

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

DECK - Q1 2017 Deckers Outdoor Corp Earnings Call

EVENT DATE/TIME: JULY 28, 2016 / 8:30PM GMT

OVERVIEW:

Co. reported 1Q17 revenues of \$174m and GAAP loss per share of \$1.84. Expects FY17 EPS to be \$4.05-4.40. Expects 2Q17 reported revenues to be up 1-3% YoverY and EPS to be approx. \$1.12-1.22.



CORPORATE PARTICIPANTS

Steve Fasching *Deckers Outdoor Corporation - VP, Strategy & IR*

Dave Powers *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Tom George *Deckers Outdoor Corporation - CFO*

CONFERENCE CALL PARTICIPANTS

Camilo Lyon *Canaccord Genuity - Analyst*

Eric Tracy *Brean Capital, LLC - Analyst*

Randy Konik *Jefferies LLC - Analyst*

Warren Cheng *Evercore ISI - Analyst*

Erinn Murphy *Piper Jaffray & Co. - Analyst*

Corinna Van Der Ghinst *Citigroup - Analyst*

Jay Sole *Morgan Stanley - Analyst*

Molly Iarocci *Stifel Financial Corp. - Analyst*

Sara Shuler *Credit Suisse - Analyst*

PRESENTATION

Operator

Greetings and welcome to the Deckers Brands first-quarter fiscal 2017 earnings call. At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation.

(Operator Instructions)

As a reminder this conference is being recorded. I would now like to turn the conference over to Steve Fasching, Vice President of Strategy and Investor Relations. Thank you. And you may now begin.

Steve Fasching - *Deckers Outdoor Corporation - VP, Strategy & IR*

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 the call today other than statements of historical fact are forward-looking statements and include statements regarding our anticipated financial performance including our projected net sales, margins, expenses and earnings per share as well as statements regarding our business transformation plans, product and brand strategies, market opportunities and restructuring plans.

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 forward-looking statements.



The Company has explained some of these risks and uncertainties in its SEC filings including the risk factors 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 will now turn it over to Dave.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Thanks, Steve, and good afternoon, everyone. Fiscal 2017 got off to a solid start, driven by a combination of better full price selling and a shift into some expenses to later in the year. First-quarter revenue was \$174 million and diluted loss per share was \$1.84.

Before Tom walks you through more details of our financial performance I will provide an overview of our brand and Omni-Channel performance and reiterate with more detail the four priorities for the organization that I laid out on our last earnings call. Beginning with our Fashion Lifestyle group, which includes the UGG and Koolaburra brand. As we expected UGG revenue was down in the first quarter compared to last year due to a difference in the timing of orders as we shifted orders in advance of our business transformation systems implementation, which benefited Q4 and negatively impacted Q1.

The first quarter was highlighted by strong demand for the brand's spring and summer collections, especially the sandal category, which grew 70% compared to last year. The performance of seasonal product helped propel UGG into the top 10 selling spring and summer footwear brands for many key accounts for the first time ever. We are building on this momentum with expanded collections and based on initial conversations with wholesalers we feel confident about the brand's prospect for continued growth next spring.

At the same time the UGG team is beginning to execute its plans for this fall and holiday. The main focus is on the launch of the Classics franchise, which showcases the wide consumer appeal and diverse assortment that includes that new Classic, Classic Slim, Luxe, Classic Cuff and Classic Street. The new Classic is now available on our eCommerce site and is just starting to hit shelves in our concept stores and across wholesale.

The marketing collateral for the new Classic showcases the added features and benefits such as the water and stain resistant treatment and the improved comfort and traction delivered by our TreadLite outsole. We are pleased with the reads from our initial launch and are excited as we prepare for this key selling season when the bulk of the marketing and PR will hit to drive brand heat at the most important time of the year.

On the men's side we are providing more marketing support for our slipper and casual business to grow awareness and drive relevancy for our men's offering. This fall the brand has a new message for men, as we invite our male consumer to take a break from their busy lives and to do nothing. The campaign is a humorous take on the downtime men enjoy while wearing our slippers and loungewear.

The Do Nothing campaign will feature Tom Brady and other well-known individuals. And it will be supported with a video campaign that we believe will resonate with a wider audience and bring new consumers to the brand.

Shifting to Koolaburra, this fall we are launching Koolaburra by UGG with 12 styles at price points ranging from \$39 to \$90. The brand will be available at select retailers such as Kohl's and Shoe Carnival as well as directly at Koolaburra.com. We are excited to see how consumers react to the product which will help us assess the long-term market opportunity for this brand.

Moving to our Performance Lifestyle group, which includes the HOKA, Teva and Sanuk brands. HOKA ONE ONE sales were up 2% compared to double-digit growth the last several quarters. The slower growth in Q1 was expected as we launched the newest iteration of the Clifton, the brand's top-selling shoe in July versus June last year.

The early results for the Clifton 3 are surpassing the Clifton 2, a great sign for health of this burgeoning franchise.

And last quarter we spoke to you about the recent launch of a new style, the Clayton. We are pleased to report that the Clayton was named Editor's Choice from Runner's World. The success of our recent launches gives us added confidence in our product pipeline and our ability to further grow market share in the run specialty channel.

HOKA will be well represented at several upcoming events including the Olympics in Rio, where two athletes will be wearing HOKA and the Kona Ironman US Championships where the brand will have a major presence as the official sponsor.

