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DECK - Q2 2017 Deckers Outdoor Corp Earnings Call

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OVERVIEW:

Co. reported 2Q17 revenues of \$486m and GAAP EPS of \$1.21. Expects FY17 revenues to be down 3% to down 1.5% and EPS to be \$4.05-4.25. Expects 3Q17 revenues to be down approx. 2% to flat vs. same period last year and EPS to be approx. \$4.16-4.28.



CORPORATE PARTICIPANTS

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

Tom George *Deckers Outdoor Corporation - CFO*

CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Deckers brand second-quarter fiscal 2017 earnings conference call. (Operator Instructions) I would like to remind everyone that this conference call is being recorded.

I will now turn the call over to Steve Fasching, Vice President Strategy and Investor Relations.

Steve Fasching - Deckers Outdoor Corporation - VP of Strategy and 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 policies. Please note that certain statements made on this call are forward-looking statements within the meaning of the federal securities laws which are subject to considerable risks and uncertainties. These forward-looking statements are intended to qualify for the Safe Harbor from liability established by the Private Securities Litigation Reform Act of 1995. All statements made on this call, 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 any forward-looking statements. The Company has explained some of these risks and uncertainties in its SEC filings, including in 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 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 and CEO, Deckers Brands*

Thanks, Steve, and good afternoon, everyone.

For our second fiscal quarter, we delivered earnings per share of \$1.21, up 9% over last year and at the high end of our expectations. Revenues were \$486 million, which was slightly lower than guidance, primarily due to approximately \$6 million in orders delayed in shipping as a result of a new transition to a new European 3PL. We expect these orders will be made up in our third quarter.

I am pleased to report that our inventory at the end of September was down 3% compared to last year. As we said, we plan to manage the excess inventory we carried over from last winter by reducing future buys and packing and holding products and using it to fulfill our orders this season. We delivered on our plan, and going forward we expect to manage inventory in line with sales.

Before Tom walks us through our financial performance in more detail, I will provide you with an overview of our brand and Omni-Channel performance, speak to our plans for the upcoming holiday season, and provide commentary on what continues to be a weak consumer environment.

Beginning with our fashion lifestyle group, which includes UGG and Koolaburra, revenue for the quarter was down 2%. However, if you exclude the impact of the 3PL switch, UGG revenue was in line with expectations.

The second quarter is primarily a sell-ing when UGG delivers its initial fall shipments. This year, our fall launch is highlighted by the debut of the brand's Classic II boot, which we are supporting with highly visible digital campaigns to drive brand interest heading into our key selling season. Although it is still early, we are pleased with the consumer response to II and that the transition has proceeded smoothly. We believe there is only a small amount of Classic I left in the marketplace.

Additionally, the overall total brand inventory in the wholesale channel is lower year over year.

Recently, we have seen some diverted Classic product that has shown up at unauthorized retailers. The amount of diverted product is small, and we typically see this happen every year around this time. As we have in the past, we are moving quickly to take appropriate action.

Shifting to Koolaburra, this is the first year of selling the brand's new full collection under our ownership. We are now selling at wholesale accounts, including Kohl's, Shoe Carnival, DSW, and Amazon, and on the Koolaburra e-commerce site. We view this year as a way to test the market and size the opportunity for Koolaburra. We believe Koolaburra provides a way to reach a new consumers through new channels of distribution without harming the premium positioning UGG has established in the marketplace, but it is something we are closely monitoring.

Moving to our performance lifestyle group, which includes the HOKA, Teva and Sanuk brands. For the quarter, HOKA sales were up 39%, fueled in part by a successful launch of the CLIFTON 3, which earned Best Update by Competitor magazine. HOKA continues to be embraced by competitive runners and incredible athletes.

In September, HOKA athlete, Pete Kostelnick, wore the CLIFTON 3 as he set a new Guinness World Record by running from San Francisco to New York in 42 days. At this year's Iron Man World Championship in Kona, Hawaii, HOKA was the second most worn shoe brand. We are beginning to see the strong word-of-mouth marketing that has fueled HOKA's domestic growth spread outside the US, which is timely as we are stepping up our efforts to capitalize on the brand's international prospects.

Teva and Sanuk both performed in line with our expectations for the quarter. For Teva, the brand is focused on developing the right product for the modern outdoor consumer. Our recently introduced Arrowood boot has had strong sell-through with retailers like REI and is gaining traction with new retailers. The success of the Arrowood, along with the De La Vina and Foxy boot is demonstrating the brand's opportunity to gain market share in closed toe footwear.

For Sanuk, the brand continues to establish itself since transitioning to our corporate headquarters. The new leadership team is now in place, and we have filled key management positions in marketing, product, and sales. Sanuk is looking ahead and is focused on returning to its core product and marketing strengths.

Turning to our channel performance, beginning with direct to consumer, our DTC comp was down 3.2% in the second quarter. Our stores continued to be challenged by weak traffic. That said, we are optimistic we can improve on our recent comp trends during the back half of the year with the addition of new product, including the Classic II; a broader, more developed Classics franchise including swim, luxe and street; increased marketing investment; and a growing trend of consumers buying closer to their wearing occasions.

