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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and thank you for standing by. Welcome to the Deckers Brands First Quarter Fiscal 2019 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 would now like to turn the call over to Erinn Kohler, Director, Investor Relations and Corporate Planning.

Erinn Kohler
Director, Investor Relations & Corporate Planning, Deckers Outdoor Corp.

Thank you, everyone, for joining us today. On the call is Dave Powers, President and Chief Executive Officer; and Steve Fasching, 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 our 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, Erinn, and good afternoon, everyone. Before I get into the details of another successful quarter, I'd like to recognize our CFO transition and thank Tom George for his nearly nine years of service to the Deckers organization. In his time here, he helped guide the transformation of the company from predominantly wholesale business to a multi-brand global omni-channel organization. I wish Tom all the best in his future endeavors.

Furthermore, I would like to formally welcome Steve into his new role as CFO. I am confident that Steve will provide a seamless execution of our long-term strategic plan with a continued focus on profit improvement while driving the organization through its next phase of growth.

Now turning to our results, our first quarter fiscal 2019 achieved record revenue for the period, reaching $251 million. We exceeded sales and EPS expectations as our brand portfolio continues to benefit from positive momentum, focused and strategic distribution, and a customer-driven, compelling product offering.

On top of this, gross margins continue to benefit from improved full-price selling and the execution of our cost savings initiatives. These results demonstrate our continued focus on de-seasonalizing our UGG business and improving operations in our first quarter.

For the first quarter, sales came in at $251 million, up 19% to last year and above the high end of our guidance range by $16 million. Non-GAAP loss per share was $0.98 compared to a loss of $1.28 last year. The sales beat was driven by approximately $10 million from the shipment of wholesale and distributor orders originally anticipated for the second quarter, strength in our UGG wholesale business both domestic and international stemming from strong spring/summer product performance, and Teva global wholesale as reorders came in above expectations.

Starting with our Fashion Lifestyle group, UGG sales in the first quarter were up 19% over last year to $136 million, predominantly from the growth in the global wholesale channel followed by a positive contribution from the DTC channel. UGG brand strength continues to grow, and I am encouraged by the evolution of the spring/summer product offering driven by the women's sneaker and sandal categories, which both posted double-digit gains. Reorders also drove upside both in the U.S. and internationally with strong sell-through at our top accounts.

On top of this, UGG was a top 10 spring/summer footwear brand at Nordstrom for the first time ever, which is a testament to the ongoing strategic partnership the team has developed with Nordstrom, the work the product team has put into the design and functionality of the offering, and the fact that the product is resonating with our consumers.

The UGG Spring Summer business also experienced improved full-price selling during the first quarter compared to years past, driving higher sales as well as gross margin gains. The sneaker and sandal business saw continued success in the quarter, with positive consumer adoption of new products. Specifically, we saw strong interest with spring/summer styles such as the Poppy, Holly, and Joan sandals.

The strength of UGG's Spring Summer business in this past quarter demonstrates that our efforts on evolving the product offering and reaching new consumers is paying off and I'm optimistic that this signals our strategy of developing UGG into a year-round brand is working.

Turning to the Performance Lifestyle group, HOKA ONE ONE had another excellent quarter both in U.S. and overseas with total sales growing 53% to $47 million. As I laid out in the last call, we see a long runway for growth internationally for the brand, and this was evidenced in the first quarter results as the international business was up significantly year-over-year.

Domestic sales also increased substantially as the brand continues to take shelf space and market share as well as benefit from a more frequent replenishment cycle. The first quarter for HOKA was eventful as the brand launched the Clifton 5, the Torrent, and the Bondi 6.

Starting with the Clifton 5, the launch was significant as a driver of a year-over-year growth with sell-through very strong for both men and women.

Next, the Torrent is a new trail shoe that in the offering and is the most price accessible within our trail category, with positive initial feedback.

And finally, the Bondi 6 launched at retail in July, with strong sell-in of the style in our fiscal first quarter.