Now to Teva. First-quarter sales decreased \$7 million or 17% compared to the same period last year. The decline was due to challenges with booking closeout sales caused by our business transformation implementation and also marketplace challenges from higher footwear inventories in the channel which impacted the spring re-order business.

While sales were down they were better than expected. Teva continues to see a lift across its sport sandal category and generate significant organic PR. The brand is leveraging its high-profile collaborations while focusing on infusing performance and design elements that will boost ASPs.

For example, this past season the brand collaborated with Derek Lam on a sandal that retailed for \$85. The collaboration was featured in Athleta and was their number one selling product across all categories in May and June.

Looking ahead, we believe there is opportunity in closed-toe footwear and we are very excited about the launch of the Arrowood collection of sneaker boots available in retailers such as Dillard's and Zappos and on Teva.com.

Onto Sanuk where sales were down \$7 million or 20% compared to the same period last year. This was in line with our expectations as the brand is experiencing similar challenges as noted with Teva. We are seeing continued success with the yoga sling collection which included new higher priced premium styles this season as well as the great response to men's casual styles.

We have completed the transition of the brand to our corporate headquarters and have brought in Magnus Wedhammar as the General Manager of the brand. Magnus is an industry veteran with experience at Sperry, Converse and Nike. We look forward to Magnus's impact on repositioning the brand and developing new product and marketing to reignite sales.

Turning now to our channel performance, beginning with direct-to-consumer. Our DTC was down 7.3% in the first quarter or \$3.8 million. The decline in our DTC comp was due primarily to negative store comps and to a lesser extent the impact of the implementation from our new ERP system, which disrupted our eCommerce fulfillment during the first two weeks of the quarter.

In addition, like the majority of the retail industry, our brick-and-mortar locations continue to be challenged by weak traffic, especially in the US. Our continued promotion of Classics to make way for the new Classic pressured top line and contributed to the negative comp.

With respect to our retail optimization efforts, during the first quarter we closed six of the approximately 21 stores targeted for closure during fiscal 2017. As we indicated on our last call the majority of the closures are scheduled for after our key selling season.

Now to our global wholesale business. Wholesale distributor sales declined \$37 million or down 24%. As I mentioned earlier the wholesale sales decline is not indicative of the underlying business but was impacted by timing dynamics related to our business transformation implementation.

I am encouraged by the changes that are being made under Stefano Caroti's leadership and are more optimistic about our growth opportunities in the wholesale channel. As we continue to develop our distribution, we have brought in Tracy Paoletti as VP of UGG Sales. Tracy joins Deckers from ASICS where she has a strong track record in managing marketplace transformations and creating strategic long-term customer partnerships to grow the business.

I would now like to restate and expand on the four strategic priorities I laid out last quarter. Our first priority is on product, with a focus on elevating product design, fueling innovation and increasing our speed to market. To compete in today's marketplace and satisfy our consumers we must move faster and provide new and innovative product more frequently.

In order to do this we are improving our go-to-market discipline to enhance SKU productivity and reduce our overall product development calendar. In addition, each season will feature big launches that bring new and exciting product to market while also testing product for the future and reacting in-season.

We have leveraged what we learned from the successful launch of Classic Slim in our Rain collection last year. A year ago we tested both of these in our DTC channel, saw that these products resonated with consumers and these styles have now become top sellers into our wholesale accounts for this fall. For this year we are testing the market with meaningful launches like the Classic Street, Classic Cuff and the Teva Arrowood collection with the goal of building on these for next year.

Second, connecting with consumers digitally through targeted marketing and robust eCommerce. A strong digital presence is key to creating brand heat and driving sales. We have shifted the vast majority of our marketing dollars to digital and are using enhanced analytics to target and reach consumers effectively.

In addition, we are focused on developing compelling digital marketing campaigns that create brand relevance and create engagement through interactive consumer experiences. This fall we will roll out two major digital video campaigns, one featuring Rosie Huntington-Whiteley and another featuring Tom Brady. We are very excited about our plans to use these key influencers to elevate the brand and create engaging content.

Third, we must drive growth by optimizing our Omni-Channel distribution globally. We need to ensure that we are reaching new consumers through the right channels and distribution and existing consumers in the channels where they shop the most. To do this we are segmenting our product line and wholesale accounts and working with wholesalers to develop product that appeals to the taste of their consumers.

Our product developers are working on segmentation now and we will begin to see the benefits next spring with a more complete rollout by fall of next year.

Fourth and finally, driving efficiencies to streamline the organization and improve operations. We have completed our major investments in Omni-Channel, new talent and upgraded systems and are now fine-tuning our business. As an organization we are focused on our commitment to improving profitability over the long term and investing in the areas of the business that offer the greatest returns.

Executing on these four priorities will take time and as I have said before this is a transition year. But I feel very good about the speed and energy with which the organization and our management team are tackling them. With that I will now turn the call over to Tom.

Tom George - Deckers Outdoor Corporation - CFO

Thanks, Dave, and good afternoon, everyone. Today I will take you through our first-quarter results in greater detail, provide an outlook for the second quarter and discuss our fiscal 2017 guidance.

Please note throughout this discussion when I refer to non-GAAP financial measures I am referring to results before taking into account restructuring charges incurred in the first quarter. 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 investor information tab.