With respect to our retail optimization efforts, during the second quarter, we closed one store, bringing our total store closures this year to seven. We're still targeting to close 21 stores in FY 2017 with the remaining 14 doors set to close in the back half of the year.

Meanwhile, the new stores we have opened this year are performing well. All the new concept stores have included our new store design that delivered the ultimate physical brand experience and expresses the brand's philosophy of contemporary California casual. The consumer response has been positive, and we believe our refreshed look helps further elevate the brand with our target audience.

The new Omni-Channel initiative that we recently launched is our UGG Rewards loyalty program. Last year, we had great results with our pilot rewards program in select markets and have now rolled the program out nationally to our DTC channels. We are very excited about how UGG Rewards engages our consumer base and provides us with a way to further build our ecosystem of consumer information. Points are earned through purchases in our DTC channels and through social activity. Points for social activity are limited to each quarter, and a purchase is required in our DTC channel in order to redeem a reward. We believe UGG rewards will help drive improved DTC results by encouraging consumers to make additional purchases, thereby enhancing the lifetime value of our consumers.

Now to our global wholesale business. Wholesale and distributor sales were flat for the quarter with domestic sales up 5% and Asia-Pacific 1% up, offset by the decline in EMEA, which was primarily related to the aforementioned transition to a new 3PL. Excluding this temporary disruption, sell-in for the quarter went as planned.

As we move into our busiest sell-through period, we continue to be confident that this inner strength of our fall collections and the updates we made to the iconic Classic franchise. However, as the year has progressed, retailers have become more cautious. The impact from last year's warm winter, combined with the sales compression caused by the buy now, wear now trend has caused retailers to be cautious about committing to future orders. Therefore, we have lowered the top end of our guidance range to reflect what we believe will be a slightly weaker reorder environment.

In this challenging revenue environment, we recognize the importance of driving efficiencies, and we are focused on improving our long-term profitability. To this end, we continue to gain more visibility into the opportunities to optimize our allocation of resources in order to execute on the key priorities of the business. These long-term opportunities include improving how we bring product to market, gain better returns on our marketing investments, and drive general SG&A savings.

Our organization is committed to improving our strategic execution. As I have stated before, one of my highest priorities is driving efficiencies to streamline the organization and improve operations. As we approach the fall and holiday selling season, the team is prepared and focused. I believe that we have the most compelling product assortment in the history of the UGG brand with a full franchise of Classics, a robust assortment of weather product, great fashion in casual boots, as well as a more versatile slipper offering. While there are challenges in the marketplace, I am confident we will be able to execute on our plans for the season.

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 second-quarter results in greater detail, as well as provide our outlook for the third quarter and for fiscal 2017.

Please note throughout this discussion where I referred to non-GAAP financial measures, I am referring to results before taking into account restructuring charges.



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 second quarter. As Dave mentioned, revenue was a \$486 million, which was slightly below our projections for the second quarter, primarily due to product in our EMEA region shipping later than expected, which is now figured into our third-quarter projection. This delay was caused by a logistical change to a new 3PL partner. While sales were slightly below plan for the quarter, gross margins met our expectations and improved year over year. Gross margin for the quarter was 44.5% compared to 44% last year. The improvement versus last year was driven primarily by improved input costs. SG&A dollar spend in the second quarter was \$162 million, flat compared to last year. This result for the quarter was better than expected and was primarily the result of lower international costs.

For the quarter, GAAP earnings per share rose \$1.21 versus \$1.11 a year ago. The year-over-year improvement was driven by lower input costs. Our non-GAAP earnings for the quarter was \$1.23, which was ahead of our guidance of \$1.12 to \$1.22.

During the quarter, the Company incurred restructuring charges of \$0.9 million due to retail store closures and office consolidations.

Inventories at the end of Q2 were \$578 million, a decrease of 3% over the same period last year. We are pleased with the inventory improvements we have seen in all of our brands. Our inventory was slightly better than our expectations as we effectively managed purchase activity down and fulfilled orders using carryover products.

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

Now moving to our outlook. For the third quarter, we expect revenue to be in the range of down approximately 2% to flat compared to the same period last year. We expect earnings per share of approximately \$4.16 to \$4.28 compared to earnings per share of \$4.78 last year.

Also as a reminder, in Q3 of last year, we reversed expenses related to performance-based compensation of approximately \$0.38 per share, which creates an SG&A headwind this year.

Additionally, this year we expect a tax rate of approximately 27% versus approximately 22% in Q3 last year.

For the full fiscal year, we are lowering the top end of our guidance range. We now expect revenue to be in the range of down 3% to down 1.5% and earnings per share to be in the range of \$4.05 to \$4.25 on a share count of 32.5 million shares.

As a reminder, our earnings-per-share guidance for the third quarter and full year exclude any pretax charges that may occur from any further restructuring charges.