Also, this week at the Outdoor Retailer Show, HOKA was presented with the Gear of the Year award from Outside Magazine for the Mach road shoe. The Mach is a new release from the Fly Collection that we launched earlier this year, which is geared towards both the runner and the fitness enthusiast. The Fly Collection has brought new consumers into the brand and we are seeing strong conversion of both core styles and styles within the Fly Collection at both wholesale and our own DTC.

As we continue to build the HOKA brand, the first quarter results are an indication that the product is resonating, we have partnered with the right retailers, and our digital marketing efforts are paying off with continued DTC gains. I am confident that HOKA is well-positioned to continue its growth trajectory and we have the right team in place to execute our long-term plans.

Shifting to Teva, the brand had a strong quarter with sales up 6% to $40 million. Sales were accelerated in May in June, which drove reorders above expectations and produced strong gross margins gains over last year.

The Hurricane XLT2 and Original Sandals performed well and drove the bulk of the volume. The brand continues to resonate with the younger consumer, and according to the market research firm YouGov, Teva brand impression in the U.S. with 18 to 34 year olds is up 21% in Q1 versus a year ago.

Sanuk sales were down 7% in the quarter, in-line with our expectations which anticipated this year's top line would be impacted by the continued weakness in the U.S. surf specialty channel as well as the strategic pullback in certain international markets. That being said, the brand saw success with the new colorway offerings under the Yoga Sling franchise as well as the new Yoga Sling Cruz, the first closed-toe offering in the franchise, which is off to a strong start in our DTC channel.

Moving to our performance by channel, wholesale increased 23% over last year. Domestic and international wholesale was up in the high-teens and high 20s, respectively. Strong reorders across UGG, HOKA, and Teva, along with $10 million of earlier-than-planned shipments, buoyed performance.

Looking out to the remainder of the year and as I mentioned on my last call, our focus within the wholesale channel is to allocate and segment UGG classic product to better control inventory in the U.S. marketplace as well as capitalize on the international opportunity for HOKA.

Next, DTC comparable sales increased 6%, with total DTC sales up 12% compared to last year's first quarter. This was led by strong performance from our E-commerce channel, where both UGG and HOKA contributed materially to the total growth.

Our digital marketing efforts continue to foster a closer relationship with our consumers. For example, in just the past year, our UGG loyalty program membership has doubled, now reaching over 1 million members, and in the past four quarters, over 26% of our direct-to-consumer sales can be attributed to loyalty program participants. This is driving consumer retention, increasing the frequency and volume of repeat purchases, and we are pleased to see such positive engagement from our consumers.

Overall, it was another strong quarter for Deckers, and I believe it reaffirmed that the strategic decisions we have made to drive the business towards healthy, profitable growth are working and we are on track to deliver on our fiscal 2019 guidance.

Also, we are making great progress on our operating profit improvement plan, including the strides we have made to improve our supply chain, optimize our retail fleet, and capitalize on operational efficiencies. These actions, in combination with the momentum we have built in our brands, are leading us towards successful execution of our fiscal year 2020 targets.

With that, I'll hand over the call to Steve, to provide more details on our first quarter financial performance and outlook for the second quarter and full fiscal year.

Steven J. Fasching

Chief Financial Officer, Deckers Outdoor Corp.

Thanks, Dave, and good afternoon, everyone. Before getting to our results, I'd also like to take a moment to thank Tom. His financial and operational leadership over the years has helped propel Deckers to a global leader in the footwear industry. It has been a pleasure working alongside Tom, and I wish him the best of luck in the future. As I now take on the CFO role, I remain focused on executing on our operating profit improvement plan, and delivering on our long-term targets. This quarter is another example of the progress we are making, and I look forward to continuing to help drive the organization forward.

With that said, I'd like to provide you with an update on our first quarter financial results, as well as our outlook for the second quarter and full year. Please note that throughout this discussion where I refer to non-GAAP financial measures, I'm referring to results before taking into account nonrecurring charges that our management believes are not core to our ongoing operating results.