Now to our results for the first quarter. As we mentioned on our previous earnings call we expected revenue to be down in the quarter compared to last year as a result of a timing shift this year with some sales recorded in Q4 of last year due to our ERP implementation. We also had some orders shift into Q2 this year, in line with the new product launches occurring in Q2 and further pressure on our DTC retail sales.

With that I am pleased to say our revenue in the quarter exceeded guidance by nearly \$5 million. This upside versus guidance was driven by more regular sales and fewer closeout sales in the quarter than expected.

The lower mix of closeout sales also contributed to a slightly better than expected gross margin for the quarter. Gross margin was 43.7% in the first quarter compared to 40.5% last year. The overall improvement in gross margin versus last year was driven by the previously mentioned lower proportion of closeout sales, a higher proportion of sales from DTC and improved international margins.

SG&A dollar spend in the first quarter was \$155 million, up \$4 million compared to last year due to higher fixed cost from additional retail stores and higher depreciation related to our ERP implementation. This result for the quarter was better than expected and was primarily the result of a delay in marketing spend which is now planned to occur later in the third quarter.

For the quarter GAAP loss per share was \$1.84 versus a loss per share of \$1.43 a year ago. Our non-GAAP loss for the quarter was \$1.80 which was ahead of our guidance of a loss of \$2.10 to \$2.20 and was primarily due to higher than expected revenue, improved gross margins and the timing of certain expenses.

During the quarter the Company incurred restructuring charges of \$1.7 million due to retail store closures and office consolidations.

Inventories at the end of Q1 were \$469 million, an increase of 26% over the same period last year. This was in line with our expectations.

As a reminder, our inventories are elevated relative to last year due to lower sales recorded in the third quarter of last year. The majority of this elevated inventory consists of UGG weather styles, slippers and casual boots that are being carried over into the fall 2016 line. We have reduced future buys of this product and still expect to manage our inventory down to more appropriate levels by the end of our second fiscal quarter.

During the first quarter the Company did not repurchase shares. And as of June 30, 2016 the Company had \$77.9 million remaining under its \$200 million stock repurchase program.

Now moving to our outlook. For the second quarter on a reported basis we expect revenue to be up between 1% and 3% compared with the same period last year. We expect earnings per share of approximately \$1.12 to \$1.22 compared to earnings per share of \$1.11 last year.

For the full fiscal year we are reaffirming the guidance we outlined on the last call. We still expect earnings per share to be in the range of \$4.05 to \$4.40 on a share count of 32.5 million shares. This excludes any pre-tax charges that may occur from any further restructuring charges which we anticipate could be up to \$15 million in fiscal year 2017.

As we look at the balance of the year it is still early and the improved Q1 performance is mainly due to timing. The better than expected sales and gross margin in the quarter was relatively small and expected to offset in Q3. And as we stated earlier, we also plan to shift marketing expenses to Q3, our largest revenue quarter.

Also as a reminder in Q3 of last year we reversed expenses related to performance-based compensation, which creates an SG&A headwind in the quarter compared to last year. Based on this, we expect roughly 90% of our back-half profit to occur in Q3.

And with that I will turn it over to Dave for his closing remarks.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Thank you, Tom. And thanks again to everyone for joining us today. I'm excited about our plan for the year, and while there are challenges in the marketplace I am optimistic about our ability to achieve the sales and profitability targets that we have established.

As I look long term I am confident in the direction of our brands and how the teams are working together to get after the opportunities in front of us. I would like to end by thanking our employees. Our Company has undergone a great deal of change within the last year.

From new leaders to new systems and processes, our employees have embraced each change and have shown remarkable adaptability. Thank you all for your hard work and dedication. Operator, we are now ready to take questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Camilo Lyon, Canaccord Genuity.

Camilo Lyon - Canaccord Genuity - Analyst

Nice job on the quarter. I guess first just from a modeling perspective. Tom, just what was the marketing shift out of this quarter that is expected to hit Q3?

Tom George - Deckers Outdoor Corporation - CFO

It is about \$5 million to \$6 million.

Camilo Lyon - Canaccord Genuity - Analyst

Great.

Dave Powers - Deckers Outdoor Corporation - President & CEO, Deckers Brands

Yes, Camilo, this is Dave, it is a combination of creative spend and consumer facing spend.

Camilo Lyon - Canaccord Genuity - Analyst

Got it, got it. And then just if we could step back a little bit and talk about channel inventory, how you feel about it now with respect to the Classic 1.0.

Know that by this time you would have hoped to have cleared it out of your wholesale channel, partners channel inventory. Could you just update us on where that is, is it still being sold through your outlets, how that inventory is flowing through? And then any sort of insight you could provide beside the fact there has only been a couple of weeks in market, any sort of read on how the 2.0 is faring with customers?

Dave Powers - Deckers Outdoor Corporation - President & CEO, Deckers Brands

Yes, we feel good about the amount of Classic 1 that is out in the channel. We have worked hard over the last few months with our major accounts to take back the inventory and clean up the channel. And so it is the amount of Classics across the marketplace in the channel right now is in line with our expectations and that has gone very well.

The goal here is to make sure that the Classic 2 launch is a success. And so the primary channels of distribution for us will be clean of the old Classic as we showcase the new Classic coming in. And that transition has gone very well.