To give some further color, as we look at the balance of the year, we expect that over 60% of our revenue for the year is still ahead of us. And, as Dave mentioned, retailers are being more cautious this year and are preferring to carry less inventory and, instead, are relying on an ability to place in-season reorders.

Furthermore, since retailers continue to remain cautious, we have updated our thinking about our guidance assumptions. Our outlook now assumes a weaker demand environment for reorders.

In regards to our inventory outlook, as previously mentioned, we are pleased with our position entering the third quarter. For the next few quarters, if sales levels are achieved at levels consistent with our guidance, we expect to manage inventory in line with sales.

Finally, we continue to see stable prices in the sheepskin market, in part due to the impact that we have made by utilizing UGGPure. We expect our sheepskin costs for fiscal year 2018 will be similar to this year and to not affect our gross margin. This does not constitute our gross margin guidance for next year as our sheepskin costs are only one component of our gross margins.

With that, I will now turn it back to Dave.

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

Thanks, Tom. Before we turn it over to Q&A, I would like to quickly recap the quarter and provide some thoughts looking forward.

Since I have taken over as CEO, I am in the process of looking at the whole organization. I am trying to understand where the opportunities exist and how we can best take advantage of them. While I am pleased with the financial results for this quarter, I understand there is more to do. The Company is energized about the upcoming selling season, and we are encouraged by some early indications we are seeing with the Classic II launch. We are stepping up our marketing efforts and incorporating more digital to highlight the features of our new products and better educate consumers on the product offering we have for them.

And underlying all this is a drive in the organization to deliver improved operating efficiencies that will lead to long-term value creation. While the current market conditions are challenging, it only reinforces our need and urgency for change.

In our supply chain, we are working on initiatives such as automation to improve yields, migrating manufacturing to lower-cost opportunities, reducing SKUs, and reducing product development time. And it doesn't stop with the supply chain. While still early in my assessment, I see additional opportunities across the Company and look forward to providing more details on upcoming calls.

Now let's open up the call for Q&A. Operator, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Camilo Lyon, Canaccord Genuity.

Camilo Lyon - *Canaccord Genuity - Analyst*

You mentioned something at the start of the call regarding non-approved sites that are selling in line product. I was wondering if you could peel a little more color as to why that (inaudible) part of the controls there and if you see that impacting your full price businesses?

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

Yes. Happy to comment on that. I think, before I jump into that, it is important to know that from our perspective the only thing that has really changed with regards to our current business and guidance is that we are anticipating our retailers are going to be a little bit more cautious with regards to inventory levels and reorders. So hence, the tightening of our guidance of our range and there is no change in the low end of our guidance.

Q2 came in as expected except for the one issue we had in Europe with the 3PL and DTC is tracking as planned. So now, we certainly didn't plan for new product introductions ending up on Costco and Rue La La, but it is something that happens to us every year to some extent. We don't think it is cause for major concern, and we are not seeing a negative impact on the sales of our Classic II as a result.

The reason being that the amount of inventory in those channels is generally -- our best belief is that it is less than 1% of the total units we sell in the quarter. So you're talking about a very small amount of inventory on two discount websites, and we believe the average consumer has no idea that they are really there, especially when they are looking for a brand-new product launch and wants the product from a trusted source.



So to address the specifics of your question, here's what we can say. The type of activity typically happens every year and the volume that we are seeing is consistent with what we normally see. We believe that this represents less than 1% of the total unit volume we sell in the quarter and even less in the back half of the year. You are talking about maybe 50,000 units on an annual volume for the UGG brand of 18 million units. So it is a really small number.

However, it is sensitive due to the launch of the Classic II this year, and so we are taking it very seriously. Based on our investigation, we believe the diverted product came from two to three sources. One is a small European distributor, and the second is one to two rogue North American independents that we think saw an opportunity to flip the inventory for a quick buck early in the season.

So we have identified the sources, and we are taking aggressive action legally, like we do every year. And so we are going after those, and that is part of the plan right now.

At the same time, we are working closely with our key accounts to ensure they understand the context of the situation, and so that doesn't disrupt the marketplace in what is generally a very successful launch of the Classic II.

And, in fact, their own DTC channels, the Classic II is outperforming the sales of the Classic I this time last year.

So I think it is really important to put it all in context. UGG is a global multi-channel business that sells 18 million pairs of shoes a year, and quite frankly, we don't see this small amount of units on these couple websites having a big impact in disrupting our brand.

Camilo Lyon - *Canaccord Genuity - Analyst*

Thank you for that color. It is very helpful. One follow-up. On your guidance expectations and what is framing the December quarter, it makes sense that there is a little bit more caution on the reorder expectation. Does that alter your view on your DTC expectations and if you could just remind us what they are for the December quarter, and are you making any changes to your receipts with the new, more conservative reorder expectation?

Tom George - *Deckers Outdoor Corporation - CFO*

In terms of our DTC assumptions, really no change there from the original assumptions. In the second quarter, our second-quarter DTC business was as expected. So to refresh everybody's memory, on the high end of the guidance for the year where we are now guiding down 1.5%, we expect our DTC comps to be flat, and then the lower guidance we expect our DTC comps to be at negative low single digits.

