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Deckers Outdoor Corp. (DECK)

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MANAGEMENT DISCUSSION SECTION

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

I'll now turn the call over to Steve Fasching, Senior Vice President, Corporate Strategy, Planning & Investor Relations. Please go ahead, sir.

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

Thank you, everyone, for joining us today. On the call is Dave Powers, President and Chief Executive Officer; and Tom George, Chief Financial Officer.

Before we begin, I would like to remind everyone of the company's Safe Harbor policy. Please note that certain statements made on this call are forward-looking statements within the meaning of the Federal Securities laws, which are subject to considerable risks and uncertainties. These forward-looking statements are intended to qualify for the Safe Harbor from liability established by the Private Securities Litigation Reform Act of 1995.

All statements made on this call today other than statements of historical fact are forward-looking statements and include statements regarding our anticipated financial performance including, but not limited to, our projected revenue, margins, expenses, earnings per share and operating profit improvement, as well as statements regarding our cost savings and restructuring plans and strategies for our products and brands.

Forward-looking statements made on this call represent management's current expectations and are based on information available at the time such statements are made. Forward-looking statements involve numerous known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from any results predicted, assumed or implied by the forward-looking statements. The company has explained some of these risks and uncertainties in its SEC filings, including in the Risk 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.

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

David Powers

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

Thanks, Steve, and good afternoon, everyone. Today, I'm excited to share with you the details of another strong quarter which represents a great finish to a solid fiscal year 2018. We are very pleased with our recent performance, and believe these results demonstrate further progress on our transformation effort. For the first part of the call, I will discuss our performance by brand and channel, and then hand over the call to Tom for a review of our financial results. Then, we will switch gears to discuss our initial outlook for fiscal 2019, as well as the strategic priorities the organization is focused on.

Before diving in, I would like to start by saying how encouraged I am with the progress that we have made in our operating profit improvement plan that we laid out a year ago, which included optimizing input costs, consolidating our factory base, improving corporate process efficiencies and indirect spend, and transforming the marketplace through rationalizing our wholesale account base and optimizing our retail store fleet. These initiatives are the fundamental drivers of our fiscal year 2020 targets, with sales reaching $2 billion, operating margin increasing to at least 13%, and returns on invested capital improving to north of 20%.

To achieve these goals, management tasked the organization with aggressive objectives at the beginning of fiscal 2018. And looking at the results, it is evident that the team had successfully executed on our plans. For the year, the company delivered record revenue of $1.9 billion, a gross margin improvement of 220 basis points, operating expense leverage of 90 basis points, all resulting in non-GAAP operating margin of 12.4% versus 9.2% last year and well ahead of our initial guidance of 10.5%.

On top of these strong financial results, the company also repurchased $150 million (sic) [$125 million] (04:14) of stock, returning meaningful value to shareholders. While we did benefit from favorable weather conditions compared with the previous two years, we also accelerated elements of our improvement efforts. We still have work ahead of us to complete our transformation plan, but that said, given these results, I am more confident than ever that we are well-positioned to achieve our long-term objectives.

So with that, let's start with a brief overview of our performance. Revenue in the quarter was up over 8% to $401 million and non-GAAP EPS came in at $0.50 compared to $0.11 last year. For the full year, as I mentioned, revenue was a record $1.9 billion, up 6%, while non-GAAP operating income was up 43% to $236 million, and non-GAAP EPS increased 50% to $5.74, also a record.

Looking at performance by group. Within the Fashion Lifestyle group, UGG had a strong quarter with sales up 6% to $257 million, largely due to better-than-expected sales in the global DTC channel, with positive contributions from both retail and online. Helping fuel the sales beat was favorable weather late in the season that drove more full price selling of cold weather product, combined with a strong selling of the spring/summer of 2018 line.

For the year, UGG sales increased 4%, cracking the $1.5 billion mark, with international wholesale and global e-commerce accounting for the majority of the gains. During the year, the brand saw success with the renewed trend in the classic mini, continued strong growth of the men's Neumel, and benefited from consumers choosing to wear their UGG slippers year-round.

Over the past several years, the UGG team has made progress on de-seasonalizing the business with a focus on the spring and summer product offering. As evidence, the initial reaction to the spring/summer 2018 line has been positive, and selling is up high single-digits to last year, while season to date sell-through at our top U.S. wholesale partners is strong.

From a selling perspective and consistent with our strategy, women's sneakers and sandals are both up double-digits season to date. We saw success with our current spring and summer season, driven by newer accounts adopting a broader assortment of our product offering.

Also, UGG brand heat is on the rise. As according to YouGov, brand impressions in the U.S. with 18 to 34 years olds is the highest it's been since the company started tracking UGG in 2013. These trends demonstrate the success we are having engaging consumers through focused and targeted digital marketing. They are also the results of delivering compelling products that resonate with younger consumers.