So far the initial response from the press has been very positive. So PR for the launch of the new Classic has been extremely positive. People are speaking in a positive way about the new benefits. Initial feedback from the consumers, although we haven't had a lot of sales just yet, it is just hitting stores, has been positive as well. And initial sales on our website and in our stores has been in line with our expectation.



So we are off to a good start. It is early, obviously, in July to be doing this, the real launch comes to fruition end of August, beginning of September with a major marketing launch at the same time. But initial reads for the product hitting the market and the transition itself are going well.

Camilo Lyon - *Canaccord Genuity - Analyst*

Great. And if we could just -- could you talk about any sort of reads that you might be getting with your wholesale partners and how demand for the category and for UGG is shaping up? We are a couple of weeks into the Nordstrom Anniversary Sale and that typically serves as a decent indicator for just the category.

In light of last year's promotional activity that may have pulled forward some demand. So any sort of feedback that you are getting you could share would be helpful.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, the real initial read is really on the Nordstrom's Anniversary Sale. And the brand has performed very well this year in the Anniversary Sale and it gives us confidence that we are going to be set up a for a solid back half of the year.

Camilo Lyon - *Canaccord Genuity - Analyst*

Great to hear. Last thing is to have any sort of comments you can share with us on the UK business given what has gone on there and if that has been impacting retail and consumer demand and sentiment?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, it is still early to read any impact from Brexit but initially we've seen a pickup in tourist traffic but we are still cautious about the overall the local consumer. And I think our guidance reflects that in the back half of the year.

So no change there at this point. Things are on track as we expected. But still early in the whole process.

Camilo Lyon - *Canaccord Genuity - Analyst*

Got it. Thank you very much. All of the best, guys.

Operator

Eric Tracy, Brean Capital.

Eric Tracy - *Brean Capital, LLC - Analyst*

Good afternoon, everyone, I will add my congrats. If I could, Dave, maybe speak to, I know 1Q is not a great proxy but some of the differences retail versus wholesale and then stepping back bigger picture in terms of what you are seeing and any changes to the strategy around DTC and the stores specifically and how you are consistently thinking about the Omni-Channel strategy and approach and ways that you can continue to further connect to the consumer beyond just that brick-and-mortar format?



Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, for the quarter sales are in line with our expectations. Retail stores themselves were a little softer than planned. But as we said on the call a large part of that is really driven by the fact that the Classic is transitioning out.

We have some like-for-like styles like the Bailey Bow and Bailey Button that were there last year that aren't in the stores this year. So those are big styles to comp. So not too surprised there.

Wholesale sales are in line with expectations. So as you said it is a small quarter, the numbers aren't really meaningful but the trends are consistent with our expectations.

Overall for retail we are still maintaining a cautious stance. We have some openings this year that were part of the pipeline that positioned our fleet globally in a good place, particularly our concept stores. And I think this will round out the opening of the concept stores for a while.

Looking forward we are still taking a cautious stance. But we are taking a hard look at additional opportunities in pop-up stores and partner stores. We will have a continued success there.

We are going to be opening roughly about 15 new partner stores, primarily in China, this year. And initial reads on those are going well.

So the good news is that the investments that we've made in our Omni-Channel infrastructure allow us to be very flexible where we invest and where we drive the consumer. And the investments we have made in digital marketing and analytics and connecting with our consumer are allowing us to help drive that traffic where we need to.

But I am very pleased with the work that the team has done around digital marketing, being able to target and segment our consumers, engaging with them in two-way conversations online and through our websites. And I think that is something that you are going to see continued improvement on going forward. So I guess overall just to say that we are pleased with how things are going, cautious on new store openings and then continuing to focus on digital marketing and connecting with our consumer.

Eric Tracy - *Brean Capital, LLC - Analyst*

And then the follow on that in terms of the product segmentation strategy that is getting employed here, start to see I guess signs of it in spring, more fully next fall. So maybe just kind of walk through how that should play out both through the UGG brand, obviously layering in Koolaburra as well and a very different distribution. But maybe just in particular on the UGG brand how we think about that product segmentation.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, so that initial work is going well. Stefano, as you know, has been focused on that in his last five or six months here. That will primarily impact spring and fall 2017 when the product teams can align to the segmentation approach.

But the goal remains the same of segmenting the market place by channel and consumer, creating product specifically to those channels and consumers which should create additional opportunities for the brand both from a type of distribution whether it is fashion or sports, lifestyle distribution or outdoor but also in a good, better, best approach. And the main focus there is continuing to elevate the brand, elevate the positioning, the presentation of the brand.

Part of that has led to some closures of some of our accounts because we have increased our minimums to be able to enter into the brand. But I think that is all healthy move into the long-term goal of elevating all of our brands, primarily UGG, continuing to elevate that distribution and segmenting to grow.



Eric Tracy - Brean Capital, LLC - Analyst

And then my last one if I could, just in terms of the inventory positioning. I appreciate the color on the Classics as well as the carryover. If the season does come together, how are you all thinking about that carryover and the ability to sort of chase if we do somehow, someday, this lending to get an earlier-quarter winner versus just wanting to kind of clear through aggressively ahead of that potential?

Dave Powers - Deckers Outdoor Corporation - President & CEO, Deckers Brands

Yes, you know we are managing the inventories as we said through Q2 to be in a better position going into Q3. Much of that inventory as we have said is carryover from last fall and holiday but it is good first price merchandise. And so we will have the ability to react with some of that product if we see it trending early and also at-once.