Camilo Lyon - *Canaccord Genuity - Analyst*

And then any change on the inventory expectation because of the softer reorder environment?

Tom George - *Deckers Outdoor Corporation - CFO*

Not at this point in time. We feel good how we have managed inventory to date. As we noted, not only is UGG down better than we thought, but the other brands are down as well. We are pleased with that, and all the inventory that is up is at the end of the quarter is HOKA, and we are driving a lot of growth.

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

Yes. HOKA is expected to grow roughly 30% in the fourth quarter, so we are really pleased about that. In terms of inventory for the balance of the year, in terms of the UGG inventory, we're really pleased as well there, how we are continuing to monitor that flow of inventory and how we are going to be able to work with that.



Steve Fasching - Deckers Outdoor Corporation - VP of Strategy and IR

Yes, Camilo. This is Steve. Just on that, I think on the inventory -- because I know there has been a number of questions related to inventory. So pretty much, we delivered the quarter like we said we would. We said we had some carryover inventory. We are going to take care of it by the end of the quarter. We showed that. And really, going forward, we are going to continue to manage that inventory in line with sales, which is what we have said and kind of said all along.

Tom George - Deckers Outdoor Corporation - CFO

And I would also add, I think you are starting to see the positive impact of our integrated planning function that was a result of our BC investment and our ability to better manage inventory over the season and particularly in season and make those adjustments as needed.

Camilo Lyon - Canaccord Genuity - Analyst

Great. And just my final question. We are still not yet in November, and it seems like the cold weather has started to arrive. Have you seen a pickup in your business as a result of that weather now just starting to flow through, and does this alleviate some of the initial jitters that your wholesale partners have been feeling?

Tom George - Deckers Outdoor Corporation - CFO

Yes. It is still early in the season, obviously, Camilo. But where we have seen cold weather kick in, we have seen an uptick in the business, which is pretty typical. But it is good to see that impact in the business, and there are signs that that will have a pretty positive impact.

Camilo Lyon - Canaccord Genuity - Analyst

Okay. Good luck, guys, with the holiday season.

Operator

Scott Krasik, Buckingham Research Group.

Scott Krasik - Buckingham Research Group - Analyst

Good job getting the inventory down. Just a couple questions. So, first, in terms of actually getting the inventory clean, maybe explain how you did it or whom, through your preferred partners? And then second of all, it has been a few years, obviously, since Classics were selling in the summertime. So maybe just talk about your approach with regards to promotions as we go through the season. Do you think that hurts the brand if they are on sale? What you expect out of your retail partners versus what you do in DTC as well? Thanks.

Steve Fasching - Deckers Outdoor Corporation - VP of Strategy and IR

Yes, Scott. This is Steve. I will start with the inventory. So, on the inventory, we have said on the last two earnings calls that inventory was up about 26%, and we said the reason that we had the elevated inventory was primarily driven by the warm weather that we encountered last year. And, as a result of that, we were going to pack it away knowing we could resell it because it was really carryover products.

So last year, when we elevated our inventory, we talked about how we are going to elevate it, and we were going to be cautious in the inventory that we bought. We bought carryover product and then unfortunately really walked into the warmest weather winter on record in the Northeast and, as a result of that, had some excess inventory. But, fortunately, we had bought that inventory in carryover product.

So what we said we would do was carry that into the fall of this year and reduce the future buys, which typically happen over the summer months. So we were able to reduce the buys of that carryover product, which really allowed us to get inventory back in line. And that is what we have been talking about, really, for the last couple of calls, and that is what has really played out is we (multiple speakers).

Scott Krasik - *Buckingham Research Group - Analyst*

(multiple speakers) channels?

Steve Fasching - *Deckers Outdoor Corporation - VP of Strategy and IR*

Sorry?

Scott Krasik - *Buckingham Research Group - Analyst*

So it was in in-line channels, is what you were saying.

Steve Fasching - *Deckers Outdoor Corporation - VP of Strategy and IR*

No. So, this is the inventory that we were carrying. We know inventory in the channels is also lower. So not only did this quarter we were able to bring our inventory in line with our expectation, what we are also seeing out in the channel is reduced inventory this year versus last.

Scott Krasik - *Buckingham Research Group - Analyst*

Okay.

Tom George - *Deckers Outdoor Corporation - CFO*

And so just to answer your second question about promotions, as Steve said, we're heading into the quarter in a pretty clean place. And as we said on the last couple of calls, last year the promotions that we had, we really viewed as a one-time event. So there is no plan to be that promotional this year. We understand that we are going to have to take some promotions as we always do every year. That is part of doing business in Q3, and we will not be taking the discount on a Classic -- the core Classic product going forward. We did that last year. The purpose was to clean out and transition the product to the new Classic II. That will remain at full price. We are not taking markdowns on that.

That being said, we know we have some markdowns volume that we did last year that we need to comp this year in our DTC channels. That is baked into our guidance. And so we see this generally speaking as a pretty normal promotional year, but we are not going to be taking core discounts in that product.

