for the full year on sales to 26% growth; that puts us well on our plan to get to our \$7.5 billion goal that we set out last year for 2018, and that's a 25% CAGR. On the operating income, we are marching towards the operating income target as well, but we are going to find opportunities as we meet our annual targets. If there are opportunities to – for us to invest, whether it be in marketing or some of the other areas to keep the momentum and invest for the future, we're going to continue to do that.

Michael Binetti
UBS Securities LLC

Q

So then if we could just talk about the drivers of the International margins in the quarter that was kind of an interesting standout. I think, there's a lot of noise that makes it kind of hard to forecast for us. Maybe we could get a little help. Do we see that level of year-over-year improvement in the International margins continue? And importantly, if we are set for better run rate, it seems like a good place to also ask is this something that could help us accelerate the tax rate improvement that has been a topic for a while with you guys?

Chip Molloy
Chief Financial Officer

A

Yeah, over time as we get scale the International margins are going to slowly, but surely improve. And as it relates to tax, as the income grows as a percentage of our total income we will see improvements in tax rates. It's coming slowly, but I think that will start to accelerate as we get into next year and beyond.

David Bergman
Senior Vice President, Corporate Finance, Under Armour, Inc.

A

Michael, this is Dave also. Just a quick reminder too that the tax rate impact on those International investments is usually a little bit larger in Q1 and Q2, so you normally see our tax rate a little bit higher in Q1 and Q2, and then it subsides a little bit in the back half of the year. So just keep that in mind as well.

Michael Binetti
UBS Securities LLC

Q

Okay. On a similar topic, is the – as you look at the gross margin guidance for the year could you help us understand the cadence of whether the current magnitude of product cost you're seeing is sustained or is that slow

at some point through the year? And then the same question on currency, if it's stable at today's rates, when does the FX pressure on the gross margin perhaps start to roll off? Thanks, guys.

Chip Molloy

Chief Financial Officer

A

So we guided for flat for the full year. We were just down 100 basis points, so we guided flat for the second quarter. So obviously we'll start to see some improvements on the back half of the year. Our expectation will be slight in Q3 and it'll be a little bit more in Q4. And a lot of that the liquidation pressures would go away, the product margins improvements we've seen will be sustained, and FX will slightly improve.

Michael Binetti

UBS Securities LLC

Q

Thanks a lot, guys.

Kevin A. Plank

Chairman & Chief Executive Officer

A

Thank you. Michael.

Operator: Thank you. And our next question comes from the line of Eric Tracy from Brean Capital.

Eric Tracy

Brean Capital LLC

Q

Thanks, guys. And I'll add my congrats.

Kevin A. Plank

Chairman & Chief Executive Officer

A

Thank you.

Eric Tracy

Brean Capital LLC

Q

I guess, as we think about the growth coming from Footwear and International, could you maybe speak to organizationally the resources, be it people, infrastructure to support that kind of, updates on the supply chain that you feel like if it's in place to support? And then sort of secondarily on that as it relates to the SAP implementation, how that's going?

Kevin A. Plank

Chairman & Chief Executive Officer

A

Let me start at the top and let me just use Footwear as an example, and then let me let Chip and Dave weigh in on what's happening with SAP. But Footwear for us, it's interesting because becoming a Footwear brand is not something that just happens overnight and for us obviously it's taken a while, we've been making shoes since 2003, we've been selling them since 2006, so we sit here in what you call our 10th year in business, it's just it's a long road, it's a long tough slog too, but I think we're incredibly proud, A, of the progress; but more importantly, where we are at the moment of time, the ability for us to stand up and declare ourselves a Footwear brand. One thing that – I think the 64% growth that we've demonstrated in the quarter, it demonstrates the diversity that we have as a brand today across Footwear.

And again, we are to be clear, driving massive growth, and we are taking share. I think there's been some – we just want to be clear like we are a premium Footwear brand, we're a premium Footwear brand that's driving ASPs meaningfully higher as we build out our team and drive innovation across all of our categories. Again, just in the quarter alone we saw ASPs up in the high single digits just in quarter – in Q1. Next, it's – one thing we know as well is that it's – when we can be impactful is when we combine premium product and game changing athletes with powerful point of sale and distribution that really matters, and so we're fortunate to have terrific distribution partners that have been incredibly patient with us and really helping us accelerate whether it's the guys that are exactly doing it or the guys like Foot Locker or Finish Line that lead it.