But as we have done in the past we are taking a position on a few key styles to provide some upside opportunity in-season. Not to the extent we have had in the past because we are still taking a cautious look, stance on the season. But we do have at-once opportunity.

Tom George - Deckers Outdoor Corporation - CFO

Just to comment, Eric, I mean we do have some at-once opportunity but not a lot of at-once opportunity because we are at the same time we are trying to manage our inventories.

Eric Tracy - Brean Capital, LLC - Analyst

Fair enough, guys. Thanks so much, best of luck.

Operator

Randy Konik, Jefferies.

Randy Konik - Jefferies LLC - Analyst

Quick question, I guess, Tom, can you first when you gave the -- when we got the commentary on the gross margin upside, I guess, we saw, you mentioned lower closeouts, international profitability or something to that fact and something else I believe. Could we just parse the exact contribution of the factors of gross margin improvement?

I am just curious there, thanks. That is my first question.

Tom George - Deckers Outdoor Corporation - CFO

Yes, relative to our guidance we guided 40% to 41% and we came in at 43.7%. Roughly half of the improvement was related to channel mix, some better gross margins internationally and actually some better full-price margins domestically, as well.

And it was about 50 basis points of lift relative to our guidance for foreign exchange. And then the balance is about 80 to 90 basis points of improvement relative to the change in closeouts. So does that help?



Randy Konik - *Jefferies LLC - Analyst*

Yes, it is very helpful. And then just on that commentary to follow up on the closeouts, versus what you thought would be the closeout trend versus what actually happened, just a little more color around how that all played out would be very helpful.

Tom George - *Deckers Outdoor Corporation - CFO*

Yes, for the quarter we were down a little bit relative to what we guided for closeouts and we guided an amount really equal to last year. So and this quarter is a relatively small amount. So closeout miss was only about \$6 million, a small number.

We were able to more than offset that with improved full-price selling including improved direct-to-consumer business. And from a full-year perspective we are still reiterating that we feel good about our full-year promotion and closeout mix and our assumptions remain the same as our prior guidance there.

Randy Konik - *Jefferies LLC - Analyst*

Got it, that is very helpful. And then when you gave us the initial annual outlook, or fiscal outlook, and then we got the reiteration today, if you go back a quarter ago you gave us some assumption of what expectation was for cancellation rate and I guess weather pattern per se.

Can you give us, just remind us of what you would expect from a cancellation rate and a weather pattern rate -- weather pattern net annual and that fiscal outlook? Thanks.

Tom George - *Deckers Outdoor Corporation - CFO*

Well, for the high guidance case we have assumed a modest improvement weather conditions relative to what we experienced this past third quarter. And from a cancellation point of view --

Steve Fasching - *Deckers Outdoor Corporation - VP, Strategy & IR*

Yes, so Randy --

Tom George - *Deckers Outdoor Corporation - CFO*

Go ahead, Steve.

Steve Fasching - *Deckers Outdoor Corporation - VP, Strategy & IR*

From a cancellation on a kind of wholesale distributor what we have said is on the low kind of equivalent to last year to a slight improvement on the high. As Tom mentioned on the low similar weather pattern to a slight improvement on weather. And then on a DTC basis kind of a flat to low single-digit decline on the comp.

Randy Konik - *Jefferies LLC - Analyst*

Got it, that's very helpful. And then also if you think about the Classic 2.0 it has got more, I don't want to say, more variability from a Slim to a Luxe to a different, just different items versus the Core in the past, that's Classic 1.0 I guess you would say. Are you encouraging your wholesale customers to order a certain way of that line or how should we be thinking about how they are trying to buy the line for holiday 2016?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes we are, actually. What we have done is we have taken the learnings from our DTC channels last Q3 and applied those learnings from a mix of selling to our wholesale accounts depending on the positioning of the account whether they are a premium wholesale account or not. But essentially we are asking everybody to diversify their line and the net result of that is if the Core Classic item, the Classic Slim -- I'm sorry, the Classic Short, Mini and Tall represent 20% of the overall business this year which is down from roughly 25% to 30% last year.

And the rest of that will be made up from that new styles in the franchise. So the goal there is maintain the strength of that core business through the new iteration, the Classic 2, but be able to appeal to a broader consumer base and a much more exciting presentation at retailers through the franchise launch.

Randy Konik - *Jefferies LLC - Analyst*

Got it. My last question is, I apologize because there is a lot of nice healthy items here that you guys are experiencing. And it would be -- my last question would be the Koolaburra test, I guess you would call it, with Kohl's, and I think you said Shoe Carnival.

How wide was the testing with Kohl's? And then if it proved successful I am assuming you I guess analyze the holiday sell-throughs and what have you around that test. How should we be thinking about the longer-term opportunity for this sub-brand or brand?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, so as we said we have an official launch this fall. It is a pilot launch and we are going in with a relative conservative approach because we want to make sure we have a high degree of sell-through. We have a -- it is not all stores in some of these retailers that we mentioned but it is a good healthy mix, over a couple hundred stores in Kohl's, for example.

And we have inventory to chase in-season. So we wanted to go out with a powerful presentation, we are going to have strong marketing in-store and POS to highlight the launch and we are excited about that. But we had inventory to chase into the business in-season and going into spring.