Scott Krasik - *Buckingham Research Group - Analyst*

That's helpful. Thanks. And then, just -- if I could just follow up one last one. Any major regional differences on the comps? How is the cores and pressure you have seen in those big markets? Has that abated at all? And then, any change in the trajectory of the dot-com growth?



Tom George - *Deckers Outdoor Corporation - CFO*

From a regional perspective on the comps for the quarter, Europe was positive. So we are seeing some improvement in Europe, whereas the North America comp and the Asia-Pacific comp were negative in the quarter.

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

And just the impact on tourists. What we have said there is, it continues to impact our DTC business, although the impact is being reduced. So, if you look at the impact that it had a year ago to the impact that it had on the last quarter, it is less of an impact. So we are seeing that improve.

Tom George - *Deckers Outdoor Corporation - CFO*

And then really no change in the expectation for the e-commerce business going forward. It seems to be tracking well, and we are still confident that we have a good business model there with good digital capabilities to drive traffic, and so we are staying the course on e-commerce.

Scott Krasik - *Buckingham Research Group - Analyst*

Great. Good luck. Thanks so much.

Operator

Mitch Kummetz, B. Riley.

Mitch Kummetz - *B. Riley - Analyst*

Yes. Tom, I just want to follow up on Camilo's question earlier about the parameters in the revised guidance. I know that especially on the wholesale side, I know previously the low end assumed a mid single-digit decline in wholesale distributor sales. The high end was flat. Is the high end now kind of low single digits?

Tom George - *Deckers Outdoor Corporation - CFO*

Mitch, for the high end, you mean the (multiple speakers) family?

Mitch Kummetz - *B. Riley - Analyst*

The high end of the range of the guidance now previously was flat.

Tom George - *Deckers Outdoor Corporation - CFO*

Now we are assuming down 1.5% for the full year (multiple speakers).

Mitch Kummetz - *B. Riley - Analyst*

No, I am not talking about the overall -- let me rephrase the question. I am speaking to the wholesale business. Previously, the range assumed flat on the high end, down mid-singles on the low end. I'm just wondering what the new wholesale assumption is.



Unidentified Company Representative

So, on the high end, where it was flat, right. The way you are interpreting it is correct. So down low single digits.

Mitch Kummetz - B. Riley - Analyst

Okay. And then, just in terms of the promotional environment, I know that the prior guide, the low end, again, doesn't sound like you have changed the low end. You were assuming sort of a similar promotional environment to last year. Can you just talk a little bit about the promotional environment?

It seems to me that season to date, things are worse than they were last year. But, obviously, there is a couple of key months to come. I mean, is the assumption that some of that gets better? Because, if it isn't, then it feels like we can almost end up with a worst promotional environment this year than last, which might jeopardize the low end of the guidance, if I am understanding that correctly.

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

Yes. So, from our perspective, in our DTC channels, we are not more promotional than last year. I think there is a lot of noise around promotional activity because there is some closeout inventory that is out there. That pops up on your phone. It looks like things are worse than they are, but when you actually look at the amount of closeout inventory in the marketplace, it is not that worse than it usually is in the past.

Now, that being said, we did allow some key accounts to carry Classic I over this year. So we made some sales of Classic I product to a handful of accounts to sell through. So that is out there. But, generally speaking, it is not a more promotional environment from our perspective than it has been in the past.

Tom George - Deckers Outdoor Corporation - CFO

Mitch, good point. On the low end of the guidance, we really continue to be highly confident with that. We had the same assumptions on the low end that we did before. And that is similar weather to last year, so that would be warm weather and a similar promo environment last year. Although we are seeing some -- a better promo environment, we are assuming as bad a promo environment in the low end of the guidance that we had last year. So, again, some cautious assumptions at the low end, so we feel very comfortable with the low end of the guidance.

Mitch Kummetz - B. Riley - Analyst

Right. And the last question, I know you guys are not providing Q4 guidance, but we can kind of back into what the assumption there is. And I'm getting something in the range of sort of \$0.52 to \$0.60 for Q4, which would be a pretty big step up from \$0.11 last year. I know at this time last year, I think you were guiding to something like \$0.57, but it ended up being \$0.11. So I am just trying to understand how to think about what your expectations are for the fourth quarter. I know that you were expecting to be a lot better in Q4 last year, and then it didn't happen. I imagine a lot of that had to do with the environment and the weather. But what gives you the confidence in being able to put out that kind of an increase in Q4?

Tom George - Deckers Outdoor Corporation - CFO

Mitch, in the fourth quarter, HOKA is a big driver of that. We expect roughly 30% growth in HOKA. We are comfortable with the product, the marketing, the momentum in the marketplace. So that is a big driver as well as we expect better DTC business in the fourth quarter. One of the reasons is we are -- for most of the fourth quarter, we are still going to have at least 15, 16 stores, more than we did a year ago. So that is going to be very helpful as well.