But leading with signature products like the Curry 2, I mean, what Stephen Curry is doing right now is an incredibly impressive, and something that is I think we can only imagine just how big it is going to continue to become. But when you think about premium just a few examples, the Curry 2 basketball shoe that we've put off at \$130; the Curry 2.5 that when he actually broke the record of 73 games and broke the Bulls record, that shoe is getting to the market at \$135. When you look at things like football cleats, the first category we entered in 2006, it's a \$140 cleat, it's the highest price point in the marketplace and frankly we have designs on being the number one football cleat by market share within the next, let's call it, 24 months.

For us to make that statement, again 10 years ago we had people laughing and saying you can't compete, it'll never happen, so it's been a 10 year slog for us to do that, so as we sit here in year six of running, in year five of basketball, imagine what we're going to look like in year 10 in both of those categories. And it doesn't just stop there, it's coming across the brand with like the Jordan Spieth, with the Tempo Tour at \$220, and the Drive One at \$200, driving premium from a consumer base that is really in love with the product and again we're doing this demonstrating with the best athletes in the world that are wearing our product.

One area I just want to spend a minute on, as I talk about Footwear, is running and I want to get back to answering like, how are we doing with the team and supply chain, so bear with me if you can, but I just want to be clear. In running alone in 2015 we had four styles above \$100 in running. In 2016, we're going to have eight styles above \$100 in running. In 2017, we expect to have 14 different styles above \$100. Now you can ask the question, and I just want to be able to set in perspective of what that means, is that getting into these market categories, there's a lot of things because supply chain has a lot to do with it. It doesn't mean we just make a pretty shoe and then we put a big price tag on it, you have to earn the right to do that, and that begins with the price to value relationship that the product that you're putting on the shelf ultimately has.

When we do that it's an incredibly long and difficult process, because this comes down to how do you actually get the shoes made, and beyond just the team, and we're incredibly excited about what we're building in Portland, a new 100,000 square-foot headquarters that we'll have there, based in Portland, that'll really give us access to talent without having to uproot families and move them across the country. And so again, we're going to go where the fish are there.

But let me use the example of something like Footwear ASPs in running. In 2011, we launched our real first running shoe, that is still in the market today, and this has become a heritage product for us, and it's called the Under Armour Assert. And when we launched it, it had a \$70 price point. It started at a \$90 price point and settled at a \$70 price point for us. When we launched the Assert, by 2013 the Assert was doing about 0.5 million units for us. In 2014, it did about 1.2 million units for us. In 2015, it did 1.7 million units, and this year the Assert is going to be about close to 2.5 million units of Asserts that we'll make this year. And you could say, why are we making a low price point shoe? The problem that you have with a factory base is that factories mean that there's people, and keeping the consistencies in the product lines for us to manufacture goods on a consistent basis, it's a really valuable thing, and it's part of the overall strategy to make ourselves important to some of the biggest and the best footwear manufacturers in the world, like the Yue Yuen.

So while we say that, we want you to understand we're not just driving toward lower price points. By having the competency and the consistency with our manufacturing base, it allows us to attract better talent from our manufacturers that are putting their A-teams on our product that allow us to make higher price point goods, like for instance the SpeedForm Gemini that we launched in 2015. And when we launched the Gemini we did about – close to 0.5 million units in 2015, and it'll be over 780,000 units this year, closing on 800,000 units. Those kind of increases, and we're going to do that at a \$130 price point.

To find and build that competency is something that just takes time, and the good news is that we have the equity of brand that has allowed us to endure to get through the difficult years of building out the infrastructure, the team, the manufacturing cycle, and the supply chain for us to get it there. And we've had amazing partners that have been incredibly patient with us. But we understand is that that patience wears out at some point, and as I said the good news is that we've got these over 14 styles above \$100 coming in 2017. But we're incredibly proud I think of the product we have in the market, even right now in our new SpeedForm style like the Slingshot, which is a terrific all-knit upper running shoe at \$140. The Gemini 2 RE at \$150. I mean, I think when you look at our training product line, we have a new product called the Amp at \$120, which is going to be – it's a new precision fit technology for the midfoot. So we see ourselves taking these steps across really all aspects. But I want to be clear, building out a footwear company, it takes time. And we're incredibly proud of the growth we have, and again that all anchors with, we put 64% on the top line of growth in Footwear and it's obviously incredibly important to us as we think about the business going forward.