The way to think about it is this is a pilot season. We want it to be successful, high sell-through rates and create some demand and excitement and then we will reevaluate going into next year. But assuming that goes well then we are going to be hitting the ground hard with trying to activate that growth quickly.

Randy Konik - *Jefferies LLC - Analyst*

You've been extremely helpful. Thank you.

Steve Fasching - *Deckers Outdoor Corporation - VP, Strategy & IR*

Yes, Randy, just to add on that we are kind of thinking of it is still in small dollars. So in our guidance it is \$10 million to \$15 million revenue opportunity.

Randy Konik - *Jefferies LLC - Analyst*

No, I get it. I am just getting a proof point that how you think about it and the longer-term opportunity, that is all. Thanks a lot.



Operator

Omar Saad, Evercore ISI.

Warren Cheng - *Evercore ISI - Analyst*

Good afternoon, this is Warren Cheng online for Omar. I just wanted to ask specifically about the outdoor and sports retailer channels or any other distribution channels where you are not heavily penetrated today but you could be down the road.

As you have rolled out Classic 2.0, some of these other new products that came out last fall and as you have kind of cleaned up some of your wholesale distribution, better segmented and elevated the brand there, can you just talk about how those retailers are reacting? Have you had any discussions with them ahead of this holiday? I am just trying to get a sense of when they could be a bigger part of the wholesale distribution.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, we have had initial conversations and we have mentioned opportunities in the outdoor channel and the sports lifestyle channel. Those are not major players for this fall and holiday. It is more looking into next year and fall 2017 when we have time to build specific product.

That being said, there are a few styles, for example in men's winter boot, that we have done to enter into the outdoor channel. So that is a test that we will be doing this fall and holiday. But the majority of that segmentation opportunity starts next year.

Warren Cheng - *Evercore ISI - Analyst*

Okay, great. And my follow-up is I think last quarter you mentioned a couple hundred wholesale accounts that you've exited from the smaller accounts that weren't representing the brands correctly. Can you give a sense for the wholesale account you exited how large are they on a sales run rate basis, on an aggregated sales run rate basis?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

I can say it is very small. I don't have the specific dollar amount or percentages, but it is very small to the total. And I think it is more about brand presentation in market and controlling our distribution.

Warren Cheng - *Evercore ISI - Analyst*

Great, thank you.

Operator

Erinn Murphy, Piper Jaffray.

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

I guess, Dave, first for you. On the direct-to-consumer comp in the quarter could you just maybe break out for us how that looked outside of the US versus inside the US? And then anything particular on Japan and China and that international commentary would be helpful.

And then I guess last on the cadence of the comps throughout the quarter. How did that look when you looked at the months of April, May and June?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

To answer your last question first, April and May were more difficult and then we saw better improvement going into June. So much more improvement in comps there.

Tom George - *Deckers Outdoor Corporation - CFO*

From a regional perspective North America was the worst, mainly driven by some of those retail concept stores and those flagship stores. We still had some challenges there. Europe of the three regions performed the best, although still challenging and then Asia-Pacific was somewhere in the middle there.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

And then with regards to Asia Pacific between China and Japan, China is actually churning very well and we see that through both our own stores and the partner stores. So feeling really good about that opportunity.

Japan is a little bit more challenging at the moment. But it is still an important market for us.

We have new leadership on the DTC side of the business there that is coming on. And so managing that business and also transitioning some of our wholesale accounts into shop in shops has been positive for us as well. But the real opportunity short and long term continues to be China.

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

Okay, that is helpful. And then one of the comments, Dave, you made earlier on in the prepared remarks was just that UGG was within the top 10 selling spring-summer brands for some of your retailers. I would love to just hear a little bit more about how those conversations as you talk about spring 2017 are shaping out.

It sounded like you guys were having fairly constructive conversations with the retailers. I know we have heard from other vendors that spring 2017 is looking a little bit cautious thus far. So any kind of context for kind of how you are navigating would be great.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, that is very exciting for us and I would say it is a major milestone for the brand. To be able to crack the top 10 in some of these key accounts in spring and summer product driven by sandals and sneakers is a big deal for the UGG brand. And so the feedback from the accounts has been that sell-through has been high.

They are very pleased with how those categories are performing. And then initial presentations on spring and summer product for spring 2017 has been positive as well. So I feel like we are starting to gain some momentum there.

It is still early days, it is still a small amount to the total year. But the product is resonating and I think our continued focus on evolving UGG beyond the winter holiday time frame and changing people's perception of the brand is starting to pay off.

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

And then just last, I didn't hear you guys mention on the call the Macy's initiatives you have underway. Can you just remind us where you are at with some of those select doors that you are working with right now?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Sure. The launch with Macy's at Herald Square will be on August 28. We are extremely excited about that opportunity to showcase the brand.

It will involve the new store design in a powerful presentation in that marketplace. The wholesale distribution that we talked about in the last call is still in the works but we are working through the details of that. And we will at a minimum have a small store test going into spring.

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

Got it. Thank you, guys, and best of luck.

Operator

Corinna Van Der Ghinst, Citi Research.

Corinna Van Der Ghinst - *Citigroup - Analyst*

Thank you. Hi, good afternoon. My first question was also kind of around these newer categories that you guys are seeing some great traction in with the sandals and also we've been hearing really great feedback on your rain boot category as well.

