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DECK - Q1 2015 Deckers Outdoor Corp Earnings Call

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## OVERVIEW:

Co. reported 1Q15 YoverY revenue growth of 24%. Expects FY ending 03/31/15 revenues to increase approx. 14%. Also expects 2Q15 revenues to increase approx. 18% and diluted EPS to be approx. \$0.98.



## CORPORATE PARTICIPANTS

**Linda Pazin** *Deckers Outdoor Corporation - VP of IR*

**Angel Martinez** *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

**Dave Powers** *Deckers Outdoor - President of Omni-Channel*

**Tom George** *Deckers Outdoor Corporation - CFO*

## CONFERENCE CALL PARTICIPANTS

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**Erinn Murphy** *Piper Jaffray & Co. - Analyst*

**Evren Kopelman** *Wells Fargo Securities - Analyst*

**Robert Drbul** *Nomura Securities Intl - Analyst*

**Sam Poser** *Sterne, Agee & Leach, Inc. - Analyst*

**Scott Krasik** *BB&T Capital Markets - Analyst*

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**Fan Ye** *Credit Suisse - Analyst*

**Howard Tubin** *RBC Capital Markets - Analyst*

## PRESENTATION

### Operator

Good afternoon ladies and gentlemen. Thank you for standing by. Welcome to the Deckers Outdoor Corporation first quarter FY15 Earnings Conference Call.

(Operator Instructions)

I would like to remind everyone that this conference is being recorded. I will now turn the call over to Linda Pazin, Vice President of investor relations and corporate communications.

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**Linda Pazin** - *Deckers Outdoor Corporation - VP of IR*

Welcome everyone joining us today.

Before we begin, I would also 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 security laws.



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 other than statements of historical fact are forward-looking statements. These forward-looking statements include statements related to the company's anticipated financial performance, including its projected revenue, expenses, growth margin, operating margin, capital expenditures, earnings per share and effective tax rate, as well as to the company's brand strategies, store expansions and cost structure as well as the Outlook for the company's markets and the demand for its products.

The forward-looking statements made on this call are based on currently available information and because the company's business is subject to a number of risks and uncertainties, some of which may be beyond its control. Actual results may differ materially from the results expected at the current time. The company has explained some of these risks and uncertainties and its earnings press release and in its Secretary filings including the risk factors Section of its annual report on form 10-K and its other documents filed with the SEC.

Listeners are cautioned not to place undue reliance on forward-looking statements which speak only as of the date hereof. The company undertakes no obligation to publicly release or update the results of any revisions to forward-looking statements. As a reminder, we have posted supplemental information about the 2015 first quarter in a document entitled first fiscal quarter 2015 commentary. On our corporate website at [www.Deckers.com](http://www.Deckers.com).

You can access this document by clicking on the investor information tab and then scrolling down to the featured reports heading. We believe the approach are providing this additional background information to you will make it easier for you to digest the financial performance from the quarter and free up more time on the call for explanations of our performance and Outlook, discussions of our strategic initiatives and Q&A. With that, I'll now turn it over to the President, Chief Executive Officer and Chair of the Board of Directors Angel Martinez.

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**Angel Martinez** - *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

Well, thank you Linda and hello to everyone. Zohar Ziv, Chief operating officer, Dave Powers, President of Omni-Channel and Tom George our chief financial officer are also on the call.

While we are pleased to have achieved the 24% revenue growth for the first quarter, which was driven by the growing year-round strength of the UGG brand combined with increased contributions from our Teva, Sanuk, and Hoka brands. We believe that the investments we are making to build a world-class Omni-Channel organization and transform our business from a domestic footwear wholesaler into a leading multi-channel global brand operator are having positive impact on our results. We're better connecting our consumers with our brands and driving sales, fueling a solid start to the new fiscal year.

This year we brought to market the most complete spring collections ever across our brand portfolio and the customer response has been very positive. We believe that the combination of great product and our enhanced selling and marketing capabilities that we've developed as a part of our omni-channel strategy, as well as our expanded store presence are all fueling strong growth across our brand.

For the UGG brand, this spring was about diversity. Giving the consumer a broader selection of fashion and casual boots, shoes and sandals that reflect the UGG brands successful yet premium brand ethos. At the start of the quarter, specialty classics, slippers and fashion boots continued to sell well following a very good winter.

As temperatures turned more seasonable later in the quarter, sell through of fashion and casual sandals and casual shoes picked up and this momentum carried through July. The UGG brands first quarter performance was also driven by higher initial fall shipments as many wholesale accounts and international distributors increased their orders for our expanded offering of transitional styles, which start to arrive on shelves in the coming weeks.

Now to Teva, where the focus has been on evolving the brand beyond its traditional outdoor distribution, into more mainstream retail in order to target a lot larger audience. The primary vehicle driving this initiative is our Originals collection. A product line of sandals derived from the Teva brands authentic roots in whitewater and iconic styling that originally put the brand on the map but with more modern trend right style products that appeals to today's consumer.



Originals performed well in the first quarter despite the slow start of the warm spring weather. By focusing time, effort, and resources on key retailers that we believe fit our distribution strategy, we were able to drive double-digit sell through while also reaching new and influential consumers.

Sanuk had a strong quarter, due to a large part the continued success of women sandals, most notably the Yoga Sling series. What has been particularly encouraging is the performance of the yoga franchise in many of the brands larger national accounts including Nordstrom, Dillards, Journey's and DSW. Since we acquired the Sanuk brand, one of our primary goals was to extend the brand's presence beyond the action sports lifestyle channel and evolve it into a more year-round brand. The success of the spring line has helped us gain more shelf space for our fall offering, that now includes a broader selection of casual shoes and boots that can be comfortably worn during colder weather.