Next, Koolaburra continues to track ahead of plan as revenues more than doubled in the year to $18 million, driven by strong full price sell-through at major account. Our initial strategy for the brand was to determine marketplace demand for the product in the family footwear channel. And as you can see by our results, the first two seasons have been very positive, and we see an ability to continue to take market share and drive healthy profitable growth.

Switching gears to our Performance Lifestyle group. First, HOKA's explosive growth continued in 2018 with sales increasing 47% to $153 million, with the fourth quarter up 34%. These exceptional results are due to the brand's dedication to developing innovative and technical footwear that resonates with the authentic running community. Styles like the Clifton and Bondi, which embody the brand's ethos continue to be bestsellers. The Speedgoat 2, which recently won the Editors' Choice Award from Runner's World and Trail Runner, demonstrates the success of innovation within the brand and is now a topselling style as well.

On top of this, HOKA recently launched collaborations with Outdoor Voices and Engineered Garments. The Outdoor Voices partnership introduced a special addition Clifton 4 collection that will tie together performanced based and active lifestyle brands. This collection reflects the growing popularity of versatile footwear that blends athletic performance with everyday lifestyle. The partnership with Engineered Garments introduces the special line of our Hupana style to reach men and women who incorporate fashion and design into their fitness lifestyle.

Over the last few years, HOKA has also seen growth through category expansion. The brand launched the products in the dynamics stability category, and these styles have quickly become an important element of the overall offering. For the spring, HOKA launched the Fly Collection, which has brought new consumers into the brand and is geared towards both the core runner and the everyday fitness enthusiast.

Within the U.S., HOKA's wholesale business was up nearly 40% on the year, and the brand became a top 5 brand in two leading specialty accounts, Fleet Feet Sports and JackRabbit Sports. This was combined with meaningful growth in our own e-commerce business in the U.S. Domestically, we will continue to drive growth by working with our wholesale partners to strategically expand HOKA's presence in brick-and-mortar, while at the same time offering a seamless digital experience as consumers migrate online for their replenishment needs.

On the international front, HOKA sales were up over 50% for the year, with the largest share coming from Europe. Looking forward, Europe represents the largest near-term opportunity for growth, with the APAC region beginning to ramp up. We are seeing early and organic adoption of the brand in APAC, and continue to see significant opportunities down the road as we build brand awareness.

Turning to Teva and Sanuk. I'm encouraged by both brands' overachievement of their profitability targets for fiscal year 2018, as gross margin and contribution were up significantly over last year and above expectations. Both brands play an integral role in the portfolio; and combined with HOKA, the Performance Lifestyle group provides counter-seasonal business to our Fashion Lifestyle group.

For Teva, sales were up 13% on the year to $134 million, driven by high-teens growth in the U.S. e-commerce business. On the product side, the brand recently introduced the Hurricane XLT 2, which was an update to the original Hurricane. This shoe is a staple on the Teva lineup, and the improved design and functionality is driving slightly higher price points and margins. With the brand's focus on leveraging the core heritage of the original's franchise, we are fostering a relationship with the new and younger consumer.

Turning to Sanuk. Sales for the year were down just under 1% to $91 million. The result was driven by mid single-digit growth in U.S. wholesale, offset by the planned decline internationally as the brand is in the process of resetting its distribution. We also significantly reduced the amount of closeouts in an effort to clean up the marketplace and drive margin improvements. On a product front, Sanuk introduced the Chiba Quest in the fourth quarter, an important update to our Sidewalk Surfer franchise, and it was also met with positive market response.

Now, moving to channel performance. Total company wholesale sales increased 2% in the quarter and 6% for the year. The year's results saw a mid-teen growth internationally and low single-digits domestically. The initiatives we have undertaken to clean up the marketplace and fuel a higher proportion of full price sales is bearing fruit. And combined with the continued growth of UGG's men's, UGG's spring and summer, HOKA and Koolaburra, we are offsetting headwinds of the ongoing account rationalization and the soft foot traffic at certain brick-and-mortar retailers.

Shifting to our direct-to-consumer channel, DTC comps increased 15% for the quarter, driven by positive results across both retail and online. For the year, the total comp increased 7%. DTC sales increased 18% in the quarter and 7% on the year on continued strength of our e-commerce platform. Our international online business achieved over $100 million in sales during the year as the continued shift of marketing spend to digital pays dividends in the form of incremental sales with a strong return on investment.

As I reflect back on the year, I am proud to say that the team delivered exceptional results that exceeded our initial targets despite the many challenges the organization faced. As part of our transformation efforts, we drove a healthy gross margin improvement and SG&A leverage, delivering a significant increase in profitability and return on invested capital. While we did benefit from weather during the year, our overall fiscal 2018 results showed excellent progress on our long-term objectives.