Just to kind of dig into how you guys are looking at that opportunity as we get into next year and beyond, are you looking to add more depth in your orders with your existing wholesale accounts, are you kind of looking to expand the SKU opportunity there or where are you kind of seeing opportunities to add shelf space? And also could you talk a little bit about some of the transitional items that you guys are looking at ahead of the true cold-weather break for this year?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, so the categories that you mentioned, rain boots, sneakers for us, TreadLite across men's those are the categories that we are starting to see traction on and we are continuing with two approaches. One is to further develop the line, so this fall and holiday you are going to see a much broader expansion in the rain category with the good, better, best approach that we are really excited about.

And then the opportunity for us at a minimum is to create more shelf space in the accounts that we do business with today. So I think none of us are completely satisfied with how we show up in spring and summer as a brand. I think there is opportunity to have a stronger presence, a broader SKU count.

It doesn't mean that we need to develop more product. It is placing the product that we are having success with and creating a bigger presence in those key accounts.

At the same time the conversations with people like Macy's allows us to get new distribution and really showcase the breadth of the line across men's and women's and spring and summer, as well. So it is a two-tiered approach building on our winners that we have had success with and expanding those but really driving more additional shelf space and then with some new distribution at the same time.

Corinna Van Der Ghinst - *Citigroup - Analyst*

And just kind of given that we are coming out at that season, how are you guys feeling about the price points that you guys are positioned at on that spring-summer assortment for now? And then as you kind of move forward with your segmentation strategy, how much higher do you think



you could take your price points within that premium distribution channel like a Nordstrom's, for example? Does your sweet spot kind of move higher as you start to segment some of these lower-end channels or how are you thinking about that?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, it is a great question. I believe, and if you talk to Andrea, the President of UGG and Fashion Lifestyle group, there is opportunity for higher price points in some of that top tier distribution.

As we continue to elevate the positioning of the brand, work on the design DNA and the material and finishing that product we think we can raise ASPs a little bit in some of those key categories and those channels, especially compared to the competition. And at the same time that allows us to have more entry level price points in kind of the mid tier of the distribution channel. So I think it is a great opportunity for us, the consumer is showing that they love the product and as we continue to elevate design I think we have an opportunity to raise ASPs over time.

Corinna Van Der Ghinst - *Citigroup - Analyst*

Great and then just one quick follow-up on your direct-to-consumer comments. Just with the store closures and the work that you are doing around retail with direct-to-consumer exclusives in some of these new platforms, and you have guided flat to down for this year, when do you think that you guys could return to positive growth on the DTC comp side?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, it is tough to say. In the macroenvironment I feel good about what we are doing to control with our controllables when the consumer comes into the store.

Getting back into the Classics franchise will help, having the Classics at full price, having the Bailey Bow and the Bailey Button and those iterations at full price, the new collections at higher price point will help, launching the outerwear category in our DTC channel this fall and holiday, ultimately getting back into a meaningful loungewear business and handbag business over time. Those are all things that are in work that are going to benefit our DTC business. But exactly when we will return to those kind of levels that are showing continued growth, it's still early days to be able to tell on that.

Corinna Van Der Ghinst - *Citigroup - Analyst*

Fair enough, thanks so much.

Operator

Jay Sole, Morgan Stanley.

Jay Sole - *Morgan Stanley - Analyst*

My question is, you have done a lot of great work to diversify the UGG product line for the winter, the November-December season. There is a lot more fashion. Does that change the weather sensitivity of UGG in that quarter because the mix has changed?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

That is the goal ultimately, Jay, is that we become less reliant on weather. And I believe that if we continue to excite our consumer with fresh, innovative new product that is so compelling that it doesn't matter what the weather is outside that we will be successful long term.

So that is where we are starting to see success both in Q3 and in Q4 and spring and summer. But ultimately, and also what we are doing with the diversification and minimizing the reliance on the Core Classic with the other franchise items that we are launching, the goal is to become less weather dependent as a brand on an annual basis.

Jay Sole - *Morgan Stanley - Analyst*

Got it. I mean, so would you say that -- and obviously that is the goal. How much volatility do you think is possible just from a top-line perspective for the assortment as it exists today in the November-December time frame?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, I think this year November time frame and December time frame we are still taking a conservative approach on it. We haven't turned the corner on being less weather reliant yet. I do think the newness in the line is going to help, but we are still taking a conservative approach and outlook for this fall and holiday.

Jay Sole - *Morgan Stanley - Analyst*

Got it, okay, that is helpful. And then the last one for me is just on the less closeouts in the quarter and more regular sales, can you just talk about what brands those -- that piece of the quarter we're in?

Tom George - *Deckers Outdoor Corporation - CFO*

Yes, it was, Jay, this is Tom. It was really all of the brands that we had fewer closeouts against a small number in the quarter. And the more regular sales it was, again, really sort of evenly distributed through all the brands.

Jay Sole - *Morgan Stanley - Analyst*

Okay, got it. Thanks so much. Good luck.

Operator

Molly Iarocci, Stifel.

Molly Iarocci - *Stifel Financial Corp. - Analyst*

A couple of ones from me. I am just curious, what kind of commitments do you have on your carryover inventory? Do you feel comfortable with the sell-in of that in the back half?

Tom George - *Deckers Outdoor Corporation - CFO*

Yes, Molly, this is Tom. We feel very comfortable. We have got a strong backlog.