The HOKA ONE ONE brands momentum continues to gain pace. We believe that our innovative new products are garnering great attention and our expanded distribution is opening up a wider consumer audience. From a product perspective, we believe that HOKA's unique higher volume and soft density material is proving to be a disruptive force in the running shoe industry. We are seeing this unfold and sell through of the brand latest introduction, the Conquest and the Clifton.

At this stage, we are still very much in seed mode and we plan to continue to limit distribution to the specialty running channel as we cultivate brand's authenticity. That said, we believe HOKA's differentiated market positioning provides us the opportunity to develop a product line extensions for the larger national sporting goods chains and athletic specialty stores. This is something we are working towards for early next calendar year.

As you just heard the new fiscal year is off to a solid start. Now that we're three months closer to our peak selling season we remain confident in how the business is set up for success over the remainder of the year. Among the key pillars that support our Outlook is the successful fall pre-book that we completed in late April. In addition to growing of the order book, the composition was a positive indication that our wholesale accounts and international distributors have a higher degree of confidence in the UGG brand's expanded collection of fashion boots, casual boots, shoes, and slippers following strong sell through this past winter.

Retailers also responded favorably to updated styling and sharper price points on many key styles, which we believe will also resonate with our consumers. Included in this year's pre-book was I Heart UGG a new premium brand created by UGG that caters to the tween girl. We've just launched a select retail locations including several of our company-owned flagship stores in the US and China and Japan as well as Nordstrom, Zappos, and Dillards.

This includes many high-traffic locations, such as Mall of America, South Coast Plaza, Madison Avenue and Chicago among others and also in our brand showcase store here at headquarters. We are also opening two I-heart UGG concept stores in late August including a 600 ft.2 store in San Francisco and a 1000 ft.2 store in Waikiki. There was great interest generated from the preview of I Heart UGG and the launch could certainly have been wider; however, we chose to limit distribution out of the gate, in order to test the market response before potentially expanding the line from both a style and door standpoint next year.

We are very excited about the new line and feel very good about its growth prospects given both the quality and the appeal of the product that we are introducing. We're rolling out a marketing campaign, which taps heavily into social media and leverages direct association with key movie and TV stars that are well known among the tween audience.

HOKA ONE ONE recent performance also contributed to our pre-book performance and is helping to fuel our optimism about our growth prospects in FY15. While still a small percentage of our overall business, HOKA is growing rapidly and we believe that it has a sizable runway in front of it. We think it has solid potential to capture additional market share of the global \$14 billion running category over the long term.

Another pillar of our outlook is the increase investments we're making in our brands. For FY15, we've increased our total company marketing spend as a percent of sales to approximately 6% from a little over 5% in our last fiscal year. The majority of the increased marketing spend is being directed towards the UGG brand with the incremental dollars going towards a combination of digital programs and tactics aimed at broadening brand awareness and driving traffic to our direct-to-consumer channel.



Spear-heading this initiative is the UGG brand first global brand marketing campaign titled "This is UGG". The campaign takes the physical feeling of the UGG brand DNA and turns it into an emotional connection by showing how the brand fits into consumers lives in smaller moments that are actually the biggest: these biggest moments that feel like nothing else.

The goal is to connect with consumers on an emotional level positioning UGG as a global premium lifestyle brand year-round. We also plan to integrate Tom Brady, the face of our men's campaign, into "This is UGG" through a series of print and digital stories that focus on his best moments off the field. "This is UGG" kicks off August 18 and the men's campaign debuts in early September in conjunction with the start of the NFL season.

This month we supported the launch of I Heart UGG through coordinated print, digital, and in-store activations and they are communicating how the product is uniquely different from the UGG brand, yet incorporates the UGG brand DNA. We want to convey to the tween consumer that the I Heart UGG brand is fun, young and playful and delivers the comfort and craftsmanship that is synonymous with the iconic global UGG brand.

Now let me turn the call over to Dave who will discuss the direct-to-consumer division and our international wholesale business, the other main pillars of our growth strategy. Dave?

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**Dave Powers** - *Deckers Outdoor - President of Omni-Channel*

Thanks Angel.

Our direct-to-consumer business continues to generate solid gains with the first quarter total sales increasing 33% over last year and DTC comparable sales, which include worldwide retail same-store sales and worldwide comparable e-commerce sales, increasing 10% compared to the same period last year. This was driven by a 39% increase in comparable e-commerce sales as digital traffic and conversion were both up double digits, partially offset by a low single-digit comparable store sales decline.

While store traffic has been a challenge, we are pleased with the trends in-store conversions, which were up double digits in every region compared to the same period last year, giving us confidence that the steps we are taking to elevate the in-store experience are yielding returns and that webrooming is a positive trend in the marketplace.

By region, Asia Pacific DTC comps increased 38% compared to the same period last year, fueled by strong trends in both Japan and China. North America DTC comps rose 5% driven by strong e-commerce sales partially offset by weaker store comps and EMEA DTC comps decreased 1% with soft store trends offsetting strong e-commerce results consistent with the European market.

We believe that, particularly in the footwear business, a significant number of consumers try on product in brick-and-mortar locations and further research and purchase products online. As a result, we believe that our stores and websites are interconnected in a way that requires them to be analyzed on a combined basis. We now know that brick-and-mortar locations fuel e-commerce and vice versa. And we believe that a portion of our e-commerce growth is fueled by our increasing store base.

We see the Infinite UGG program and similar Omni-channel initiatives providing increased contribution to overall DTC comps going forward as a further tie of our stores and websites. As we look towards the remainder of the year we feel good about the opportunities for the continued expansion of our DTC business. With respect to our store expansion plans, we are still targeting between 30 and 35 new stores for this fiscal year.