Also note, our non-GAAP results are not adjusted for constant currency. A reconciliation between our reported GAAP results and the non-GAAP results can be found in our earnings release that is posted on our website under the Investors tab.

Now to our results. For the first quarter, as Dave mentioned, revenue was $251 million, up 19% to last year, above our high guidance of $235 million. The beat was driven by UGG global wholesale performance and spring/summer product reorders, which included some earlier than planned wholesale and distributor shipments and better than expected reorders for Teva.

The largest drivers of the revenue upside to guidance were approximately $10 million from earlier than planned shipments to both domestic and international UGG customers and approximately $4 million from Teva, again both domestic and international.

Gross margins were up 270 basis points over last year to 45.9%, and also better than our expectation. The main driver of the year-over-year increase were stronger DTC margins across all brands, foreign currency tailwind of approximately 100 basis points, improved gross margins in Teva in their second largest sales volume quarter, and better full-price margins within UGG U.S. wholesale.

Non-GAAP SG&A dollar spend was $154 million, up 6.2% from last year's $145 million. As a percent of revenue, non-GAAP SG&A expenses were 61.4% in the quarter, down from 69.1% last year. Non-GAAP loss per share came in at $0.98 compared to last year's loss of $1.28 and our guidance range of a loss of $1.50 to a loss of $1.41.

The majority of the earnings per share beat was from timing of wholesale and distributor orders shipping earlier than previously anticipated as well as the shift in certain operating expenses to later in the year. Non-GAAP adjustments in the quarter were approximately $0.5 million and were primarily related to organizational changes.

Our balance sheet at June 30 remains strong as cash and equivalents were $418 million, up from $280 million at June 30 of last year. Inventory was down 1% to $436 million from $442 million at the same time last year and similar to last year, as we had no short-term borrowings under our credit lines.

During the quarter, we repurchased 86,000 shares of the company's common stock at an average price of $116.56 for a total of $10 million. Of the $400 million that was authorized by our board last year, $241 million remains available as of June 30, 2018.

Now moving on to our outlook, for the second quarter of fiscal 2019, we expect revenue to be in the range of $485 million to $495 million and non-GAAP earnings per share to be in the range of $1.60 to $1.70. For the full fiscal year 2019, we are raising our guidance to account for the better-than-expected performance in Q1. The upside we are flowing through to the full-year guidance is $5 million of revenue and $0.05 in earnings per share.

We remain confident in our ability to execute on the balance of the year and have updated our full-year outlook to include revenue now in the range of $1.93 billion to $1.955 billion, gross margins slightly better than 49%, SG&A slightly better than 36.5% as we defer our first quarter savings to marketing efforts later in the year with operating margins between 12.6% to 12.8% and delivering non-GAAP earnings per share now in the range of $6.25 to $6.45 on a share count of 30.7 million. Our guidance for the second quarter in fiscal year 2019 excludes any potential non-GAAP charges, as well as the effect of any future share repurchases. Recognizing there have been recent movements in foreign currency exchange rates, we remain largely hedged and our updated guidance incorporates the impact of our exposure on any un-hedged amounts.

Additionally, our guidance assumes an effective tax rate of approximately 22%. It is also worth mentioning that at this time we do not anticipate any financial impact due to the recently imposed tariffs, but we will continue to monitor tariff policy decisions as they evolve.

Now, I'll turn the call back to Dave for his closing remarks.

David Powers

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

Thanks, Steve. Our results this past quarter and updated outlook for the remainder of the fiscal year further support my confidence in our ability to achieve our long-term fiscal 2020 targets. On top of this, the continued success of the UGG Spring Summer business and the impressive growth of the HOKA brand are proof that our areas of focus and investment are driving the business forward.

Looking ahead, we will continue to ramp up our innovation and digital marketing efforts to optimize the potential of all our brands globally.