And when you go through the process of allocating the inventory you have on hand relative to the wholesale orders we have and our expectations for direct-to-consumer, which we are taking a cautious view on comps in direct-to-consumer, we feel really good where we stand with our inventory levels.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

We have also tailored off of our receipts to be able to balance that out, as well.

Tom George - *Deckers Outdoor Corporation - CFO*

Right.

Molly Iarocci - *Stifel Financial Corp. - Analyst*

Okay, great. And then what percent of your mix are you expecting to come from the Slim and Luxe products this year versus last year? And then is the Street product only a DTC launch this year or are you launching it into the wholesale channel?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, so I can talk at an aggregate level. So as I said before the Core Classic, the Short, Mini and Tall is 20%. The Luxe, the Slim and the Street make up another 25%.

So it is primarily Slim followed by Street and then Luxe. The Street launch is all channels. And I think it is going to be an exciting opportunity to reach a new consumer in all of these channels and we are going to support that with the marketing campaign that we talked about for all of these franchise items that we are launching in partnership with Rosie Huntington-Whiteley and a powerful digital campaign to support each of those.

And they all have a staggered launch. So each month we will have highlight, we will be able to highlight one of those key styles as we build in momentum into the back half of the year.

Molly Iarocci - *Stifel Financial Corp. - Analyst*

Okay, great. And then last one, what other influences are you seeing from the new President of the Fashion Lifestyle group, Andrea? Just curious, it sounds like she has had some perspective on an ASP strategy, what other ideas are you carrying forward?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes the goal for Andrea and the team is first and foremost to maintain and elevate the positioning in the brand. We think there is opportunity to create an even stronger halo at the high end of the market and position it a little bit more than accessible luxury brand over time. We can do that through design and price point of marketing and communication.

Continue to balance out the category mix as we have been doing and build on where we are seeing success. And that leads into growing in our spring and summer business in a major way.

We do believe there is continued opportunity to activate growth in the lifestyle areas of the business, so loungewear, outerwear, handbags over time. And so they are in early days of that developing that with the right team and the right approach and the right design DNA.



And then continuing to segment. But it is really refocusing on where we can win in the short term, gaining success in new styles, elevating design and innovation and that making sure that the way we show up around the globe is the premium presentation of the brand and a positive brand experience.

So it is exciting opportunity for the brand right now. Andrea is bringing a great deal of energy and leadership to the teams and really focusing us on where we think there is opportunity to go after it.

Molly Iarocci - *Stifel Financial Corp. - Analyst*

Great, thank you.

Operator

Christian Buss, Credit Suisse.

Sara Shuler - *Credit Suisse - Analyst*

Hi, this is actually Sara Shuler on for Christian. Regarding DTC in your comments you said you had some challenges with your ERP implementation. Can you give us a little bit more detail on that?

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, that has been primarily focused on our eCommerce business. We had delayed shipping for a few days there at the beginning of the quarter due to our ERP system implementation. It caused a few more delays than we had planned.

So that played into the negative comp for DTC over the course of the period. But we are back on track, that was a temporary delay and the system is up and working.

Steve Fasching - *Deckers Outdoor Corporation - VP, Strategy & IR*

Yes, one thing, this is Steve, Sara, is that was planned so we had planned it on the quarter. And the reason we picked that period was because it was really at the end of the year and it's the slowest part of our season.

So it wasn't that it was unexpected, it was just that because we implemented it at the end of the year we suspended shipping while we upgraded the systems. So it wasn't a surprise, it was planned.

Sara Shuler - *Credit Suisse - Analyst*

Got it. That is very helpful. Thank you.

And one last quick question. You said that you are working to enhance your product development calendar. What do those kind of development leadtimes look like now and what is your goal that you are working towards?



Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, so this is a major priority for us to be able to continue to bring freshness to the marketplace. So right now our average leadtime is anywhere from 15 to 16 months from start to finish.

What we have done in the short term is taken 25% of our line and reduced that to nine months. So that allows us to chase trends off quickly, react to what we are seeing in the business. And at the same time starting for spring 2018 we are going to be moving to a four-season development calendar, as well.

So that will help us really put some power behind our summer and our winter, holiday time product at the same time. So that is where we have gotten to so far. There is still opportunities beyond that for even shorter quick-strike opportunities.

But that 25% of our line moving to nine months will be a major move for us. And the team has done a great job at allowing that to happen.

Sara Shuler - *Credit Suisse - Analyst*

Great, thanks.

Operator

Thank you. At this time I will turn the floor back to management for closing remarks.

Dave Powers - *Deckers Outdoor Corporation - President & CEO, Deckers Brands*

Yes, so thanks, everybody, for turning the call today and taking the time. I think the questions were strategic. We appreciate your interest in the brand and where things are going in the Company.

As we said before there is a lot that we are going through right now, this is a transition year but as I said on the call I am very pleased with how the teams are managing through the transition, gearing up for the fall and holiday time frame. And as we feel confident about what we control we are still taking a cautious outlook for the rest of the year and approaching figure conservatively.

But from where we stand today we feel optimistic that we will be able to deliver on what we said. Thank you.

Operator

Thank you. This concludes today's conference.

Thank you for your participation. You may now disconnect your lines at this time.



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2016, Thomson Reuters. All Rights Reserved.