With that, I'll hand the call over to Tom to provide details on the fourth quarter and fiscal 2018 financial result, as well as our initial outlook on the first quarter and full year fiscal 2019.

Thomas A. George

Chief Financial Officer, Deckers Outdoor Corp.

Thanks, Dave, and good afternoon, everyone. Today, I will take you through our fourth quarter and fiscal year 2018 results in greater detail and provide our initial outlook for the first quarter and fiscal year 2019. Please note, throughout this discussion where I refer to non-GAAP financial measures, I am referring to results before taking into account restructuring and other charges that our management believes are not core to our ongoing operating results. Also note, our non-GAAP results are not adjusted for constant currency. A reconciliation between our reported GAAP results and the non-GAAP results can be found in our earnings release that is posted on our website under the Investors tab.

Now, to our results for the fourth quarter. Revenue was $401 million, up over 8% from last year and above the midpoint of our guidance range by $28 million. The better-than-expected performance was driven by our UGG global DTC business as Dave mentioned, with positive contributions from both online and retail, HOKA U.S. wholesale, and UGG European wholesale.

Gross margin was 48%, up 500 basis points over last year. The gain in gross margin was largely due to fewer closeout sales and an improved promotional environment in the quarter which contributed 160 basis points, continued realization of significant progress on our supply chain improvements worth approximately 170 basis points and 120 basis points from FX with the balance being driven by favorable channel mix.

Non-GAAP SG&A expense was $173 million, up from $154 million last year. The year-over-year increase was impacted by an increase in incentive compensation due to better-than-expected sales and profitability and higher marketing and sales related expenses. Non-GAAP EPS came in at $0.50 compared to our guidance range of $0.15 to $0.20, and $0.11 last year.

Now to sum up our fiscal 2018. Revenue was $1.9 billion, up over 6% from last year. The UGG and HOKA brands contributed the bulk of the year-over-year increase, up $56 million and $49 million respectively, and included in these figures is a $12 million benefit from FX.

Gross margin was 48.9%, up 220 basis points over last year. The gain in gross margin was primarily due to 120 basis points from supply chain improvements, 40 basis points from FX, and the balance from a less promotional environment resulting in fewer closeout sales and a higher proportion of full price selling.

Non-GAAP SG&A expense was $695 million, up from $670 million last year. As a percentage of revenue, SG&A improved 90 basis points to 36.5% from 37.4% despite incentive compensation up over $30 million to last year. Non-GAAP operating income increased 43% to $236 million from $166 million last year, while operating margin increased 320 basis points to 12.4%. Non-GAAP EPS came in at $5.74 compared to our guidance range of $5.37 to $5.42 and $3.82 last year. For the year, non-GAAP adjustments were $14 million and was related to the proxy contest, the board's consideration of strategic alternatives, retail store closures and transfers, as well as other organizational changes.

Turning to our balance sheet. We ended fiscal 2018 with $430 million in cash compared to $292 million last year. Our year-end balance includes a shift from international to domestic cash as a result of repatriating $250 million. It is also worth noting that our cash balance is net of shares repurchased. Inventories were essentially flat at $300 million compared to our sales growth of over 6% for the year. We had no short-term debt outstanding under our credit lines and on a pro forma basis, our calculated return on invested capital improved to over 19%.

During the quarter, we repurchased 1.34 million shares of the company's common stock for a total of $125 million. Combined with earlier repurchases, the total amount repurchased in fiscal 2018 was $150 million ahead of our previously stated intention of $100 million. Of the $400 million that was authorized by our board last year, $251 million remains authorized and outstanding as of March 31, 2018, therefore we will continue to evaluate our capital allocation strategy and view share repurchase as an attractive option to drive shareholder value as we continue to execute on our transformation plans.

Switching gears, our global backlog inclusive of bulk orders showed an increase year-over-year at March 31. If our backlog had included bulk orders last year, this would represent an increase of approximately 4% on a comparable basis. As a reminder, our backlog at March 31 only includes orders from wholesalers and distributors for delivery in April through December, and only represents about a third of our total revenue for the year. The figure does not include our company DTC sales, all of the fourth quarter or any future orders we're going to book such as at once orders or closeouts.

Finally, moving on to our outlook for fiscal year 2019, we have made some strategic decisions that better positions the company to compete in today's marketplace and build the organization for the future. While these will create some top line headwinds in the current year, we still expect to achieve overall revenue growth. For fiscal 2019, we expect revenue to be in the range of $1.925 billion to $1.95 billion, which represents year-over-year growth of roughly 2%. And as we have accelerated many of our gross margin transformation efforts into fiscal 2018, we expect gross margins to improve to slightly better than 49% in fiscal 2019.