Eric Tracy
Brean Capital LLC

Q

That's great. If I could switch gears to Connected Fitness. Obviously it seems like the wearable side, HealthBox, the early read is extremely strong. Maybe just talk about any updates, the \$200 million rev target you laid out for that Connected Fitness business directly? And then secondarily, kind of the halo effect of [ph] selling more shirts than (52:11) shoes. Any sort of update on how you're seeing that monetization of the core business? Thanks.

Kevin A. Plank
Chairman & Chief Executive Officer

A

So, first of all, we've made this statement recently, and I really love it. I think it just – it describes what we've been trying to put together with Connected Fitness. And it's this idea, is that data is the new oil. Like those who have the data, those who have the understanding of the consumer, we believe are the ones that are going to win. And for us, laying out, now having a Connected Fitness community of over 160 million with adding well over 100,000 new registrants every single day that are volunteering information to us, like how much they slept, how active they are, what they did when they exercised, how hard they exercise. And they're doing things like using our gear tracker up to the tune of a million people that are asking us to tell them when they should buy a new shoe by evaluating the type of terrain they are running on and the distance they're running on. The information we're getting is extraordinary. But frankly, we're still – we're in the first inning of what's happening in this world.

But what we do have is we have the ability to use data. And a key initiative for Under Armour Connected Fitness, and I want to be clear, is that we're going to – we want you to understand is that we believe in the growth opportunities, as I mentioned in my prepared remarks as well, is that we did in the first quarter in revenues what we did in all – in just 90 days, what we did in all of 2015. So we see things like premium, we see things like subscription, we see opportunity for us there. But to understand like what exactly is the product is something that is going to be a continuous work in process for us. And our job is to find synergistic ways that enhance consumer engagement and drives value to the community, really delivering great value to the community. And so, we've laid that bogie out there about \$200 million in 2018, and we feel very good about that. But we also believe that,

speaking of map and terrain, there will be ebb and flow as to what happens with this product and as it evolves into building the best product for our consumer.

So, I want to let you know and just remind ourselves that we are certainly still in investment mode this year, focused on engagement and what we call the single view of the consumer as it relates to SAP, is that we have a major initiative with them that will give us a really one-and-only look as a company, is that the fact that we're not burdened with so much legacy and have the ability to truly define what the company in the future should look like, of not only just guessing or using things like a recommendation engine based on previous purchasing history, but truly knowing the activities that consumers are engaging in to deliver, to meet the consumer where they are and deliver better products for them at the right time. But our investments are going to enable us to build out again what we're calling our math house with data, and ultimately we believe we're going to help us empower us to sell more shirts and shoes.

So we're doing that not by ourselves, but we've brought together some really great partners in IBM and the Watson platform where we're gaining more competency in big data analytics, and again I think we are still in the first part of this as well as something like the Under Armour HealthBox that our first reads on it are very positive, but we think it's a product that'll continue to evolve and we'll continue to define and allow the consumer to take us with the data that they want. But at the end of the day we feel incredibly – we feel really good about what happened in the first quarter of getting that product launched, and launched at CES, but we think that there is – definitely this math and terrain will continue to evolve for us.

Eric Tracy
Brean Capital LLC

Q

That's great. Thanks for all the detail. All the best, guys.

Kevin A. Plank
Chairman & Chief Executive Officer

A

Thanks.

Operator: Thank you. And our next question comes from the line of Omar Saad from Evercore ISI.

Omar Saad
Evercore ISI

Q

Hey, guys. Great quarter. Thanks for taking my question.

Kevin A. Plank
Chairman & Chief Executive Officer

A

Thanks, Omar.

Omar Saad
Evercore ISI

Q

I wanted to follow-up on the Connected Fitness, Kevin, to make sure we understand when you say in the first quarter you matched revenue versus – in the first quarter versus all of 2015, is that people going to the Under Armour website through the Connected Fitness platform? Help me understand exactly what that dynamic means and how it's working?