Steve Fasching - *Deckers Outdoor Corporation - VP of Strategy and IR*

Yes. The point there on the DTC is the announced closures, they will be open for part of Q4, and they will close at the end of the quarter. So year over year, we are going to get performance from those stores that will close at the end of the quarter, whereas this year we will also have the new stores.

Mitch Kummetz - *B. Riley - Analyst*

Okay. Great. Thanks, guys. Good luck.

Operator

Omar Saad, Evercore.

Omar Saad - *Evercore ISI - Analyst*

I wanted to ask my first question around some of the new products this year that I think are pretty interesting, the Classic 2.0, the Slim, the Street. I know it is still really early. Would love any sort of anecdotal data points or updates around that. A lot of the conversation has been around the core and the Classic and the inventory hangover from last year. But I think there is some pretty interesting stuff coming this year, and I would love an update on how you are feeling about that right now.

Tom George - *Deckers Outdoor Corporation - CFO*

Yes. It is a good question. We are feeling pretty good. As we said, the launch of the Classic II has been successful, and the results of that product so far, given the weather challenges, are very good. And our DTC channel of the Classic II is selling better than the Classic I at this point last year. So that is positive.

The Street is doing well also. That was a new addition to the Classics franchise named after a little bit more younger, fashion-oriented consumer, especially with the shopper price point. That seems to be doing well. Specific styles like the McKay and the Quincy combat boot in that collection are strong.

The Slim hasn't really fully kicked in yet, but it does well in places where we see colder weather. So of the three, the Slim is probably the one that needs to kick in a little bit more as we get into the season. It is a little bit higher price point than the Classic, so that could be something to do with it.

But, generally speaking, between the new Classic, the Street, the Slim, and the Luxe, we are pleased with how the Classics relaunch has gone across those styles. But the real strength is coming out of Classic II.

Omar Saad - *Evercore ISI - Analyst*

Are you finding that you need to do some marketing or branding around that to kind of explain to the customer or explain to the retail point-of-sale the differences in these products and help hold the customer's hand around why these are (inaudible) updates?



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

Yes. You know, we have done quite a bit of that. We have toolkits for all of our stores. In e-commerce, we have shared that with our key accounts -- well, all of our accounts as to the difference on how to sell the different products. You remember, all of these products that I just mentioned have our new (inaudible) threadlike outsole, which has better rebound and around the foot comfort and better traction. And they all have the water-resistant finish.

So we are speaking to that in a really powerful way online and in digital media and on our website. We are educating the consumer in our stores, and we have educated our accounts on how to speak to that as well. But it is something that we are monitoring every day, and we are actually making adjustments on the fly to make sure that we are optimizing that story across those franchise styles.

Omar Saad - *Evercore ISI - Analyst*

Got it. Got it. And then, last question, the new loyalty program around UGG, I think it was early October, would love to get your sense and get your sense of like what the impetus behind was that? What do you expect out of that program? Are you getting sign-ups? Is there interest at the customer level? I think it is a little bit different than the traditional loyalty program, but any insight around that would be helpful as well. Thanks.

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

It is a good question. We are very excited about the program and what it can do to help us engage with our consumer for the short-and long-term. And really it allows us to gain more insights to our consumer shopping behavior and their preferences and optimize the lifetime value of each of our customers. So we tested this last year in two key markets around this time. Had great success. We modeled out the impact of the business and the financial model. Got great response from the consumers that engaged into those markets. And so when we launched it out in October in our DTC channels, the percentage of the consumers that are signing up is in line with our plan. And we are excited about the number of consumers we have in building our database of real, rich information that we can begin to cultivate for the long-term.

It is a little bit different probably than traditional models because one of the objectives of the rewards program is that we leverage our database in those customers to help promote the brand. So the social side of this is pretty exciting for us. You, obviously, need to make a significant purchase before you get rewards back towards your next purchase. We have a timeline of 90 days to use the reward, so there is a sense of urgency. And so what you might see as an example is, if a customer earns enough rewards between purchases and social behavior in Q3, they could come back with a 20% -- or a \$20 reward program to use in Q4 to help drive additional DTC volumes.

So that is the premise of it. But beyond the financial part of this is really the intel we get on our consumers for the long-term to cultivate that relationship not lifetime value.

Omar Saad - *Evercore ISI - Analyst*

Thanks, Dave. Best wishes for holiday.

Operator

Corinna Van Der Ghinst, Citi.



Corinna Van Der Ghinst - Citi - Analyst

You guys talked about a more cautious signatory management philosophy for retailers and buying closer to need, which makes a lot of sense. And I know it is still early in the boot selling season, but I was wondering if you could give us some more color on what your guidance assumes for the cadence over the next couple of months based on what you are seeing from your retailer shipments and just weather trends, et cetera?

Tom George - Deckers Outdoor Corporation - CFO

Similar to prior December quarters, it starts coming in around Black Friday and late November and then early December is when the volume of the business is.