We also continue to improve SG&A as a percentage of revenue and expect it to be slightly better than 36.5%. We expect operating margin to be in the range of 12.6% to 12.8%. We are projecting an effective tax rate of approximately 22% with diluted earnings per share between $6.20 and $6.40 and capital expenditures to be between $35 million and $40 million. Our fiscal 2019 guidance excludes any charges that may occur from additional store closures and other restructuring charges and does not include the impact of additional share repurchases.

Fiscal 2019 revenue expectations by brand are as follows. UGG is expected to be down low single digits as growth is being offset by the allocation and segmentation of the classics franchise that will be implemented for fall 2018, the continued rationalization of the wholesale account base and further store closures. The anticipated impact of these decisions is approximately $50 million. HOKA growing in the mid-20% range, fueled by both U.S. and international expansion, Teva down high single digits largely due to the cleanup of international distribution as we convert EMEA to a distributive model and Sanuk flat to last year as the brand continues to drive ASPs and a higher proportion of full price sales in an effort to better control the North American marketplace.

DTC comp is expected to be flat with a continued challenging traffic environment in retail as well as an assumption of a more normalized weather season. And additionally, we expect in-season cancellations to slightly outweigh reorders.

Now for the first quarter of fiscal 2019, we expect revenue to be between $225 million and $235 million, and non-GAAP diluted loss per share of approximately $1.50 to $1.41 compared to a loss of $1.28 last year. The drivers of the year-over-year variance in EPS include a lower effective tax rate this year versus last year, decreased shares outstanding this year due to our recent share buyback activity, and orders that were pulled forward into the first quarter of fiscal 2018.

Since the first quarter is a loss quarter, this year's expected lower tax rate due to tax reform and a lower share count due to our share buyback program result in an increase to our loss on a per share basis. The combined effect of the lower tax rate and lower share count is approximately $0.12 per share.

And as a reminder, in the first quarter of fiscal 2018, we experienced a pull forward of wholesale orders of approximately $20 million. This drove an earnings per share benefit of approximately $0.15 to last year's first quarter result.

I will now hand the call back to Dave to provide a little bit more context on our strategic priorities for the upcoming year.

David Powers

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

As Tom just mentioned, we have made some strategic decisions for the coming year that I believe will better position the company for future success. But before I go into details I'd like to start with our initiatives for fiscal 2019. We are intently focused on executing on our plan, elevating our brands and continuing to lay the groundwork for our growth drivers including driving further operational efficiencies, evolving our digital marketing and e-commerce capabilities and continuing to evolve our speed and go-to-market process.

We also see fiscal 2019 as a continuation of our transformation plan, positioning the business for profitable growth. We are in the process of updating our long-range plan and once complete, we can provide an update on our outlook. But as you can see from our results, we are well on our way to exceeding our initial targets we set last year for fiscal 2020.

Next, as we enter fiscal 2019 and coming off a strong 2018, we have several opportunities ahead of us to continue our forward momentum. At the same time, we are making strategic decisions that will generate some top line pressure in the current year but are in the best interest of the brand's long-term success. These actions include further rationalization of brick-and-mortar and online wholesale accounts, the implementation of a classics product segmentation and allocation strategy, and continued optimization of our retail store footprint.

But we plan to overcome these near-term revenue headwinds by continuing to invest in HOKA to drive growth in the U.S. through taking market share, gaining shelf space in premium distribution and driving traffic to our own e-commerce sites, taking full advantage of the momentum that this brand is building internationally and developing innovative products to win with the authentic running community.

Additionally, we'll be building on UGG strength as we see continued growth from expanding upon and building awareness of our men's line, offering compelling women's spring and summer product, and strategically bringing on new accounts that will expose the brand to a new and younger consumer.

Finally, for Teva and Sanuk, both brands are in the process of rightsizing their international distribution in an effort to return to top line growth. Fiscal 2019 will be a continuation of that process with the goal of a return to more significant growth in fiscal 2020. As we position both brands to accelerate sales, we will do so in a way to maintain the healthy profitability margins they achieved last year.

I think it's important to end with a reminder of our commitment to driving operating margins to over 13% which will put us in the top quartile of industry levels. We are ahead of the plan on this front but have more work to do and will continue to make improvements over the upcoming fiscal year.

Our achievements in fiscal 2018 and the work the organization has been tasked with in 2019 will lay the foundation for the company to drive future growth, and at the same time maintain leading operating margin levels. As you've seen, this drives significant cash flow and returns value to shareholders while at the same time preparing us for future growth. More than ever I am excited about how the company is positioned and the potential that exists within our organization and in the marketplace.

