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Deckers Outdoor Corp. (DECK)

Q1 2018 Earnings Call

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Robert Drbul

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Deckers Brands First Quarter Fiscal 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions. [Operator Instructions] I would like to remind everyone that this conference call is being recorded.

I'll now turn the call over to Steve Fasching, VP, Strategy and Investor Relations.

Steve Fasching

Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.

Thanks and welcome, everyone, joining us today. On the call is Dave Powers, President and Chief Executive Officer; and Tom George, Chief Financial Officer. Before we begin, I would like to remind everyone of the company's Safe Harbor policy.

Please note that certain statements made on this call are forward-looking statements within the meaning of the federal securities laws which are subject to considerable risks and uncertainties. These forward-looking statements are intended to qualify for the Safe Harbor from liability established by the Private Securities Litigation Reform Act of 1995. All statements made on this call today, other than statements of historical fact, are forward-looking statements, and include statements regarding our anticipated financial performance, including, but not limited to, our projected revenue, margins, expenses, earnings per share and operating profit improvement, as well as statements regarding our cost savings and restructuring plans, strategies for our products and brands, and our review of strategic alternatives.

Forward-looking statements made on this call represent the company's current expectations and are based on currently available information. Forward-looking statements involve numerous risks and uncertainties that may cause actual results to differ materially from any results predicted, assumed or implied by the forward-looking statements.

The company has explained some of these risks and uncertainties in its SEC filings, including in the Risk Factor section of its Annual Report on Form 10-K. Except as required by law or the listing rules of the New York Stock Exchange, the company expressly disclaims any intent or obligation to update any forward-looking statements, whether to conform such statements to actual results or to changes in its expectations or as a result of the availability of new information.

With that, I'll now turn it over to Dave.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

Thanks, Steve. It has been a productive first year as CEO and a lot has transpired over the last 12 months. I am confident in the changes we are making to the business and believe the results of the last two quarters are providing the organization with the momentum needed to achieve the goals we have set for fiscal 2018 through fiscal 2020.

The team has stepped up to the challenge and we are making significant progress in establishing the building blocks that will make us a more nimble, efficient and profitable company. Some highlights for the last 12 months include: the formulation of our \$100 million operating profit improvement plan; implementation of marketplace transformation with a focus on elevating the consumer experience; the UGG brand's progress in diversifying its spring and summer line-up; enhancing our Omni-Channel capabilities; and launching new products and categories, including the UGG Classic II and new HOKA styles.

These accomplishments, along with all the other initiatives our employees are tackling, make me confident that the steps we are taking are in the best interest of our brands and consumers and will also drive long-term shareholder value.

Importantly, our results are beginning to show the progress we are making. Fiscal 2018 is off to a good start and continuing the momentum of the fourth quarter. Sales came in better than expected at \$209.7 million, which was driven by a few factors. First, timing, as we shipped approximately \$20 million of wholesale orders earlier than expected to optimize marketplace opportunities. Second, stronger than expected global reorders for UGG, HOKA and Teva spring product, reflecting consumer demand for these products. And third, double digit e-commerce growth, which drove a 12.7% increase in DTC comparable sales.

The combination of higher sales and a decline in SG&A expenses of \$7.9 million, driven by our cost savings plan, resulted in a non-GAAP loss per share of \$1.28, a significant improvement over the loss of \$1.80 same quarter last year. Before Tom walks you through more details of our financial performance, I will provide an overview of our brand and Omni-Channel performance and update you on the progress we are making on our operating profit improvement plan.

Starting with our Fashion Lifestyle group, the first quarter is typically the lowest revenue quarter for the group. However, our continued focus on developing compelling spring and summer product, new key wholesale partnerships and the strengthening of our e-commerce business is quickly raising the significance of this quarter.

UGG sales came in better than anticipated, \$114.7 million, fueled by growth in the spring and summer product line, combined with some earlier than planned fall shipment.

Our UGG spring/summer collection continues to make great strides, especially in the sneaker and sandal category, as the Tye and Sammy sneakers and Kari sandals sold out at wholesale across all regions. In particular, we are very encouraged with the performance of these categories which, combined, were up 20% year-over-year. This performance gives us confidence that our focus on developing compelling spring and summer product is resonating with our consumers and gaining traction in the marketplace. Initial reaction for spring/summer 2018 is very positive and it's contributing to the changing perception of UGG as a spring and summer brand.