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

Yes. I mean, it is still early in the season. I think we are not seeing any major changes to date, but there is, through conversation -- there is a sense of cautious nature and stance from our retailers, and it really comes down to what they see in their business and how they are managing or hoping to buy, which is from our perspective, tighter than they usually do. And they are being cautious on when and how many reorders they are placing, hence the adjustments in our guidance.

Corinna Van Der Ghinst - Citi - Analyst

Okay. Great. Yes, that is -- I was looking to see if there were any changes. And just in terms of order cancellations, order shipments, have you seen any shipments that have been pushed out further than you were previously planning so far this fall, and does your updated guidance incorporate any additional expectation of cancellations just for future prior guidance?

Tom George - Deckers Outdoor Corporation - CFO

On the guidance, the low end of the guidance assumes net cancellations. So we are taking a real cautious view there, and that is consistent with what the low end of the guidance assumed before as well. And on the high end, we are assuming some -- a little bit of a reorder relative to cancellations on the high end.

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

Yes. And I would say, to date, we are not seeing -- we haven't had any signals that things are changing or there is any need to push out shipments to deliveries at this point.

Corinna Van Der Ghinst - Citi - Analyst

Okay. Perfect. If I could just sneak in one more question. I don't think you talked too much about the fashion products during the quarter, but our checks indicated that it performed quite well over second quarter. So can you just comment on how that did relative to your expectations? Is that more transitional product that you guys were selling during the quarter, or how do you expect it to kind of perform into the next few quarters?

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

Yes. Well, we had a good spring and summer with our fashion product, primarily in the sandals category and the sneaker category. And we are seeing -- we have seen great success early fall and late-summer in sneakers, which is a big opportunity for us and we are very focused on in Q4. I think the opportunity there next year is to have an even stronger transitional product stance than we have this year. We have focused heavily on the new franchise product, which is more of a cold weather product offering across the Street and the Slim, et cetera. But the opportunity is in



spring/summer sandals in a major way and then really getting out with the sneaker opportunity and then more of a transitional boot opportunity, which we are going to be launching in spring and building on for next late Q2.

Corinna Van Der Ghinst - Citi - Analyst

Okay. Thanks so much.

Operator

Erinn Murphy, Piper Jaffray.

Erinn Murphy - Piper Jaffray - Analyst

A question, Dave, for you. When do you anticipate the Classic Is to truly be out of the market? I guess the reason I ask, it seems like even on your own website, I am seeing examples of Classic I (inaudible) being on discount next to full price Classic II [daily batches]. So I just am curious when would we start to see that clean up a little bit.

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

Yes. A couple things to comment on that. If you go on our website right now, you see the Classic I and the Classic II. And the reason we did that is we saw a lot of people coming into the website, still looking for the Classic I. And so we made a decision after some testing to put the Classic I up as a way to compare it to the Classic II to better educate the consumer on the difference between the two, why the price point differences. And what we are seeing is the pickup in both Classic II and Classic I sales on the website.

In fact, when you show them side by side by that, like that, generally speaking, the consumer opts to the Classic II, and that is where we are seeing the pickup in sales. So that is very encouraging.

As we said before, we are going to maintain some inventory to fuel our outlet business over the next 12 months or so. And, at this point, that is still the plan to do that.

Erinn Murphy - Piper Jaffray - Analyst

Okay. That's helpful. And then, just a clarification. I think you said earlier, if you look at Classic II this time versus Classic I this time last year, you have seen a pickup in the businesses are performing better. Is that on a unit basis, or is that total sales volumes, just price differential right now?

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

Both. Yes. And that is just in our DDT channels. That comment was particular to our DTC channels. We have pure visibility.

Erinn Murphy - Piper Jaffray - Analyst

Got it. Okay. And then just last question --



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

But it is encouraging it is \$5 more than the Classic last year, too.

Erinn Murphy - *Piper Jaffray - Analyst*

Right. So you are seeing the unit. Okay. And then, on Amazon, I think last quarter you talked a little bit more about kind of pursuing opportunities with your relationship with Amazon for the UGG brand. Where are you guys at now with that -- with those conversations?

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

Yes. We are still in conversations with Amazon. They were here this week, and we are in ongoing discussions with them about the best way to partner with them for all of our brands going forward. So more to come on that, but just know that we are still in discussions and pleased with how they are going.

Erinn Murphy - *Piper Jaffray - Analyst*

Okay. Thank you, guys.

Operator

Randy Konik, Jefferies.

Randy Konik - *Jefferies - Analyst*

A question for Dave. I want to ask more about long-term thinking around how you are going to think about distribution and supply chain. So I guess the things that we are hearing from you and hearing from many is the idea that the department stores or the wholesale customers are -- they are not buying deep. They want to place preorders, and in some respects of other brands, they don't want to buy wide in terms of an assortment. They want to stick with what they know can work.

How do you think about how the supply chain needs to kind of morph? I mean, in athletic, we are starting to see more companies kind of move to a little bit more localized production and items of that nature. So I'm just trying to get some perspective on how you think about the next five years from now or the next few years, how do we think about managing the SKU count beyond the Classic and then how to manage where everything sits in the supply chain? Thanks.