With that, I'll turn the call over to the operator for Q&A. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] One moment please, while we poll for questions. Our first question is from Jonathan Komp with Robert W. Baird. Please proceed with your question.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.
Q

Yeah. Hi. Thank you. Dave, kind of a bigger picture question, I noticed that the outlook for the year for 2019 you provided you're looking at about 2% top line growth and that's with about a $50 million drag on the UGG side with some of the changes you're making. So in other words, you'd be pretty close to 5% on an underlying basis. So I'm wondering if that's more along the lines of the underlying growth that you think is capable [ph] at (29:14) portfolio, or how do you think about the ongoing underlying revenue capability?

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

Yeah. Jonathan, that's the right way to think about it. I think as we came off a really strong year and we saw success across all channels, and particularly some of the help we got through the cold winter and positive weather for the brands, we think that there's opportunity there but we're in this for the long term, and we want to make sure we set the UGG brand on the right path with regards to our transformation of the distribution in the marketplace, elevating the brand in the right accounts, continuing to rationalize the stores that we distribute the brand in, and segmenting based on consumer and where they shop by channel.

So we feel that this is the right time to make sure that we reset that distribution, that we get a better handle and control on the classics franchise and maintain a clean and healthy inventory in the marketplace. So that combined with the rationalization of the retail fleet which we've already spoken about, from my perspective it's a very healthy strategy to maintain the health and integrity of the brand and to really set us up for profitable growth and the right channels with new consumers going forward.

So it doesn't get in the way of us delivering on our 2020 targets. We still think we can exceed the 2020 target to $2 billion and 13% and we're tracking towards that. But we've taken this opportunity this year to be realistic and smart about the distribution of the inventory.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.
Q

Got it. And just to follow up on the 2020 targets on the margin side. Looking at 2018, you exceeded the initial margin target by quite a wide margin. Could you maybe just kind of go back through maybe some of the factors that led to the upside, and then as you look forward, whether there's some more potential to show some upside or just what the different dynamics might be looking forward versus kind of the overdelivery looking backwards?

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

A

Yeah. I think Steve and I can tag team that. But obviously, the focus of the teams in getting after opportunities faster than we expected is a big part of that. A large part of the beat, obviously, was driven by the improvements in cost of goods and margin, cleaning up the channel and making sure that we have higher full price sales, fewer closeouts and continuing to drive efficiencies across the organization. Certainly we saw greater improvement in 2018 or FY 2018 than we expected. We don't expect to see that level of acceleration in FY 2019 as there's still work to do across the organization, but we will play that forward through 2019 and stay on track for FY 2020. Steve, do you want to add anything to that?

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

A

Yeah. Just to go back a little bit. So we talked about it in the call that you just heard. On the 2017 to 2018 improvement largely driven by supply chain initiatives that we had talked about last year and some of what Dave mentioned, accelerating a little bit of that forward into 2018. So 2018 coming in a little bit better than what we had initially expected but kind of guided to on our last call.

We also had, with favorable weather conditions, a better promotion and closeout environment. So some of that anticipated in terms of the closeout environment, also a little bit better with the weather. Those were kind of really the big drivers of FX in there, about 40 basis points in the year.

And then going forward, as you look at our guide for 2019, as we indicated there's a little bit of improvement, a little more on the supply chain initiatives that's going to help us out. A little – we'll lose a little bit on the promotional environment as we have assumed a more normalized winter season so we'll lose a little bit of ground there. Overall we should pick up a little bit.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. That's helpful. Thank you.

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

A

Thank you.

Operator: Our next question is from Camilo Lyon with Canaccord Genuity. Please proceed with your question.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.

Q

Thanks. Good afternoon, guys. Just going back to the 2019 guidance, I guess a couple of questions. Dave, if you could just maybe articulate a little bit more about what you're talking about with respect to the classic segmentation and what that should look like at the consumer level? And then if you can provide some context around the expectation of cancellations being greater than the orders in the scenario where it appears that the channel is very clean and you've really talked about implicitly that [ph] indicates (34:01) and how that kind of marries with one another.

It seems that the Classics segmentation strategy and the ability for the focus on your distribution channel should make those channels actually healthier. So I'm just trying to understand to put the pieces altogether as to why we should expect to see such a big headwind of that $50 million on the UGG brand?

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

A

Yeah. So with regards to the segmentation, and I like the way you frame it, what does that mean for the consumer, from my perspective what that means for the consumer going into the individual channels is a more tailored assortment specifically for that store and that consumer. So we've done a lot of work over the last couple years to segment the line beyond the Classics franchise, making sure that we have the tiers covered between core and Premium and Pinnacle and across kind of core department stores and new emerging use distribution.

And we felt this year it was the right time to do the same with our Classics franchise. So we have gone through every account in North America and allocated what we think is the right assortment based off that channel. So when the consumer comes in, they'll have a more tailored assortment specific to their style preference and also price, et cetera.