Kevin A. Plank

Chairman & Chief Executive Officer

A

We mean subscription numbers and as we're driving, developing and building retail there as well right now. So, it – I mean, again, the growth has been consistent, so I think, we – where we are right now is really thinking about user engagement and really making sure that while we have a big number, we're over 60 million active monthly users right now that we have on the platform, and something which is a big, big opportunity for us, so – and as well as, you're right, Omar, we are driving consumers so we're matching what happened in 2015, where we've been testing everything, bringing the right amount of math of driving consumers through e-commerce to drive ultimately selling more shirts and shoes.

Again, we were really clear is that the ultimate goal that we had here is that while Connected Fitness and again, if I said there was – as we bought these apps, what they didn't have before, is while they had a great product for the consumer they had no way to monetize that product, and so by combining Under Armour who's in the physical fitness space and sells shirts and shoes, it really allowed us that we had the vehicle of, I use the analogy of the purpose of a brand is that we bring people to the amusement park and we put them on the roller coaster and they go up in the air and they get excited, when they come off, they go to the loop-the-loop, and they want to engage somehow, they didn't have a way to do that other than to see their day-to-day track. With us we have the ability to drive them through the gift shop, and with that they – hopefully we'll them – have and help them buy lots and lots of Under Armour shirts and shoes.

Omar Saad

Evercore ISI

Q

Okay. That's helpful. And then I also wanted to ask, you alluded to before the points of distribution in North America 10,000 or 15,000 points of distribution gap between Under Armour and other brands. With DTC over 30% on the business and growing really nicely especially the e-commerce piece, higher price points you talked a lot about the new shoes coming this year, next year, more and more products at higher price points.

How do you think about that kind of incremental distribution in North America, especially in lower tiers or mid-tiers of distribution? Is that something that's part of the conversation potentially over time and really requires some thought and segmentation? Or maybe help me understand how you think about segmenting the brand at those points of distribution. Are you happy with where you are with DTC and e-commerce, and your existing distribution? You maybe don't need with the opportunities internationally in Footwear and women's and youth you don't need those...

Kevin A. Plank

Chairman & Chief Executive Officer

A

Got it.

Michael Binetti

UBS Securities LLC

Q

[ph] profiles and things (58:40).

Kevin A. Plank

Chairman & Chief Executive Officer

A

Got it. So I think that what you're going to see from us is that where we've been investing in segmentation, we've been investing in merchandising that it's going to leave us the opportunity to make the best decision for the brand. Plain and simple as that we think that there are – we think there's opportunities, we think there's moments where

consumers walk into retail, and frankly they don't have an option to purchase Under Armour. And so while no hard decisions have been made now I want you to know is that our job and our goal has been to put ourselves in a position to make those decisions when the time is right and appropriate.

And so merchandising, as I said is that identifying in 2014, building the team in 2015, perfecting it in 2016, and really being able to hit on all cylinders in 2017 is the way that we're thinking about what we're going to do. I mean, driving right product, right place, right time is the message we have there, and I – you've heard how much and a fan I am of Kevin Eskridge who runs our merchandising group for us, and how highly we think of him, and frankly because he's had the experience of having run and built China for us, and now having him back here, again, but it's not one person probably the best asset he has, which is the number one required in Under Armour is he's done a great job building an expert team.

And so, we didn't have a merchandising team two years ago. I mean, we had merchandising throughout the building, but we didn't really have a specific merchandising team, so being prescriptive with product flow, key items being reinforced with new item styles, colors and making sure there's a differentiation. I mean, right now, we've got the channels of sporting goods, the mall, department stores, as well as our own distribution and then possibly broader distribution as we think about it. So, again, at Under Armour, we really, we say the only thing that gets you fired at Under Armour is someone says, that's the way we've always done it. And so we do believe we're different company every six months, and we'll continue to make those – make the best decisions that allow us to meet consumers where they are and we think that merchandising segmentation is going to be a critical tool for us in our toolbox as we move forward.

Omar Saad

Evercore ISI

Q

Thanks. That's perfect.

Thomas D. Shaw

Director-Investor Relations

And operator, that's all the time we had today. So I want to thank everyone for joining us on the call and we look forward to reporting to you our second quarter 2016 results which tentatively have been scheduled for Tuesday, July 26, at 8:30 a.m. Eastern Time. Thanks again, and goodbye.

Operator: Thank you. Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may now disconnect. Everyone, have a good day.

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