I'm encouraged by our results for the first quarter, and I'm excited by the progress we continue to make in the business. This would not be possible if it were not for the exceptional employees of the Deckers organization, and I would like to thank all of them for another great quarter and for their dedication and execution in building our brands in today's global marketplace.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question today will come from Camilo Lyon of Canaccord Genuity. Please go ahead.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

Hey, good afternoon, guys.

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

Hey, Camilo.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

Thanks for taking my question. I had a couple questions, I wanted to touch on couple topics. Firstly, your inventory levels are incredibly clean. They have been very clean for the past couple quarters. You had some reorders in the spring business that you talked about. Can you just update us on your current thoughts now that we've fully worked through the first half of the year and are now starting to deliver products into the fall season and to your retail partners, how you view the channel, and how we should interpret the decline in inventory that you just posted as it relates to the back half guidance within the context of that decline of low-single-digit UGG growth that you had articulated last quarter?

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

Okay. Yeah. There's three questions in there. So, I'll answer the first one and then I'll hand it over to Steve. But good questions, Camilo. I think, as you know, we've been working hard on a couple of things related to inventory. One is, just making sure that our brands are healthy in the marketplace. So the first priority is making sure that we have more full-price selling, the right level of inventory to maintain the strength of the brand in the marketplace, and be clean coming out of each season going to the next season. So, I'm proud of the work the teams have done.

We feel really good about the inventory levels that we have internally but also the inventory across all brands in the marketplace. And I think the indications of sell-through for spring 2018 that we just went through in Q1 indicate that we should be coming out heading into fall holiday season in good shape with UGG.

And I can let Steve speak to the specifics, but I think you'll see as we continue to work on the inventory levels, getting a stronger handle on UGG with the allocation and segmentation strategies and making sure that we're fueling the growth in the emerging brands at the same time is going to cause that to rebalance a little bit by brand. But overall, we're feeling good.

I'll let Steve take it to the details.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Yeah. So just on the inventory, right, Camilo, as you mentioned, with increasing sales we're showing improvement in inventory down little over 1%. Embedded in that we've made really good progress with our UGG inventory management so clearly down more than that. It's being partially offset by increases from our growing brands, so being HOKA and Koolaburra where we have those brands growing pretty significantly this year. We're seeing increased inventory as we begin to prepare for fulfilling those orders.

And in terms of how we see this as a setup for the year, improvement in inventory management going into the season, inventory in the channel as we see it and reported back to us is very clean. I think also when we look at the fact that we did have $10 million of orders move up a little bit earlier so into Q1 from Q2 indicates, again, how clean the inventory is in the channel and that we've got wholesalers who want our product and taking it a little bit earlier.

So, from an inventory standpoint, we think we're well positioned to get after the year. I think the quarter kind of, again, demonstrates the success that we've had with our spring/summer product and the inventory that we're carrying around that, good strong sell-in, and then we're also seeing good, strong sell-through in the quarter. And then we'll continue to bring inventory in, as we build to the big part of our season, but we think we're in a good position.

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

Yeah and just one other thing that I think will help over time is, we are starting to implement a level loading approach to the factories and much more management of timing of orders coming instead of preloading big seasons with classics to improve our turns more of a level loading approach and bringing the inventory over the season versus bringing it up front. And I think that'll help improvements in turns over time.

With regards to the inventory and then the guidance towards the back half of the year of Q3 for UGG, right now that remains unchanged. We still feel like that's the right guidance. The inventory levels support that. And I think we spoke on the last call about the puts and takes of the allocation strategy, the segmentation strategy, and a bit of an adjustment for weather that we had last year into the guidance. So that remains the same, and I think we're in good position from an inventory standpoint to deliver that.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

Great. Thank you for that detail. If I could follow up, I can't remember historically if there's ever been a time when you've had, when the UGG brand has had spring reorders? I could be wrong on that, but certainly in the last handful of years, maybe five-plus, there hasn't been that dynamic.