We think this is the right thing to do. Obviously, as I said earlier going forward for the continued premium positioning in the brand to make sure that the accounts that we are in business with for the long-term are successful. And I'll have a point of differentiation between each other, and that we're using the styles beyond the core Classics franchise to excite that consumer. What this also does is gives us an opportunity to show a broader assortment of product.

And we've been talking about diversification within the product line for some time and I think this is also a part of our ability now to go forward and really rely less on the core Classic as a driver of receiving and allow ourselves to get more assortment of products out to the consumer in a broader based, more balanced assortment going forward for the business.

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

A

And then, Camilo, just how we tie that into kind of an assumption around cancellations versus net reorders. As Dave mentioned, as we are allocating our Classic product, what we're actually selling into wholesale is more men's and spring/summer. So with kind of a relatively flattish to down a little bit on the UGG business, we just thought it was conservative to assume that there would be some cancellations of that other product. So that's kind of how that fits into that strategy.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.

Q

So that's – so you – I can't remember the last time you actually embedded greater cancellations versus reorders when you're anticipating a normalized weather pattern. Do I have my memory correct in those two [indiscernible] (37:00)?

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

A

Yeah. Well, I think the other factor that you have to consider is weather, too. So we're factoring a more normalized winter season so that's going to be a part of it, too. So coming out of a very strong year where we had net positive reorders. Kind of assuming with the change in wholesale what we're selling in, we just think it's right and conservative to take a – and it's not a big number. It's a small cancelation number.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

Okay. All right. So it seems like you're just making sure that all your wholesale channel partners, especially with the Classics franchise, is really tied on inventory that they're presenting at during the season.

Steve Fasching
Vice President-Corporate Strategy, Planning & Investor Relations, Deckers Outdoor Corp.
A

Right.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

Okay.

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

Yeah. We want them to have a healthy inventory going into the season, high sellthrough throughout the season, and there's opportunity for us with our inventory position to be able to help them through that, but really finishing the season clean as a result similar to what we saw this year because we think that's the right approach going forward, starting strong, high sell through and then finishing clean, which also gives us an opportunity to present more spring and summer product in the marketplace because the clean situation on Classics allows for more investment in new emerging categories.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

Understood. Last question I have is just on KOOLABURRA, if you could just provide an update. I think it's been well received, like you, said in the family channel and just maybe some thoughts around how you wanted to expand the brand particularly in light of this more defined Classic presentation.

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

Yeah, I think in a lot of ways this is part of the segmentation strategy and the elevation of the UGG brand, but I'm very encouraged by the success of KOOLABURRA. It's early days and it's our second season, second year with some of our key accounts. It's been very strong. What our customers are telling us is they appreciate the price point and they appreciate the margins and the full price sellthrough of the brand.

It's resonating well with that consumer both on a style and a value perspective, and we're going to continue to expand distribution. You see we're doubling the business this year and looking for further category extensions beyond just kind of cold weather product into spring and summer. But I think the tight focus on distribution, key accounts that we can get a lot of reach through with, quite frankly, little effort on our part, with healthy product high sell-through is a formula that we're learning a lot about, we're very excited about. And it's a first foray in a meaningful way into this what we call kind of the family value channel. And we're seeing great success so far with a lot of optimism for where that can go in the future.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.

A

That's great. Great job in the quarter, and good luck for the year.

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

A

Thank you.

Operator: Our next question is from Jim Duffy with Stifel. Please proceed with your question.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you. Hello, everyone, and congratulations to the team. Really great progress last year, clearly a lot of hard work behind that. To start, I'd like to talk a little bit about the UGG brand trajectory in international markets, and more so what you're assuming in international markets in the fiscal 2019 guide. Is there some of the same distribution work to do in international markets that you're referencing, seemingly in the U.S.?

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

A

Yeah. Good question. So, we're encouraged by the markets that we've been focusing on over the last 12, 18 months, which are really Germany and Europe and China, as we continue to roll out our partner program there. So, we'll continue to focus on those as the key growth drivers.

What's nice about those markets, because they are relatively new, and the maturity of the brand, is that it's a more balanced assortment, an elevated new distribution, particularly in Germany. And so, we're going to continue to drive investments and focus on growing those two markets. Tons of opportunity, obviously, in both of them. Doing it in a quality way, doing it in a balanced way. Healthy inventories, healthy sell-through, healthy brand presentation. And we will continue to do that.

We don't have the similar issues with rationalization of accounts across the international markets. A little bit perhaps in the UK, but we're also opening up new accounts to reach younger consumers, having great success with accounts like ASOS, which is an online retailer over there, which has proved to be a great vehicle for us to bring new product to the market and again reach new consumers in a consolidated way.