On top of the positive response to our current offering, first quarter e-commerce sales continued to benefit from our Omni-Channel capabilities and digital marketing efforts, such as ship-from-store, click-and-collect, and Infinite UGG. These capabilities provide the consumer more flexible ways to shop while also allowing us to manage DTC inventory levels more efficiently.

Our Performance Lifestyle group delivered a very strong quarter, led by the HOKA brand which continues to exceed expectations. HOKA revenues grew 74.2% to \$30.7 million versus \$17.6 million last year, driven by a 77.7% increase in domestic wholesale sales along with solid gains in the international wholesale business. Included in the wholesale beat was a robust reorder business across all regions, a great indication that the brand continues to gain share in the run specialty channel.

The HOKA team continues to do an amazing job introducing award-winning shoes, with the Challenger ATR 3 winning Runner's World Editor's Choice for the Best Trail Shoe, the Hupana listed as one of the best new running shoes by Women's Health, and the Speedgoat 2 receiving Best New Update from Competitor Magazine. This recognition validates the team's effort towards building brand awareness across product categories and regions centered on delivering compelling product with exceptional technical performance.

Teva sales were up 8.6% in the quarter to \$37.7 million compared to \$34.7 million last year. Sales in the quarter were better than expected due to global wholesale sales and strong global reorders. We also saw meaningful gross margin improvement with the Teva brand, and we expect margin improvement across the remainder of the year.

Sanuk sales of \$26.2 million were slightly down to last year, largely due to rationalizing our international distribution and a retail store transfer. As we focus on our domestic wholesale business, we performed better than expected with year-over-year growth and improved gross margins. I'm encouraged by the marketing and product initiatives these two brands are implementing, as well as their focus on driving efficiencies in their respective businesses.

Turning now to our channel performance. Direct consumer posted a 12.7% comparable sales increase, our largest gain in several quarters. The double-digit positive comp was due to the strength in global e-commerce sales across both the Fashion and Performance Lifestyle groups and slightly better than expected retail performance. As our consumers continue to migrate their purchasing online, the digital infrastructure we put in place over the last few years is driving significant growth, with all regions posting double-digit increases in the quarter.

Our wholesale channel exceeded expectations with 24.5% growth year-over-year. Domestic wholesale was up 8.6% to \$83.2 million and was primarily driven by strong demand for HOKA. International wholesale also had a

strong quarter, up 55.2% versus last year to \$61.4 million, with our EMEA business up over 80% and APAC up over 45%. The strong international performance was due to solid reorders with the UGG, HOKA and Teva brands.

Our industry is facing strong headwinds across the wholesale and retail channels as traffic continues to be pressured and consumers are shifting their purchasing from brick-and-mortar to online, as well as migrating to a buy-now-wear-now model, and there are no indications that these trends are subsiding. To that extent, our path forward will not be without hurdles but the focus will remain on the customer, our brands and products and achieving a level of profitability that will drive shareholder value. For that reason, coupled with the strong performance in the quarter, we believe we are well-positioned to address these challenges with our \$100 million operating profit improvement plan.

To provide a quick update, we are making significant progress in improving on our gross profit profile through consolidating our factory base, moving production to more cost-effective locations and optimizing our material usage. We are also addressing improvements in our overhead through streamlining our organizational structure, reducing inefficiencies in our corporate spend and optimizing our retail footprint. These actions will result in operating profit improvement in fiscal year 2018 with an operating margin target of 10.5%.

With that, I'll now turn the call over to Tom.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

Thanks, Dave, and good afternoon, everyone. Today, I will take you through our fourth quarter results in greater detail and provide an outlook for the second quarter and fiscal 2018 guidance. Please note throughout this discussion, when I refer to non-GAAP financial measures, I am referring to results before taking into account restructuring and other charges that our management believes are not core to our ongoing operating results. Also note our non-GAAP results are not adjusted for constant currency. A reconciliation between our reported GAAP results and the non-GAAP results can be found in our earnings release that is posted on our website under the Investors tab.

Now, to our results. For the first quarter, revenue was \$209.7 million, an increase of \$35.3 million or up 20.3% versus last year. This includes about \$20 million of orders that were shipped earlier than previously expected, as well as approximately \$15 million of revenue growth driven by increases in our UGG e-commerce business and our HOKA brand. Gross margin was 43.2% which was slightly better than expectations and compares to 43.7% last year. The year-over-year decline was driven by changes in foreign currency which negatively impacted the gross margin by 80 basis points.