We will continue expanding our store print in Asia Pacific, where we currently experienced the highest return to due to lower build-out and operating costs combined with higher productivity. The remaining new locations will be in North America with a mix of high return outlet locations and high-traffic concept stores in major metropolitan cities like Las Vegas, Seattle, San Francisco, Waikiki, Toronto, and Vancouver. We are also expanding our international digital presence through new country specific e-commerce sites for Germany and Italy.

At the same time, we are continuing to unveil enhanced features of our omni-channel strategy in order to better serve and connect with our customers regardless of where they choose to shop for our product. As we have discussed on past calls, we are taking a very holistic approach to growing our global DTC business. With the consumer firmly at the center of everything we do, which is leading our long-term strategy.

The key next step of our omni-channel evolution will be the opening of a smaller concept omni-channel store in Tyson's Galleria this fall that will feature new in-store Web technologies, such as interactive displays, and the ability to reserve online and pick up in store. Additionally, we believe that several of the initiatives we began testing in in the last two years, such as Infinite UGG and UGG by You and Swarovski crystallization are now poised to generate even greater results. As a result, we are expanding our successful Infinite UGG program to all stores in North America, all concept stores in Japan and introducing the program in EMEA this holiday season.

Infinite UGG gives us the ability to offer our retail customers every SKU available from the UGG brand through our in-store POS system, which we believe will enhance customer satisfaction and DTC growth. Our UGG By You customization program will include additional styles and design details for the consumer to choose from, such as the popular bailey bow and bailey button.

As part of our continued omni-channel investments, we are also expanding Retail Inventory Online or RIO. A new tool launched this past spring in select stores in North America and EMEA in advance of the fall and holiday selling season. RIO provides customers a visibility into store inventory, helping them to efficiently locate the product they want prior to visiting the store.

In tandem with this feature we will also be rolling out purchase online pickup in store, in both the US and EMEA this fall. Supporting increased convenience for accessing and purchasing our product while driving traffic to our stores. We are looking forward to taking full advantage of our omni-channel platform this fall and beyond.

In addition we are also making great progress on building our universe of customers through e-mail captures and loyalty programs as over 50% of all of all opt-in or sign-ups now come from our retail stores. We are continuing to inject exclusive products created just for DTC platform supporting fresh merchandise in the market and adding to the appeal of the in-store experience. We believe the combination of these initiatives should help drive incremental traffic to our brand and higher conversion combating macro traffic challenges, which in turn will fuel total same-store sales growth.

Turning to our international wholesale and distributor business, we completed the transition to a direct subsidiary model in Germany on July 1 as part of our strategy to gain more control over the global direction of our brands. The changeover went smoothly and we are now in the process of filling out the leadership team that will help us build our presence in this large and important market.

Elsewhere in Europe, we experienced a solid sell through of spring styles from the UGG and Teva brand driven by the positive consumer sponsor to our updated styles and sharper price points combined with much warmer weather across the region compared to the same period a year ago. Overall, we are pleased with the current state of our EMEA wholesale distributor business but do remain a bit cautious heading into the fall soon given the soft traffic trends that many of our key retail partners particularly in the UK.

In Asia Pacific, we remain on track with our partners store program in China, which for reporting purposes are treated as wholesale accounts. We expect there to be at least 10 stores open this year under the terms of the agreement we have signed with these three new partners. Again, these stores are in addition to the company-owned stores we plan to open this year.

Our new partners will open doors in areas of China, where we have little to no presence and believe a local operator is in a better position to run these stores successfully. We spent a considerable amount of time this past quarter in continuing to develop and fine-tune our omni-channel capabilities and the long-term road map for building a world-class omni-channel organizational globally. We are very excited about the UGG brand upcoming fall campaign "This is UGG", which will launch in August and we are also pleased with how our holiday plans are coming together for the season.

We believe we will benefit from our most compelling product stories ever and we are optimistic about our opportunities with casual boots, weather appropriate product, limited addition collections and customized product, as well as our men's twinsole and tread light programs. We believe these product innovations along with our focus on storytelling will lead to deeper engagement and interest among consumers, improved comp results in our stores and continued improvement in conversion.

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



**Tom George** - *Deckers Outdoor Corporation - CFO*

Thanks Dave.

As Linda reminded everyone, we posted the quarterly financials to our IR website, so my comments on the call are going to be brief and focused primarily on guidance. For the first quarter, we exceeded our revenue guidance by approximately \$21 million, and exceeded our earnings per share guidance by \$0.26.

Nearly half the upside in revenue was attributed to the timing of wholesale and distributor sales and the other half was from higher than expected sales. The higher-than-expected sales contributed approximately \$0.05 to the EPS beat, while the other \$0.21 was due to the timing of sales and operating expenses.

For the fiscal year ending March 31, 2015, we now anticipate revenue to increase approximately 14% up from previous guidance of 13%. Our underlying assumptions of our guidance remain the same from last quarter. We are still planning for the addition of 30 to 35 new stores, a low single-digit store comp increase and a double-digit increase in comparable e-commerce sales.

Wholesale and distributor sales for all brands are still projected to be up low double digits, driven by our Germany conversion, a high single-digit increase in UGG domestic sales, and continued growth for the HOKA brand. In terms of the bottom line, we now expect FY15 diluted earnings per share to increase approximately 14.5% up from 13.5%. This guidance assumes a gross profit margin of approximately 49% and an operating margin of approximately 13%.

We expect FY15 SG&A expenses as a percent of sales to be approximately 36%. Among other items, these expenses included increased marketing and supply chain costs, investments in IT infrastructure, expenses related to management reorganization, and operating costs associated with opening these stores in 2013 and 2014. As we've previously said, we expect to achieve SG&A leverage in the back half of calendar 2015, which will be our FY16.