A little bit of cleanup between – as you know, we're closing stores, but some of that in Japan, kind of rightsizing some of the wholesale distribution there, but none of it to the extent of what we've been going through in North America, a much healthier position from particularly the new markets, as I said, in Germany and China, and we'll continue to focus on that.

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

A

Yeah. Jim, just to give you a little bit more color on the domestic versus wholesale. So, the strategic decisions that we've been talking about, Dave just mentioned, that's largely a dynamic in the North America, U.S. market. So, that's where we're seeing kind of year-over-year decline. So, as we've guided UGG down a little bit on the year, that's really being driven by that domestic component. The international wholesale distributor business is up year-on-year in the guidance that we've given for the year. So, we expect Europe to be a grower in the UGG business.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And then, Dave, can you give us a little more color on the talk of new accounts driving uptake of a broader range of styles, some of the accounts you think will help you reach younger consumers?

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

A

Yeah. As you know, we started a couple of years ago with testing some new accounts as we were transforming and kind of repositioning the marketplace, but we did some initial accounts with Footaction and SIX:02, part of the Foot Locker group; Urban Outfitters, ASOS, as I've mentioned, in Europe, Zalando. Those are good examples of brand new distribution that is a younger consumer, that I don't really feel crosses over too much with our core department store distribution, particularly through a fashion sensibility perspective and price point.

So, those have been very successful so far. I don't want to get ahead of myself, but I think there's a lot of opportunity there going forward. And the way that the team has repositioned the UGG brand with a little bit more of a fashion edge, leveraging the California lifestyle positioning, the new product is resonating. And I think that, as I said or as you heard in the script, we talked about the brand heat and the YouGov tracking, it's starting to resonate, and the younger consumer is reaching out to the brand online. We're driving traffic through our social channels and e-commerce channels, and we're working closely with those new accounts to give them the assortment that is right for their channel and their consumer; and, so far, that's working, and we see significant opportunity there going forward.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Very good. Thank you.

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

A

Thank you.

Operator: Our next question is with Chris Svezia with Wedbush. Please proceed with your question.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Good afternoon, everybody, and thanks for taking my questions, and congratulations.

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

A

Thanks, Chris.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

I guess, first, I'm just curious, Dave, for you. When you think about the UGG brand and the rationalization you're going to be doing in 2019, how do we think that beyond 2019 into 2020? Do you anticipate still some continuation of these efforts? Or is this really just this year, this repositioning in which 2020 you can continue to see faster growth out of the UGG brand? I'm just curious how you think about the timing of all this.

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

Yeah, it's an evolving marketplace, and so I think you'll see the majority of the cleanup happen this year. But as things evolve and consumer patterns shift, we'll continue to evaluate that. I think we're just – we're very focused on the long-term goal of elevating the brand and maintaining that kind of premium positioning. What it does, though, is it also allows us, as I said, to better diversify the distribution through channels and consumer. And I think we're starting to see early success of that, protecting our core heritage distribution with key partners like Nordstroms and Dillard's, but opening up some of these new accounts which I think, over time, can be meaningful.

And so, we have – we'll end up with a more elevated presentation across the marketplace for that kind of core heritage business as well as kind of call it youth lifestyle distribution in a quality way. And I think what you'll end up seeing, starting in FY 2020, is a return to healthier growth in 2021 for the UGG brand, particularly in North America as a result of that.

Christopher Svezia Q
Analyst, Wedbush Securities, Inc.

Okay. Thank you. And you made some reference with regard to sell-in of spring products for the UGG brand, for sandals and, I think, sneakers. I believe it was double-digits. Could you just clarify what you said the actual sell-through was?

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

Yeah. We didn't get into specifics on sell-through, but the sell-in was received well, so meaning that what we show the customers, they bought a broader assortment and deeper than they have in the past. And part of that had to do with our helping them with inventory and freeing up some open-to-buy in spring and summer. But the reports so far and what we're seeing in the key categories of sneakers and sandals and fashion slippers, the sell-throughs are strong both across men's and women's. And we think that's going to lead to further growth and investment in those categories going forward.

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

Yeah. I think, Chris, on that, too, you might be referencing just kind of the season start was a little bit later this year. So, when we saw the weather turn – it was cold on the northeast – when that weather started to turn, I think, with others, as they saw an uptick in spring product, we saw a big uptick in the sell-through of the spring product.

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

Correct.

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

So, we're seeing it, but we're also seeing a nice pickup on our product.

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

Yeah. And it's also reflected in the DTC comps for the quarter.

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

Yeah, yeah.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Got it. Okay. Finally, just – I just want to – just in terms of the gross margin-SG&A cadence, any color you can add about how we think about that as we move forward? Some of the puts and takes? Seems like based on your guidance, potentially, SG&A dollars are flat to down in the back half of the year, and I would assume that most of the gross margin improvement would be somewhat front-half loaded, just given the comparisons? Or any color you can provide about that.