Non-GAAP SG&A expense was down 5.2% to \$144.9 million compared to \$152.8 million last year. Even with the higher sales, SG&A dollars declined as we continue to realize savings from the implementation of our operating profit improvement plan. Non-GAAP loss per share was \$1.28 for the quarter versus a loss of \$1.80 last year. In the first quarter, we recorded \$1.9 million in restructuring and other charges related to organizational changes and the strategic review process.

We are also pleased with the progress we are making on inventory management. Inventories were down 5.9% to \$441.6 million compared to \$469.2 million this time last year. This was driven by higher sales recorded in the first quarter as well as improvements made in managing our inventory levels.

Now, moving to our outlook. For the second quarter of fiscal 2018, we expect revenue to be down approximately 10% compared with the same period last year. Non-GAAP earnings per share is expected to be in the range of \$1.00 to \$1.05, compared to \$1.23 last year.

To give a little color on the guidance, there are a few things to keep in mind. We shipped approximately \$20 million of orders initially planned for the second quarter in the first quarter. Last year, we launched Women's Classic II and shipped a significant amount in the second quarter. The combination of these two top line events explain the projected decline in earnings per share as compared to the same period last year.

For the full fiscal year 2018, we are reaffirming the guidance we outlined on the last call. We still expect sales to be in the range of down 2% to flat and earnings per share to be in the range of \$3.95 to \$4.15 on a share count of 32.3 million. This excludes any pre-tax charges that may occur from any further restructuring charges. We are encouraged by our first quarter results and believe it positions us well to achieve our full-year outlook.

With that, I'll turn it over to Dave for his closing remarks.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

Thanks, Tom, and thanks again to everyone for joining us today. I am proud of the Deckers team for successfully executing our brand and channel growth initiatives and operating profit improvement plan, and I'm confident that this momentum will continue.

While the industry faces continued challenges, Deckers remains focused on what is in our control, which is, providing our consumers with innovative and compelling product combined with engaging online experiences, improving our speed and agility to better compete in the dynamic marketplace, and executing on our initiatives under our operating profit improvement plan to drive shareholder value. Our employees continue to amaze me with their dedication to our brand, our strategy, and most importantly, our customers.

As a reminder, with the strategic alternatives process ongoing, we will not be commenting at this time. So, I ask that you please limit your questions to our financial results announced today. Thank you in advance for your cooperation.

With that, we'll open up the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Camilo Lyon with Canaccord Genuity. Please proceed with your question.

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Thank you. Good afternoon, guys. How are you?

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Good. Hey, Camilo.

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Yeah. I wanted to get your thoughts on discussions that you may be currently having or have just had with retail partners with regards to any sort of delivery schedule, push-outs. We've heard from the channel that there have been, particularly in North America, there've been discussions to delay receipts of fall/winter products into – well, into the December quarter. Is that something that you're seeing? And if so, how are you planning your inventories around that?

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yes, good question because I think that's the dynamic that we're starting here, is happening in the marketplace. We're seeing a little bit of that but it's not a dramatic reason for the shift. The biggest portion of our shift into Q3, which is roughly about \$10 million, was really driven by the dynamic of the re-launch of the Classic last year where accounts that were launched in the Classic line to get the inventory in Q1 to be able to hit it on the floor early in Q2. Now that they have that inventory, some of that carryover inventory from last year, they're asking to take it just a little bit later but it's a small piece of the total picture. Other than that, we're hearing a little bit about that but it hasn't really been significant to the flow of inventory yet for us, yeah.

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Okay. Great. And then, just shifting gears to the expense picture. This quarter was a nice demonstration of some initiatives that you have in place with the dollar growth of [ph] I think it's (18:04) down 5%. Could you maybe articulate what were the areas of that reduction and how do we – how should we think about the cadence of expenses as the year progresses? Is that the run rate that we should be thinking about or is there a quarter in which we should expect to see a little bit more of a ramp-up as we get into the thrust of the selling season?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Camilo, it broke up a little but you were talking about the operating expense savings we saw in the first quarter?

David Powers*President, Chief Executive Officer & Director, Deckers Outdoor Corp.*

A

Yeah.

Thomas A. George*Chief Financial Officer, Deckers Outdoor Corp.*

A

Okay. Good.

Camilo Lyon*Analyst, Canaccord Genuity, Inc.*

Q

Yeah, that – initially, yes. What drove that and how will the cadence shake out?