Our FY15 guidance assumes that the company's effective tax rate will be approximately 29%. Our capital expenditures for FY15 are expected to total approximately \$100 million. This includes \$37 million for IT and related infrastructure to support our omni-channel strategy and the international expansion, \$30 million in new store openings and \$26 million for the new distribution center. For the second quarter of FY15, or three months ending September 30, 2014, we currently expect revenues to increase approximately 18% and diluted earnings per share of approximately \$0.98 per share.

One more note on guidance, the third quarter ending December 31, our older fourth quarter, will generate a lower percentage of our total annual sales and profits than in prior years due to higher profitability in our new fourth quarter ending March 31, 2015. With the concerns of a potential West Coast port strike, we made the decision during the first quarter to accelerate some product originally planned for Q2 receipt into Q1 to minimize the impact of a potential strike. We also routed some containers through non-west ports.

These measures increased our Q1 ending inventory position by approximately \$17 million, but will help address the impact of a potential strike. We are looking forward to hosting our first analyst and investor day at our new headquarters. We had initially planned to hold it in late September. With Q3 earnings released in late January, which include the bulk of results from the holiday season, we now plan to host the event sometime in the spring of 2015.

Finally, the company believes total DTC comparable sales including same-store sales and worldwide comparable e-commerce sales is a more accurate measure of retail performance. We see many of our omni-channel initiatives providing increased contributions to overall DTC comps going forward as the lines between stores, site traffic, and sales transactions have become blurred. For this reason, starting next fiscal year, we will begin only reporting a combined DTC comp.

I'll now turn it back over to Angel for his closing comments.



**Angel Martinez** - *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

Thanks Tom. While the investments that we've made as a company in the last several years are part of a much bigger strategy, to deliver sustainable growth and enhance profitability over the long term. I think it's important to point out that many of these investments are focused on marketing, our new distribution center, which will meet the demands of today's consumer who is shopping across all channels, and improved business intelligence systems that are necessary to drive growth moving forward in an omni-channel environment.

Now think back, just a few short years ago, we were a wholesale vendor that delivered product twice a year and our success was largely driven by how well buyers, wholesale buyers, responded to our collections at industry trade shows. The consumer had very little influence in shaping our future direction. This dynamic has been turned completely upside down.

The consumer is now the gatekeeper and we've transformed our business model to not only adapt to the new retail paradigm but also to thrive and to grow. We now drop product more than 10 times a year and communicate with consumers on a much more frequent and personal basis. This constant flow of information is reshaping our growth strategies, including our product development and store expansion plans, as we now have much better insight into pinpointing demand and directing capital towards what we believe will be high return high productivity locations.

Our teams saw this shift in consumer behavior unfolding early on and we think we are one of the leaders in the industry when it comes to making the necessary adjustments in order to succeed in today's global marketplace. As we move forward, we'll continue to fine-tune our merchandise, our marketing and our omni-channel strategies to ensure that we are constantly strengthening our connection with consumers and delivering them the innovative and exciting product they demand in the environment that they choose.

We will also continue exploring ways to enhance our supply-chain to drive down costs and improve efficiency to generate operating leverage. While it's early in the new fiscal year, we certainly have a good deal of confidence in our Outlook for FY15 based on the strength of our fall collections and the concerted investments we are making in our brands and the omni-channel capabilities. Operator we are now ready to take questions. Operator?

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Camilo Lyon, Canaccord Genuity.

**Camilo Lyon** - *Canaccord Genuity - Analyst*

Thanks. Good afternoon. Very nice job on the quarter guys. I just want to have a clarification question on the gross margin. In the current quarter in the quarter just reported. If you could just highlight some of the puts and takes on the gross margin and maybe tell me, if you could just give us a little bit of cadence walk through and how we should think about gross margin expansion quarter to quarter through the balance of the year.

**Tom George** - *Deckers Outdoor Corporation - CFO*

Okay. Yes. For the quarter essentially what happens, we came in pretty much in line with our internal expectations. It was down slightly and that was primarily due to a good half of the sales beat being from wholesale and distributor sales that carry lower margins.

So good news we beat the sales line but there was a little, due to the mix, there was a little bit of a pressure on the margin, and that for the quarter essentially offset what lift we had for more DTC business from it relative to a year ago, as well as what sheepskin savings we had. Keep in mind this quarter is a quarter that the sheepskin savings are less impactful than they are in later quarters.



In terms of the cadence for future quarters, what we anticipate at this point in time is expansion obviously in the out quarters with looking through here roughly the same amount of Q2 and Q3 will have the same amount of expansion between one another. So, about the same expansion for Q2 and Q3 relative to the prior year and Q4 a little less expansion because we lap some of the sheepskin savings.

So, for the June quarter and the September quarter you have some benefit of direct to consumer -- more direct to consumer content and you also have some sheepskin savings relative to the prior year, as well as in the June quarter -- excuse me -- in the September quarter and the December quarter, some benefit associated with the conversion of the Germany business to the direct model versus the distributor model.

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**Camilo Lyon** - *Canaccord Genuity - Analyst*

Perfect, that's very helpful, thanks. And then just on the inventory business you guys have done a great job of managing the inventory. Very acutely. Is there a thought or maybe a fear that your inventory might be on the leaner side then you're comfortable with or are you pretty good with where it sits from the perspective of being able to meet at-once orders should the season call for it?

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**Tom George** - *Deckers Outdoor Corporation - CFO*

We feel that we have the right inventory levels and we should be in a better position this season to be able to service some more in season demand.

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**Operator**

Erinn Murphy, Piper Jaffray.

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**Erinn Murphy** - *Piper Jaffray & Co. - Analyst*

Great. Thanks and congratulations on a very good quarter. Angel for you, I just wondered if you can speak a little bit more about the buzz you have heard so far about the I Heart UGG launch. I realize it's only been over a week now but just helping understand how you think about the rollout going forward beyond this initial fall season.