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

Yeah. Chris, this is Tom. I think you hit it in terms of SG&A guidance for the back half of the year, it's more flattish to down. And in terms of gross margin expansion, you hit it. I mean, it's more the front half of the year. I think something to point out in the fourth quarter on the gross margin, that's where we don't expect as favorable a promotional environment, so you could see some decline in the fourth quarter gross margin.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Okay. Fair enough. Thank you for the color, and all the best. Appreciate it.

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

Thank you.

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

Thanks, Chris.

Operator: Our next question is with Mitch Kummetz with Pivotal Research. Please proceed with your question.

Mitch Kummetz
Analyst, Pivotal Research Group LLC
Q

Yeah. Thanks for taking my questions. Yeah, I just want to drill down on the gross margins and maybe the sales outlook as well for 2019. So, for 2018, it looks like your gross margin was up a couple hundred basis points, maybe a little bit better than that. Steve, I think you said that the majority of that was on the supply chain, but then some of it was due to fewer promotions, less closeouts. Can you – is it possible to quantify the benefit that you received in 2018 on the promotions and closeouts relative to kind of what your plan was, or?

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

Yeah. So, what I can do is I'll give it on the year-on-year. So...

Mitch Kummetz
Analyst, Pivotal Research Group LLC
Q

Yeah.

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

...we finished 2017 at 46.7%, we finished 2018 at 48.9%, roughly 220 basis point improvement year-on-year. 120 basis points of that really came from supply chain initiatives that we drove. And as I mentioned, some of that was an acceleration of things that we had initially planned happening later, happening in FY 2018, so that's why it's a little bit higher than what we had originally guided to. The promotions and the closeouts were worth about 80 basis points. We got a lift from FX of about 40 basis points in the year. So, that's pretty much your 220 basis points.

Mitch Kummetz
Analyst, Pivotal Research Group LLC
Q

And then, for 2019, you said – go ahead. I'm sorry.

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

Yeah. I was going to say, for 2019, so kind of starting at that 48.9 gross margin percent, getting to something around 49-ish or better, coming from additional supply chain initiatives, call it roughly 30 basis points. FX, we think, will be another 30 basis points, and then that will get offset by assumptions around a more normalized winter, so we'll lose probably, we're figuring, around 20 basis points and then we'll lose a little bit with channel mix. So, as we increase our wholesale business in proportion, we'll lose a little bit on the gross margin there. So, netting a little better than 10 basis points on the year.

Mitch Kummetz
Analyst, Pivotal Research Group LLC
Q

Okay. That color was really helpful. And then, secondly, on the sales side, so I know that you're planning UGG down a little bit for the year, but in 2018 I know that UGG came in better than planned. I think it was up 4%, and you had particularly strong during the back half of the year. I'm just wondering, how much of that abnormal growth was due to reorders and cancellations that were sort of better than expected due to the weather and is there any sort of plan to give some of that back in 2019 as well?

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

Yeah. So, if you – the way we've looked at kind of the year and the weather impact, it's always difficult to figure out exactly how much is weather. I think what you heard us talk about on the call last quarter with our beat in 3Q, roughly we got about $30 million of additional wholesale reorders that we attributed largely to weather. We think there was also about a $10 million pickup in DTC business. We think there was about a $10 million pickup in Q4 in DTC due to continuation of favorable weather conditions. So, hard to gauge, but in the ballpark of, call it, 50-ish or more million.

Mitch Kummetz
Analyst, Pivotal Research Group LLC

Q

Got it. And is there any plan to give some of that back in 2019 or...

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

A

Yeah. So, there is a plan.

Mitch Kummetz
Analyst, Pivotal Research Group LLC

Q

... [ph] depend on (52:08) normal weather?

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

A

Yeah. As we've assumed in the guide a more normalized winter, we are not making those assumptions. So, to Camilo's question about cancellations and so forth, we have assumed in the guide a more normalized, whatever that means, winter, right, and we will give some of that back.

Mitch Kummetz
Analyst, Pivotal Research Group LLC

Q

Got it. Okay. All right. That's very helpful. Thank you

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

A

Thanks, Mitch.

Operator: Ladies and gentlemen, we have reached the end of our question-and-answer session, and I would like to turn the call back over to Dave Powers for closing remarks.

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

In closing, I'd like to thank the entire Deckers organization for their tireless efforts in their execution on our plan, their ongoing focus to optimize our brands in the marketplace, and their work to position the organization for growth. I'm exceptionally proud of the entire team and the accomplishments achieved last year in a challenging environment. I'd also like to thank our Board of Directors for their support and contributions over the past year. And lastly, as we drive the business forward, thanks to our shareholders for their continued support as well. Thank you.

Operator: Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.