Thomas A. George*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah. We feel really pleased and we're starting to demonstrate success there just like we said we would. It's pretty widespread. Some of it is due to lower store counts. We have lower rent, lower occupancy cost. Also, within the stores, we have lower material and supplies expenses. We spent less capital this quarter so we have lower depreciation. We're seeing lower expenses in Teva, Sanuk, Europe, APAC. Some of it is head count related and some of it just indirect expenses, just getting more competitive on corporate overheads. And we also had some marketing efficiencies in the quarter we're pleased about. Really, actual savings were more than reflected in the P&L in that we had about \$3 million in variable expenses that we had relative to the growth in sales.

So in terms of cadence, you could see in the second quarter a similar amount of savings that you saw in the first quarter. In the third quarter, that's a more difficult comparison in that last year's third quarter, we had a reversal of the management incentive comp, which was about a \$15 million credit last year that this year, we'll have savings but that credit becomes a tough comp. So, you get similar SG&A year-over-year in the third quarter. And in the fourth quarter, you get similar amounts.

David Powers*President, Chief Executive Officer & Director, Deckers Outdoor Corp.*

A

Similar dynamics.

Steve Fasching*Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.*

A

Yeah. I think, Camilo, so the important point is the flow through of the savings that you'll see in the first half is greater to Tom's point because embedded in our guidance in the second half is an expected payout of performance comp. So while we're continuing to generate savings in the back half of the year, we're up against that reversal that we recorded last year of the performance-based comp.

Camilo Lyon*Analyst, Canaccord Genuity, Inc.*

Q

Got it. That's very helpful. And this is the last one for me. It's just more of a housekeeping question. Could you just remind us what your e-commerce mix is today?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

In terms of by brand?

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Of DTC or total business?

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Yes. Well, by brand, predominantly.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Of the e-commerce business, it's mostly in the UGG business.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yes, right.

Steve Fasching

Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.

A

Yeah.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. So generally speaking, the e-commerce business, yeah, it's obviously driven by UGG and it's healthy for every brand as a critical portion of their total sales.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

For the quarter, just to put it in perspective, of total DTC, both retail and e-commerce, it was about \$65 million for the quarter. That is the lowest quarter.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Second quarter, there's some – a little bit of growth there sequentially, but the big quarters are the December quarter and then the March quarter.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. But obviously, very pleased with the results that we're seeing and the efforts that we're focusing on – technology, digital marketing, merchandising are starting to pay off in that channel which we see as a critical growth driver going forward.

Steve Fasching

Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.

A

And demonstrated in our better than expected DTC comp.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah, exactly, yeah.

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Right, right. So Tom, sorry, so DTC was \$65 million but what is e-commerce of that?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. We don't break that out...

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Or unit [ph] sales (22:10).

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. There's a lot of overlap there.

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Yeah.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

For instance, in a store, you can order product on an iPad and that's recorded as an e-commerce sale but it's really generated in the store. So, we've been merging those two.

Steve Fasching

Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.

A

DTC, yeah.

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Okay. Understood. Thanks, guys. Good luck with the bulk of the season in front of you.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Thanks, Camilo.

Operator: Our next question comes from the line of Bob Drbul with Guggenheim. Please proceed with your question.

Robert Drbul

Analyst, Guggenheim Securities LLC

Q

Hey, guys. Good evening.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Hey, Bob.

Robert Drbul

Analyst, Guggenheim Securities LLC

Q

Tom, I guess a couple of questions for you. On the UGG business, I think last quarter, you mentioned that you closed 400, was it, UGG accounts. Is there any update to where that is? Has that number changed dramatically any further? And I was wondering if you could comment a little bit on the partnerships with Macy's and Footaction, SIX:02 and maybe, Amazon?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah, happy to. So, no real update on the amount of closures, those were closed over the course of the past six to eight months. At this point, we have the distribution that we have going into fall quarter. A large amount of stores in a quantity perspective but not a large amount of revenue necessarily in regards to what it does to the total impact on the top line. But feeling good about that progress and feeling good about the moves we've made and we'll continue to make to transform the marketplace and elevate the brand into the key channels and the key partners.

New accounts such as Footaction, Macy's, Amazon, pleased with how things are progressing so far. Footaction, the test we did last year had proved successful, so there's future opportunity that we're continuing with in that channel, particularly driven by the men's business.

Macy's and Amazon, we've been in the current distribution since the 1st of January. Those are core accounts for us, and so far, so good. Working closely with those teams, monitoring those businesses and pleased with the progress so far.