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**Angel Martinez** - *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

Yes. Thank you, Erinn. We are very optimistic given what we've seen so far but as you said it's extremely early. The activity gears up around the digital marketing efforts here as the quarter progresses, so we'll know a lot more.

The response we've had to the next season's product has been very, very strong. I think you can start to see the dimension that this little brand is going to take on. The appeal to that tween consumer is pretty significant. I mean, and think about this, it's also not -- it's not just footwear, it's handbags, it's accessories. It's a lot of things that sort of round out this statement that we are making with I Heart UGG.

So, too early to tell but all the indicators are very positive and we feel confident that consumer will react probably beginning with a -- we should see a nice little bump with back-to-school and then of course as the fall weather changes.

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**Operator**

Thank you. Evren Kopelman, Wells Fargo.



**Evren Kopelman** - Wells Fargo Securities - Analyst

Thank you. Good afternoon. Congratulations. Can you comment on, you mentioned the shift in the wholesale out of -- or into Q1 but your second quarter sales growth guidance is pretty strong as well. And then the back half looks lower. Can you comment on some of the dynamics that is driving the 18% of sales growth guidance in the second quarter and then lower in the back half? Is there more shipment? Shifts? Some of that would be great. Thank you.

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**Tom George** - Deckers Outdoor Corporation - CFO

Some of it is the timing that's shifted from the June quarter into the September quarter. As some of it -- that's sort of a take. Whereas on the put side, there's -- now that we're direct in Germany we'll get a lift in sales and that contributes to some of the sales growth on that side of the equation. We have more stores relative to a year ago. That's another thing that's driving that growth and we feel real good about our UGG US domestic wholesale business also this September quarter.

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**Operator**

Bob Drbul, Nomura.

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**Robert Drbul** - Nomura Securities Intl - Analyst

Hi. Good afternoon. The question that I have -- Tom, around the gross margin again, on the fourth quarter you talked about your lapping the sheepskin. Can you put some numbers around the cost of sheepskin in the fourth quarter and I guess corresponding that to the continued penetration of the UGG Pure business on the input cost side and sort of how that's playing through the business model into this year?

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**Tom George** - Deckers Outdoor Corporation - CFO

Good question. Given we don't finalize our sheepskin for really next calendar year until October time frame, what assumptions we have for sheepskin now in the new fourth quarter which is the March ending quarter is really a continuance of our current, not only sheepskin costs, but also our current penetration of UGG Pure at this point in time. So, we get more visibility of sheepskin costs, which we'll have for the October call and at that point in time we'll even have more visibility of what our next year's penetration of UGG Pure will be and we'll be able to probably refine that number.

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**Angel Martinez** - Deckers Outdoor Corporation - CEO, President, and Chairman of the Board

I think what we said in the past is, next year we should expect penetration of about 40% on UGG Pure. Keep in mind that new product launches, such as I Heart UGG are exclusively UGG Pure and so as that grows it could accelerate our incorporation of UGG Pure into the product line. [Twin soul] is another example of where we have used UGG Pure to enhance product in ways that consumers really respond well to, creating a much better price value. So we are very selective and judicious about where we used UGG Pure but the benefits to the consumer are pretty obvious.

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**Operator**

Sam Poser, Sterne Agee.

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**Sam Poser** - Sterne, Agee & Leach, Inc. - Analyst

Good afternoon. I'm going to ask you a long one. Can you tell us the same question for Camillo on the SG& A and can you give us what the UGG wholesale business was for Q1?

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**Tom George** - *Deckers Outdoor Corporation - CFO*

We normally don't give that element.

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**Sam Poser** - *Sterne, Agee & Leach, Inc. - Analyst*

It will be on the Q. I was just wondering if you could give us what the UGG wholesale revenue was for Q1?

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**Tom George** - *Deckers Outdoor Corporation - CFO*

Might as well.

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**Linda Pazin** - *Deckers Outdoor Corporation - VP of IR*

Yes.

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**Tom George** - *Deckers Outdoor Corporation - CFO*

So on a global basis, for Q1 -- correct me if I'm wrong -- it would be approximately \$74 million. So there's that. Some of the SG& A -- sort of that cadence, more SG&A growth in the September quarter relative to the growth we saw in this quarter.

Moderate -- there's growth obviously in the December quarter, a lot more marketing there, some growth and then there'll be more stores as well. And then the March quarter of SG&A growth is pretty comparable to the growth we saw this quarter we just completed in absolute dollars.

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**Operator**

Scott Krasik, Buckingham Research.

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**Scott Krasik** - *BB&T Capital Markets - Analyst*

Hey. Hey everyone. Thanks and congratulations. Sort of a two part question on the EMEA. If you can just dig into the Germany opportunity, I think you had somewhat of a capital constrained distributor.

So what the opportunities are that you just haven't been recognizing at all, how big you think that can be in a couple of years? And then you alluded to caution around the UK. What did you mean exactly? Is that the wholesale business, the retail business? And any color you could give. Thanks.

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**Dave Powers** - *Deckers Outdoor - President of Omni-Channel*

Yes. Thanks. This is Dave.

With regards to Germany, if you think about that market now it's been a wholesale led market, and it's a very healthy market that we're taking over and transitioning into. We believe that we with the expertise we have in the region through marketing and merchandising, that will help our existing wholesale business. Not necessarily looking at new distribution opportunities because we have a pretty solid distribution network now but just enhancing that business through marketing and merchandising.



Then going direct through e-commerce, which will be launching this year. In fact I'm heading over to Europe tonight to travel to Germany next week to start looking at store locations. So we think a potential for that market is very strong and a brand awareness is strong. The brand is in a healthy position and so with a combination of elevating wholesale, activating e-commerce and direct-to-consumer retail, we think it could be our second largest market in a few years.