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

Yes, it is a great question. I think the key there is -- the first thing I would say is that, it is our obligation to work closer with those key accounts and be more strategic in how we partner with them. And we are starting to do that with the new management we have in place. We are spending more time with those key accounts. We're putting strategic account plans in place that are very robust and understanding the needs of their business better. They used to be somewhat simple we had these key item styles that would do so much volume for them and was very predictable. That environment is less predictable now, so it requires more work on our end to partner with the accounts and make sure that we are giving them fresh, exciting product that is right for their consumer base on a more timely manner.

The other part on our end that we need to do is shorten our lead time to product to market. So being more relevant from a style perspective, so developing product faster to market, and we are going through our exercises right now and reducing our lead time quite substantially to be able to do that and being able to react to the business better with our supply chain.



The last thing I think we need to do is make sure that we have more frequent drops of products so that we have more opportunity for reorders in the season at the same time.

With regards to SKU count, one of the initiatives we have across the country is optimizing SKU count, reducing SKU count, improving SKU count productivity. That being said, we also need some flexibility in there to be able to provide special product makeups for key accounts in our DTC channel so we can be more competitive and react to the business faster.

So it is a challenge. It is a challenge for everybody. I know you are hearing this from many companies right now. Our stance is to stay aggressive, be more agile, and be more urgent and fast with how we go after new product opportunities and partnering with those accounts.

Randy Konik - *Jefferies - Analyst*

That's really helpful. I guess my last question is, the HOKA business, you said, I think, grew up 40% or something like that -- or 39%. Obviously, it is getting to a place where it is getting -- it is going to start getting sizable. So maybe you could give us some perspective on how you think about framing out that opportunity in terms of maybe giving us some perspective on other brands or the size of the market that these sneakers or shoe (inaudible) kind of getting to from a door count perspective. Just trying to get some color out there so if we can think about potentially obviously valuing that part of the business. Just want to get some perspective on how that business maybe. Thanks.

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

Yes. We are extremely excited about the momentum that the HOKA brand has. I was recently at the Iron Man World Cup championship, and we were just blown away by the amount of athletes and just general public that were wearing the HOKA brand. We've continued to see momentum with that brand, both in domestic accounts, but also in our European accounts and activating business in Asia. And for us, it is really kind of supercharging investments in HOKA, both domestically and internationally. So we have talked about trying to free up some savings in SG&A across the organization. We are focused on that, but one of the reasons we want to do that is to allow us to invest deeper and put the pedal to the metal on the HOKA brand. That requires more marketing investment in North America so we can create a higher awareness, which will allow us to get into bigger distribution beyond specialty running, which we ultimately want to do, and then really get more boots on the ground, so to speak, in Europe in key markets such as Germany, France and the UK and then activate the business in Japan and China where we still -- we know there is opportunity there in a major way. But it is just a matter of really getting people on the ground in those markets to activate with the right partners.

So you are going to start hearing more about HOKA. I think you are seeing the impact it is starting to have on our business. Q4 is heavily impacted by HOKA becoming a more significant piece of our business, helping to balance out seasonality for us, and we think this brand has a lot of upside. Could be the side size of Brooks in the next three to five years.

Randy Konik - *Jefferies - Analyst*

Can I just call up on that just one last thing so I know we have to go here. It sounded like you have said extend distribution beyond premium specialty. So I get what that means, but in terms of thinking about SKU expansion, is there a place in the assortment where you think about a little bit more of an attainable price point for more of not just a premium marathon or an Ironman runner, but more of a casual runner that can look at something at a price point in a high end ASICS or something like that. I'm just trying to get a sense of how you think about product obviously (technical difficulty) position any -- where you think about potential expanding SKU counts to expand potential addressable market in that regard.

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

Yes. I know Wendy and the teams are looking at that on a constant basis. As we expand the SKU offering, we are looking at additional categories. So, in the spring, we are getting into the dynamic stability category, which we have not done before, which is the biggest category in running. We

are getting into slides so after sport slides, and we are well aware that the average price points we are running are below -- the running business is below where we trade generally around \$130 to \$160.

So we are contemplating the right way to do that. We do think there is something to be said about our premium positioning, but we know that as you go beyond core running, you're going to have to be competitive out in the marketplace. And that is something that is true both in North America and Europe. And so, at this point, it is too early to say exactly what the plan is there, but it is contemplated in the long-range plan.

Randy Konik - *Jefferies - Analyst*

Very helpful. Thank you.

Operator

I would now like to turn the floor back over to Dave Powers for closing comments.

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

Great. Thanks, again, everyone, for joining us today. I also want to thank all of our employees for their hard work in preparing us for our key selling season. I am excited about the progress we are making with all of our brands.

As we enter into the busiest part of the year, the UGG brand is top of mind, and I appreciate the energy and the dedication to get us to this point throughout the season.

I would also like to thank our shareholders for their continued support as we drive for increased value for all of our stakeholders. Thanks.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. You may disconnect your lines at this time. Thank you all for your participation.

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