Robert Drbul

Analyst, Guggenheim Securities LLC

Q

Got it. And in terms of the outlook, the full-year outlook not really changing, has there been any change to the order book for the UGG business?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. I mean, Bob, I think the best way to look at that is we feel pleased with where the order book is. Really, no changes from the – on the last earnings call. We are now starting to book spring product. We feel pleased how that is booking.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. I think, as Tom said, the real change that we're seeing so far is the early orders of spring 2018. And based off the current sell-through that we've seen, particularly in the categories of sneakers and sandals in the UGG brand, that's obviously good momentum as we go into selling seasons for spring 2018. So the order book, early indicators there are strong and we're confident and pleased with the order book for going into Q3.

Robert Drbul

Analyst, Guggenheim Securities LLC

Q

Right. Great. Thanks, very much. Good luck, guys.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Thank you.

Operator: Our next question comes from the line of Corinna Van Der Ghinst with Citi Research. Please proceed with your question. Corinna, your line is live. Do you have us on mute?

Corinna Gayle Van Der Ghinst

Analyst, Citigroup Global Markets, Inc.

Q

Hi, guys. Hi.

Operator: Yes, there we go.

Corinna Gayle Van Der Ghinst

Analyst, Citigroup Global Markets, Inc.

Q

Hi. No, we weren't on mute. Sorry, I don't know what's happening. Good afternoon, guys.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Hey, Corinna.

Corinna Gayle Van Der Ghinst

Analyst, Citigroup Global Markets, Inc.

Q

I was just hoping to ask a couple of follow-up questions on what was asked already. Just in terms of the – I know you're not going to give the actual order number or backlog number, but just in terms of the composition of the

backlog that you guys are looking at right now, can you remind us what that looks like? And also, just the ASP trend that you're expecting for this fall season?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Like, again, consistent with the last call, we saw some, as we've reported, right, we saw some growth in the backlog year-over-year. We saw the UGG business, we were pleased with how that booked. We saw more growth year-over-year internationally for UGG than we did domestically.

In terms of ASPs...

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

ASP is going higher which is helping contribute to the improvement in gross margin.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

So, that does – we've made a transition to Classic II, so we'll have more full price selling of Classic II this year as opposed to last year where we were still selling some Classic I.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Right. Yeah.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. And we're very pleased with how the classics business is set going into the year. Going through the transition from Classic I into Classic II, as we said, allowed us to kind of reset the marketplace of inventory levels in the right distribution and the right account. I would say we have a very good handle on the classics distribution right now and very pleased with the inventory levels. Expect that business to continue to be stable.

The upside, as Tom mentioned, from international, is a big part of the order book, and then upside coming out of the men's business which we're very excited about going into fall and continuing to build that growth. So, what I really like about the order book makeup is the diversity of it and continuing to expand in the channels and opportunities internationally, as well as new categories such as men's and other footwear categories within women's.

Corinna Gayle Van Der Ghinst

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Great. And then, I just wanted to ask a follow-up as well on the guidance that you guys maintained for the full year. It only seems to imply kind of flat, slightly positive top line growth in the back half of the year. Where do you see that guidance being conservative in terms of revenues at this point from based on what we know?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

We think the guidance that we put up there is the right guidance. I mean, as we commented, we feel good where the order book is at this point in time. Normally, if there's a potential for upside it is related to the – more in the DTC business that could happen, as well as some reorders and that's more of a December quarter...

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

...area but it is early. We feel really good where the business is headed. Feel really good, the opportunity out there but it is early stages still and there's still a lot of business that gets done in November and December.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. I think based on what we can control, we feel good. As Tom said, it's still very early in the year. We got a long way to go still. We believe we're set up for successfully executing against our plan and our targets. But there's still uncertainty in the marketplace, and so, we don't want to get ahead of ourselves. But there is the potential upside is in reorders if we have a strong December. We're up against some tough comps last year in DTC because we were very cold in the last two weeks of the year and that really boosted our DTC business. And then, potential upside in HOKA. That business continues to drive more significant piece of the total revenue. We had a great quarter with HOKA. There's strong momentum in there and there potentially could be upside from that brand going into Q4 next year.