With regards to the comment about being a little bit cautious about wholesale, that's with regard to the macro condition of the European market, in particularly the UK market, more with regard to our wholesale partners and just making sure that we're keeping a close eye and them and their traffic patterns as the whole market is being slowed traffic to stores, brick-and-mortar stores. So we don't want to get too excited about that until we see how the traffic macro trends continue in that market.

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### Operator

Eric Tracy, Janney Capital Markets.

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### Eric Tracy - Janney Capital Markets - Analyst

Good afternoon. Thank you for taking the questions I'll add my congrats.

I guess for Dave just to follow-up on DTC. Certainly understanding the evolution of the omni-channel business but given that you commented on essentially folks are now more show rooming early, trying on product and then going and buying online. How do you think about the evolution of the brick-and-mortar format?

Sounds like you're going to roll out towards this early test a more tech driven concept here in early 2015. But maybe just speak to that as well as what are the potential opportunities from a marketing perspective to try to drive traffic actually through the stores as well?

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### Dave Powers - Deckers Outdoor - President of Omni-Channel

Yes. It's a great question and just before I jump into that just to define webrooming, I mentioned that in the commentary. Webrooming is the practice of searching online and then shopping in-store so it's kind of the opposite of show rooming. What we're finding with the combination of our stores and e-commerce sites is there more interconnected than they ever have been and consumers they are both show rooming and they are web rooming and what we're finding through that is that we have the ability to drive traffic from one channel to the other.

So, if you think about the effect of opening a store, this is how we're looking at it now, when we open a store in a metro area, we do the sales for the four walls of that store. We also have Infinite UGG, which delivers sales to our e-commerce site. Then we capture customer data which in turn leads to sales in our e-commerce site and then we create awareness in the marketplace which drives even more business to e-commerce.

So we are starting to think about the stores as not just a store in a four wall P&L. A store that impacts the overall macro environment of our brand in that Metro area. The inverse of that is that we have the ability now through analytics and increasingly CRM and loyalty programs through e-commerce to better target customers in those Metro areas we know where they are.

We can send them through merchandising and marketing initiatives digitally back to the stores. So, that's why we're looking at this as a combined ecosystem. Stores and e-commerce sites feeling each other looking at them across P&Ls, across the organization, across merchandising. So, as we look at that it weighs heavily into our decision on where we want to put stores and we have more analytics than ever to decide where we should put a store based on what our consumers are buying, where they live, what we are learning from analytics and social to target key Metro areas.

That being said, we are still looking at locations that are going to return above 20% return on sales, being cautious of where that will be in North America. That's really a North America Europe dynamic right now. If you think about Asia-Pacific, particularly China, where there isn't a wholesale



business, we are still focused on large Metro areas and key opportunities that we're learning from our e-commerce business both through owned and partner stores.

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**Angel Martinez** - *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

Let me add to that, Eric. One of the key learnings here with an omni-channel strategy as the one that we have employed is impacted really understanding how big are the stores that you should be opening going forward? Because you may not need the back room you think you need.

For example, we have a store downstairs in our headquarters here that's called the brand showcase, features all of our brands. The footprint of the store is much smaller than it would normally be because there are also banks of iPads that allow the consumer to access any of the products from the brands not displayed in the store directly online and available within 24 hours. Interestingly that that aspect of the store is now 30% of revenue in the store.

So, 30% of revenue being driven without the need for the footprint and the needed back room and the staffing the goes with that. So, size of store and location of store are informed by the omni-channel strategy very, very important components going forward, which should yield much better efficiency.

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**Linda Pazin** - *Deckers Outdoor Corporation - VP of IR*

Just to clarify the Infinite UGG program, all the sales that take place on the iPad are credited as an e-commerce sale and not a retail sale. Although that purchase never would have occurred had the consumer not walked into the store.

We had tested that with a very small number of stores in the fourth quarter in December quarter of last year and that is now being rolled out to all of our stores in North America, as well as to stores in Japan as well. We fully expect that to contribute a much bigger percentage to our sales as that is being rolled out on a much larger scale globally.

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**Operator**

Taposh Bari, Goldman Sachs.

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**Taposh Bari** - *Goldman Sachs - Analyst*

Hey guys. Good afternoon. Nice quarter. Commentary for the spring season, I know everyone's focused on the Outlook, but spring season sounded like was a pretty good season for you guys and what seemed to be a pretty uninspiring retail environment, so do feel like you gained share higher in the quarter over the season actually not as bad as we would have thought?

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**Angel Martinez** - *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

Well, I think what's benefiting us now that we have multiple brands performing in the spring and each of them is gaining share. Certainly HOKA is gaining share in the specialty running area. I think that there is some share of that Sanuk is gaining, specifically I believe from Tom's. I think that's an opportunity, I think Teva is gaining significant share from Keen.

So, I think those are very important components that reflect the balance that we're now seeing in our spring portfolio approach. Don't forget UGG's performance in the spring was record, so that continues to evolve very nicely. So we've got a spring offering that is stronger than we've ever had and all of those brands are performing significantly better than they have in the past.



**Operator**

Jeff Van Sinderen, B. Riley & Co.

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**Jeff Van Sinderen** - *B. Riley & Company - Analyst*

Good afternoon. Let me add my congratulations as well. Can you talk a little bit more about the shelf space you're gaining with Sanuk, I think you mentioned that in your comments and then anymore color you can give us on where you are in the process of rolling out distribution of HOKA?

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**Angel Martinez** - *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

Sure. You know on Sanuk, when we acquired that brand, the brand really was 70% men's, 30% women's. It was primarily distributed in surf shops and action sports distribution.

We knew that the gender profile of the brand would need to alter significantly if we were to have any hope of selling product in department stores, for example. So one of the things we're seeing with Sanuk is a major transition to a much more compelling women's product offering. We're now seeing the shift has occurred in many locations where 60/40 women's to men's on our locations. Downstairs we're 60/40 women's to men, Sanuk stores are 60/40 women's to men's.

That's being fueled by very specific product that for example the Yoga Sling and some of the new closed toe products that Sanuk has that's been performing exceptionally well, the slip ons, the casual canvas approach they are taking in men's and women's. So all of those things are converting the brand to, I think a much more commercial longer-term growth story because we can now sell department stores, where as when we acquired the brand, I think we were very limited there because of the men's dominance really.

In terms of HOKA, HOKA distribution -- you know we have made significant inroads in penetrating the running specialty environment in the US. We are now continuing that same strategy outside the United States in our key markets where we decided to roll the brand out. We are also seeing as we've mentioned, I mentioned in my comments, next year we'll be moving into athletic specialty and sporting goods with unique product specifically for that channel. These will not be products that are running specialty will be competing with which is very, very important.

The most important thing is we will not be compromising the feel and the performance of the HOKA product in any channel of distribution, so that consumer who shops at a DICK'S Sporting Goods, let's just say, is going to have the same HOKA experience that the person who is shopping in a running specialty store. There will be different, a different product, also that running specialty store consumer I think has a need for more diversity of product. They may -- maybe when they started running they went to Dick's and brought running shoes and then over time, they migrate toward a running specialty store where they can get very specific shoes for trail running or for road running or maybe a racing shoe or a variety of other things. So the diversification of the product line is offering up these opportunities and we are very excited about that.

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**Operator**

Randy Konik, Jefferies

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**Randy Konik** - *Jefferies & Company - Analyst*

Thanks a lot. Good afternoon. So I guess my question is around posturing for holiday 2014 by your wholesale accounts, relative to holiday 2013.

How do you think they are feeling about their business going into holiday this year? How are they going to be -- how are they changing their order patterns? What type of product changes are they making in their assortment? I'm assuming that last holiday didn't have enough product and caught you by surprise. So, I am just trying to get a sense of how they are thinking going into this year's holiday?



Also, just to clarify, did you say UGG Pure will be 40% of the mix by the end of calendar 2014 or 2015? Then, lastly, from an I Heart UGG distribution standpoint, would you imagine that being a potentially wider net of distribution -- door distribution then your other lines like men's or something like that? How do we think about the actual distribution opportunity in that sub brand? Thanks.

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**Tom George** - Deckers Outdoor Corporation - CFO

Okay. First of all, the 40% is a calendar 2015 number. The I Heart UGG distribution will expand in reflection of the UGG distribution. It's going to be primarily department stores, our own stores and then key independent specialty retailers.

So you can just look at the UGG footprint and pretty much assume that you're going to see I Heart UGG potentially in most of that distribution. And when it comes to -- what was the other question?

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**Linda Pazin** - Deckers Outdoor Corporation - VP of IR

Holidays.

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**Tom George** - Deckers Outdoor Corporation - CFO

Yes. Holidays. I think confidence is probably the most important word here. I think consumers -- retailers have more confidence in the strength of the brand, the assortments are so much better than they've ever been. We now have very, very competitive products at the key price points that we did not have a few years ago. We have fashion boots. We have weather boots. We have product -- say \$175, which is a very, very important target for us.

So that has also given the retailer confidence, I think what you'll see this year versus prior years is a much expanded assortment in the season. Much less dependence on core classic and classic derived UGG product. Yes, of course, those are all still very important but you are going to see a side of UGG that you probably haven't seen in prior years due to the strength of the offering. That will continue and I think that that's again giving people confidence in the fact that they're not going to lock a customer who is looking for a fashionable season right product.

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**Operator**

Mitch Kummetz, Robert Baird

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**Mitch Kummetz** - Robert W. Baird & Company, Inc. - Analyst

Yes. Thanks. A question for Dave. I was hoping you could just maybe give us some color on the disparity in Q1 DTC comp by geographic region, it seemed like Asia Pac was particularly strong. Or at least stronger than North America and Europe, I'm just wondering if there's a reason for that difference?

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**Dave Powers** - Deckers Outdoor - President of Omni-Channel

Yes. I think the biggest challenge from a comp perspective we saw was in Europe. As I said, it's consistent with what the market is seeing there with traffic being challenging, tourism in the European market is challenging, so the toughest market was Europe followed by the US.

The US was a small comp in fact if you add Infinite UGG sales back in, it gets you back to a flat comp in North America. So pretty small overall. The real shining star of the group is Asia-Pacific, both in China and Japan, with positive double-digit sales comps in those locations.

Then the thing that's important to keep in mind about all of these is, even though we are having some challenging traffic locations in all markets, our conversion was up double-digit 20% globally across all those markets, which really goes back to the point I've been trying to make in the last couple calls is the investments we are making in our team and the capabilities around merchandising, inventory control, in-store experience, localized merchandising assortments better in tune with that local customer, those are the things that are going to make a difference and going to allow us to continue to get back some of the traffic trends globally.

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**Operator**

Corinna Van der Ghinst, Citi.

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**Corinna Van der Ghinst** - Citigroup - Analyst

Thank you. Hi guys. You've talked about the new innovations that you're implementing in omni-channel with the customer moving between your website and stores, but how do you think this omni-channel shift is impacting your customers on the wholesale side of the business? And are you concerned at all that some of these innovations in your own DTC could eventually cannibalize some of your wholesale?

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**Dave Powers** - Deckers Outdoor - President of Omni-Channel

Yes. It's a good question. We are learning about this every day. I think the good news is that most of our key wholesale accounts are also investing in omni-channel capabilities, if you think about Nordstroms, they are leading in their space and getting into with their customers and adapting their stores and sites.