Corinna Gayle Van Der Ghinst

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Wonderful. And if I could just sneak one follow-up to your earlier comments about the gross margins, can you just talk a little bit more about the measures that you guys have taken this year to improve your inventory management? I know you talked about some of the Omni-Channel initiatives that have helped you with your DTC inventories. And we've also talked in the past about the UGG Closet being utilized more as a channel for clearance. Can you just kind of walk us through how – what gives you confidence in your ability to manage those better this year as we get into the fall/winter season? Thank you.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. I think generally speaking, the focus of the organization, as you know, is on controlling costs and improving profitability. So for every brand, they've been focused on reducing SKU count, reducing the amount of closeouts in inventory in the marketplace. We're starting to see the benefit of that, particularly in the smaller brands. You combine that with the reduction in costs that we're starting to see come in from the improvements we're doing with factory and yield utilization. It's a combination of all those factors.

But as I said, I think really digging in and understanding where our inventory has been cleaning it up where it's unproductive and unnecessary, managing it more tightly than we have before. And obviously, the upside in sales helps but it's a continued focus of the organization across all brands and regions to make sure that we get the

most bang for our buck in our inventory in the marketplace right now and that we're putting product on the market that has a high success rate of sell-through.

Corinna Gayle Van Der Ghinst

Analyst, Citigroup Global Markets, Inc.

Q

Thanks so much.

Operator: Our next question comes from the line of Scott Krasik from Buckingham Research. Please proceed with your question.

Scott D. Krasik

Analyst, The Buckingham Research Group, Inc.

Q

Yeah. Hi, everyone. Thanks for taking my questions.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Hey, Scott.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Hi, Scott.

Scott D. Krasik

Analyst, The Buckingham Research Group, Inc.

Q

So, I guess it was probably September of last year when that sort of unauthorized product showed up at Rue La La and there was some resale by, I think it was a European distributor and some independent. I'm just wondering how well you policed that this year and your expectations for product, particularly Classic II, showing up where it's not supposed to?

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. Thanks for the reminder of that from last year. Interesting times. But all joking aside, we took that very seriously and we have been aggressively pursuing the control of that pricing in the marketplace as much as we can to that extent. I think you're going to see the benefit of a number of things. Us, I'm having stronger relationships with our accounts, the number of accounts that we've closed over the last year. And then, aggressively just managing our pricing in the marketplace. So, we feel good about the work we've done over the last 10, 12 months to get us into shape that we're going into fall of this year, particularly with the reset of the Classic II and the Classic I inventory for all intensive purposes out of the channel. And so, it's just something that the team with the new leadership and the North America sales force, and they're all over it and we're monitoring it on a daily basis in the marketplace.

Scott D. Krasik

Analyst, The Buckingham Research Group, Inc.

Q

That's good. And then, you're never a big brand on the Nordstrom anniversary sale but you do have a handful of boots. I'm just wondering what you've seen from that in terms of a more specially classic type looks, the fashion

product, and then historically, people have used this as an opportunity to buy classics. Just wondering if you're seeing that type of demand.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. We just had a productive meeting with the teams from Nordstrom the other day. Feedback, so far, is that the wear-now – buy-now-wear-now product, the more seasonal product, is checking extremely well. Since slowness in the more traditional winter boot product which is, I think, is an indication of the marketplace being more focused on the buy-now-wear-now mentality, but pleased with the new product and the seasonally appropriate product in the anniversary sale.

Scott D. Krasik

Analyst, The Buckingham Research Group, Inc.

Q

Okay. And just last, I don't think you bought any stock back this quarter. Is that part of the strategic review that you're not going to buy any shares back until the review is over?

Steve Fasching

Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.

A

I think the best way to answer that is the board's strategic review process is ongoing and share buybacks, among other things, are some of the things that are being considered.

Scott D. Krasik

Analyst, The Buckingham Research Group, Inc.

Q

Okay. All right. Thanks. Good luck.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Thanks, Scott.

Operator: Our next question comes from the line of Erinn Murphy from Piper Jaffray. Please proceed with your question.

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

Great. Thanks. Good afternoon. Just a couple of questions. I guess, first on the Direct-to-Consumer business, obviously being much better in Q1. Is there any change to what is contemplated in your fiscal 2018 guidance for DTC comp this year?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Based off of how Q1 performed?

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

Correct. Yeah, I think your former guidance was up low single.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

No, no.

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

So, you're – okay. Got it.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. We're still reiterating that same guidance.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. Right.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. Exactly.

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

Okay. And then, just within the regions, underlying that comp, could you just speak to how EMEA versus Asia, whether you want to break that out, China, Japan versus the U.S. performed, within that 12.7%?

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. I'll, at a high level, while these guys look at the detail – strong performance across all regions. And the focus of the organization on e-commerce channel, the digital marketing capabilities, the operations side of the site, the product segmentation and merchandising on the site, all paying off and contributing to the growth. But very pleased with the growth across all brands and all channels – I mean, sorry, all regions in the e-commerce section of the business.

Steve Fasching

Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.

A

I might want to add one comment relative to the first quarter. I mean, we're really pleased with that 12.7%. Keep in mind, that's our lowest quarter. A year ago, as we were transitioning to our new ERP system we missed about – we scheduled it that way, the first, I think, week and a half of last year's first quarter. We didn't have any e-commerce sales...

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Cut over in the new system.

Steve Fasching

Vice President-Strategy & Investor Relations, Deckers Outdoor Corp.

...because we cut over to the new system. So, it made it for an easier comp this year.

A

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Got it.

Q

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

And then, just in terms...

A

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Yeah. Thanks for the reminder.

Q

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

Yes, region performance – Europe was very strong, North America was very strong, and positive gains in Asia but not as strong as Europe and North America.

A

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Okay. And then, just shifting gears, I think following up on Drbul's questions earlier on new accounts. Within Macy's, how many doors are you at now versus where you were January 1 when you started rolling out that test? And any thoughts on door potential over time?

Q

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

Yeah. Sure. So, the test we did last fall was 35 doors, including the new concession in Herald Square. In January, we went to 200 doors for women, then 50 doors, I believe, 50 doors for men, and that will not change through the remainder of the year. And from our perspective, we think that's the right amount. That represents the best-in-class of the Macy's footprint, but also, what we think is the best service location. So, it's not self-service. It's a traditional sit-and-fit approach and that's the game plan going forward. There's obviously opportunity in more Macy's doors but we're not contemplating that necessarily at this time. And we're going to play it through the rest of the year in the 200 doors that we are currently in.

A

What's also good to know about that is the diversity of the offering at Macy's is very strong. So, they have good support for the spring and summer product in women's and a very good support for the men's business going forward as well.

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

Got it. Thank you. And then, just last on HOKA, definitely a bright spot in the report. Can you just speak to the international footprint of that brand today? And then, what are the biggest opportunities from a growth perspective going forward?

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Sure. So internationally, we have a strong business in Europe that's really led by our French subsidiary and the growth opportunities over there are really around the UK and Germany, very similar to the UGG business. We have a strong business for HOKA, surprisingly up in Scandinavia, small but very health with regards to the size of the business for the size of that market. E-commerce, UK, Germany continue to be the biggest growth opportunities for HOKA in that market. The teams are aggressively getting after that opportunity, leveraging off the strength of the French market.

Internationally, very early days. Japan just started the business in a more direct way this year and initial indications look very good. China, the teams there are having initial indications with key partners in the marketplace of partnering with somebody to take that brand to market.

From a growth opportunity globally, we still see tremendous growth within the run specialty channel in the U.S. We're currently number six, according to NPD, in the run specialty channel. We could still double the business in that channel and just crack number five or four in the brands that are in that channel today.

So, that's where we continue to be focused. The key is maintaining credibility and authenticity in that run specialty channel, but really, increasing awareness before we start contemplating more self-service environments. And as I said, the growth opportunity in Europe is UK and Germany, and then, Japan and China, in addition to driving as much business as we can through our own e-commerce channel.

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

Thank you, guys. All the best.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Thanks.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Thanks.

Operator: Our next question comes from the line of Omar Saad with Evercore. Please proceed with your question.

Omar Saad

Analyst, Evercore Group LLC

Q

Thanks. Thanks for taking my question. I wanted to ask actually about the pull forward a little bit that's kind of having the strange effect on the revenue for this past quarter and the next one. It's a little bit counter-intuitive as we keep hearing from retailers wanting to push deliveries out closer to need. Maybe you could talk a little bit

about what drove the pull forward. Is it one of the new accounts or is it something going on with an existing account?

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. It's a combination, really, of two drivers. The first is a lot of that inventory was pulled forward by distributors. They picked up early at port and a lot of those planned receipts were on the cusp of June and July, and so, the inventory was there. The distributors were able to pick it up early and they did. And I think it's still a lot of that inventory is still kind of in season. It's not necessarily fall product where I think you're still hearing about some of the push-outs. So, just the fact that we were ready to go and the accounts were willing and looking to take some of that early. It's more about inventory being on the cusp of July versus June.