I actually firmly believe that our stores and e-commerce sites are driving traffic and awareness to the total business, including wholesale. One of the opportunity for us is to continue to use our analytics and information that we are learning from our stores and our sites to help drive traffic to wholesale and vice versa.

So, I think consistent with what's happening in the total marketplace, those retailers who are realizing that there is a revolution going on out there and they're changing their approach and implementing their own omni-channel capabilities, those are the ones that are going to succeed and those are the ones who we're going to continue to partner with.

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**Angel Martinez** - Deckers Outdoor Corporation - CEO, President, and Chairman of the Board

Let me add to that. I think that the one of the things that's obvious, is the consumer today sees a product presentation online let's say and expects that same assortment and that same product to be available at retail. Either at your own stores or in a wholesale point of distribution.

So, as I was saying in my comments, while it seems that years ago the wholesale buyer was the arbiter of what the consumer saw as a brand, now the consumer doesn't want that kind of editing going on. They want to see what they expect to see on their iPad. They want to go to the store, whether it's your store or a wholesale partner, and say, this is what I'm looking for. I want this product, and if you don't have it, at that brick and mortar location, they walk out and order it online.

So, it behooves I think the wholesale channel to represent brands appropriately and consistently with what the brands are doing on their websites and in their own stores. Otherwise, they're going to walk a customer and the smart ones, Nordstrom included, Dillards, they see that and they are focusing on the brands that consumers are demanding and giving that assortment the type of presentation that it requires in order to assure that kind of consistency.



**Operator**

Corinna Freedman. Wedbush Securities.

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**Corinna Freedman** - *Wedbush Securities - Analyst*

Hi. It's Corinna Freedman from Wedbush. I just wondering your use of cash and you still have about \$70 million on your share repurchase, and just wondering if you plan to return to the market anytime soon or is it just not a priority at the current time? Thanks.

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**Tom George** - *Deckers Outdoor Corporation - CFO*

That's our high-class problem, good margins, good earnings generate a lot of cash and at this point in time really our priority is to reinvest in the business and we do have that \$70 million available on the current share repurchase and probably that -- historically we've done share repurchases opportunistically. And that's probably leave it at that.

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**Operator**

[Fan Ye], Credit Suisse.

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**Fan Ye** - *Credit Suisse - Analyst*

Hi. This is Fan sitting in for Christian Buss. I was wondering if you guys could give us an update on your efforts to develop a new, more capital efficient store. Wondering how far -- where you are in that process, whether you've identified appropriate markets or specific locations? Just wanted to see where we are in terms of rolling out that first prototype? Thanks.

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**Dave Powers** - *Deckers Outdoor - President of Omni-Channel*

Yes. Good question. First of all, the progress we've made over the last year and is pretty significant. The average cost of buildout of our stores come down roughly 30% and that's largely due to the reengineering and the fixtures but often just being more efficient in our ability to build those stores with the right contractor and the right operations globally. But we are continuing to look at that.

The omni-channel store that we're launching in Tyson's Galleria this fall, is the next step but that once really more from a design and experience perspective. We are still focusing on that as being an efficient store buildout but long-term, I think we're going to take a holistic approach and re-look at the overall design of the UGG stores, see where there is efficiency and savings from a buildout of the fixtures, also in POS systems and all the operational components of a store. That also plays into our conversation around smaller store footprints.

So my goal over time is to continue to lower the overall capital expenditure on a store. As I said, we've come down 30%, I think there's probably another 10% to 15% in there somewhere. And then as we open in Asia Pacific more stores in that region those stores are less expensive to build than they are in North America, which would play into that as well.

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**Operator**

Howard Tubin, RBC Capital Markets.

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**Howard Tubin** - *RBC Capital Markets - Analyst*

Hey guys. Maybe just follow-up on that question. Anymore color you can give us on their brand showcased store, which you've learned from so far and what the potential for that concept is beyond the one store you have right now?

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**Dave Powers** - *Deckers Outdoor - President of Omni-Channel*

Yes. Good question Howard. Especially since you been to the store and I know you've experienced it.

We learn from that store every day. We're testing a lot of different things in that store. We've recently been testing cross merchandising around categories, so you can walk in and see a sandal table that's represented by all of our brands or a boot table.

We just launched I Heart UGG in there to see how that works with that local consumer. We are doing surveys with consumers. It really is proving to be a fantastic lab for us both on a consumer insights level but also a merchandising and an omnichannel perspective.

As Angel mentioned 30% of our revenue in that store is generated through our iPad e-commerce, so we are learning about operational efficiencies and inventory control as well. Based off initial response to the concept, which has been very positive, and our desire to get more distribution for some of our smaller brands and more awareness for those brands. We are considering opening up a multibrand showcased store next year. Not a guarantee, but it's something that we are -- it's on the list of things that we're looking at right now.

We have a store model and design that we think feels pretty good and so we're exploring that idea for both North America in key tourist, high visibility locations to showcase our other brands but also as a way to bring some of those brands into places like China and Japan in a more meaningful way as well. So, so far six or eight months in we're pretty pleased with how it's working customer response has been very positive and we think it's something unique in the marketplace.

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**Operator**

That concludes today's question-and-answer session that Mr. Angel Martinez at this time, I will turn the call for back to for any additional or closing remarks.

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**Angel Martinez** - *Deckers Outdoor Corporation - CEO, President, and Chairman of the Board*

Well, thank you all for participating in the call. Clearly, it was a strong quarter but we -- we're just getting geared up. You can see the progress we've made against our initiatives and the return that we're getting on some of the investments we have been making over the last few years and we'll continue to drive this business as the opportunities continue to expand right in front of us.

I'm very proud of our teams across all the brands and very proud of the brands. I think the brands have made tremendous headway in the last year particularly and really appreciate your support and your confidence in us and our brands. Thank you all.

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**Operator**

This concludes today's conference. Thank you for your participation.

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