About a quarter of that upside came from HOKA which was driven by the eagerness to get the Clifton 4 in to the marketplace for the July 4 weekend in North America. And so, fortunately, we had a good transition from the Clifton 3. The inventory was ready to go and the launch plans are ready to go. So, we allowed customers to pull that inventory in early so they could set up and sell over the July 4 weekend, which is proving to be a smart move. We're getting – hearing good reports in the sell-through and we're seeing that also on our e-commerce channel, and I think that could potentially lead to some upside for that brand in Q2. But with regards to UGG, it's more budgets getting through the inventory they have and the normal course of business going into Q2 and Q3.

Omar Saad

Analyst, Evercore Group LLC

Q

Thanks, Dave. And then, on HOKA, which you were just mentioning, how do we think about the marketing plan? You mentioned the need to get the word out on the brand. And what are you – are you piling in more dollars behind that? Is there a certain marketing approach, brand awareness building approach that you guys are taking that could accelerate and then hit an inflection point at some point in the next couple quarters?

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah, great question because one of the key investments in our cost savings over the next three years is going to be HOKA marketing. We have the product, obviously, we have best-in-class product that's resonating with consumers. We think we have the right creative to appeal to the core authentic hardcore runner, but also, the female consumer and the lifestyle consumer.

So, the investment that we're going to make is really in driving awareness through continued on-the-ground events, having a presence there so we remain authentic and important in doing try-on sessions where we can. Heavy, heavy focus on digital and segmented offering in reaching the consumers that with relevant product for how they're going to use the product. You won't see any TV or out-of-home or things of that sort but it's just a matter of ramping up and getting very targeted on the consumers that we think are appropriate for this brand and the product.

It is the heavier investment in marketing currently than the rest of the brands and we'll continue to invest in that brand even more so going forward, particularly when the cost savings start hitting the bottom line in a more aggressive way.

Omar Saad

Analyst, Evercore Group LLC

Q

Got it. And then, if I could squeeze one more question on UGG. How do we think about the piece of the business now that's really driven by some of the innovations in the last few years? Things like the Luxe and the Slim and the Classic II, are those big franchises in a big component of the overall UGG, kind of 2Q/3Q sales volume? And are there other updates on these types of platforms that could also be important this year? Thanks.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. Great question, and we had a fantastic meeting the other day where we reviewed the entire Classics' offering. And then, we had a great conversation around how we start segmenting that. Now that we've reset the Classics franchise, we have extensions off the Core, into the Slim and Luxe, and the Street Style. Now, we're focusing on where we can segment those styles, and then, where we can innovate off of those styles. So, you'll see a little bit of that this fall.

If you remember, last year, we said the first priority was reset the Classics franchise, and then, we're going to focus on extending – on the extension beyond that in Fashion. But going forward, you're going to see more iterations off of the Slim and the Luxe in repositioning those based off the segmentation strategy.

They're all performing well. They're becoming a more significant part of the business. We're learning on – a lot about who is gravitating to each of those styles, whether it's a younger consumer or an older consumer, the channels that they like to shop in. But it is giving us a broader platform to build off of. And as far as innovation coming this year, we'll be launching the first ever waterproof Classic into the channel this year into wholesale and retail. And my instinct tells me that that's going to be a strong seller that we can build off going forward as well.

Omar Saad

Analyst, Evercore Group LLC

Q

Thanks for all the color. Good luck.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Thank you.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

A

Omar, thank you.

Operator: That's all the questions we have in queue. I'd like to turn the call back over to Dave Powers for closing comments.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

In closing, I am very pleased with the results of the quarter, and while it represents only one quarter of our long-term plan, it gives me great confidence in the team's ability to execute on driving improved profitability over the long term. We are urgently addressing the challenges of a dynamic marketplace with the continued focus on our customer and our product evolution.

The success we saw with the UGG's spring and summer offering, the numerous awards won by HOKA and the progress seen in Teva and Sanuk speak to how we are driving the business forward. Improvements in our supply chain efforts, reducing corporate overhead, rightsizing the retail fleet and rationalizing our wholesale account base demonstrate how we are tacking our cost structure to increase profitability. The combination of these efforts will lead us to long-term targets we articulated in the last call, with an operating margin of 13% by fiscal year 2020.

I'm very proud of the Deckers team. Their hard work and dedication, which have gotten us to this point, now more than ever, I am excited about the opportunities in front of us. I would like to thank all of our stakeholders for their support and employees for their focus and passion for the business as we continue to execute on our plan.

Operator: Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.

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