Clearly better product, but also it seems like there's just a better underlying demand backdrop. So, is that – is the strength of demand in the spring/summer season changing at all? How your wholesale partners viewed their initial orders with you for the fall/winter season, such that maybe they're realizing that they under-ordered, or might be caught short of inventory if things play out as maybe the first half has?

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

Yeah. It's a great question. I think we have had some orders in spring and summer in the past, but it wasn't necessarily spring and summer product. It would have been more kind of classic or slippers, or continuity product. This is, what's encouraging about this is we're getting some reorders, and the volumes are still small in the scheme of things but in true spring/summer product in a marketplace we're up against some tough competition. So, I think that does speak to obviously the strength of the product, and I think if you look at what's on offer from UGG now compared to what was on offer two years ago, it's dramatically different and much more commercial but also stronger DNA of the brand. And I think it also speaks to the momentum we're making in reaching a newer, younger consumer through our marketing efforts, repositioning of the brand.

Again, I think if you look at this from a customer's perspective, it's a different brand presentation in the marketplace than it was a couple years ago. And I think you're starting to see those impact the belief in the UGG brand from our key wholesale accounts and hence the reorders that we saw.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

That's great. And then just one more, if I could sneak it in. Steve mentioned that there was some OpEx that got pushed out [ph] in two year (00:25:17). Would you just provide a little bit more detail on what that was and how much of that was pushed out?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Yeah. So, in terms of what you're seeing on the OpEx beat in Q1, largely marketing and there are a few other things that were falling into that. So, what we're going to do is – with the strong revenue we see that as an opportunity to move some of that marketing expense into the back half of the year.

So, what we've done is kind of moved, redeployed some of that marketing dollars that we had in Q1 moving really to the back half of the year. So, that's really the kind of the bulk of the difference. There are some other – few other kind of puts and takes largely timing-related but the big component I would say is marketing expense.

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

Yeah, and the focus of that marketing shift will be UGG's Spring and Summer in men's and driving the HOKA opportunity in a bigger way in the end of Q3 and Q4 heading into FY 2020.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.
Q

Got it. Great start to the year. Good luck with the fall/winter season, guys. Thank you.

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

Thanks, Camilo.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Thanks, Camilo.

Operator: Our next question will come from Regan Corcoran of Baird. Please go ahead.

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

Yeah, hi. It's actually Jon Komp from Baird. Just wanted to ask Dave...

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

Hey, Jon.

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

Hey, everybody. Maybe just going back to some of the discussion you just had Dave but when you step back and look at the UGG momentum you're seeing, is there any way to kind of talk through how you're viewing the contributors to that strength between [ph] the marketing (00:26:46) and brand repositioning? Maybe how you see the drivers overall for UGG specifically?

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

Yeah, I think it's multifaceted, Jon. It's a combination of marketplace strategy with regards to kind of core product and continuity product, making sure that we have the right inventory levels in the marketplace, that we are with the right accounts, and that our segmentation strategy is making us meaningful to each account, specifically to their consumer needs.

And as you know we've been working on that for a couple of years. I think Stefano and his team have done an incredible job with that particularly in North America, which needed a lot of work and I think you're seeing the results of that now.

And on the brand side, Andrea and the design teams over there and the marketing teams have really done a great job of repositioning the brand to a new consumer with a fresh, new perspective of the brand but also maintaining the connection through our digital marketing efforts and our loyalty program to our core customers at the same time.

So – and when you do that it becomes incremental and you bring in new heat and energy to the brand combined with the excitement in the new product and innovation that we're bringing to the marketplace. I think that's going to continue to drive opportunity for the brand long term.

The third part of that is really going after younger consumer and that's been a journey we've been on over the last 18-24 months, again, with product, with marketing, with PR influencers, events, leveraging all those, and some of the collaborations. But also cultivating these new accounts that we talked about in the past such as Footaction, SIX:02, Urban Outfitters, ASOS, et cetera. You know the heavy lifting that the teams have done to cultivate those opportunities is starting to pay off. And I think that's great and it speaks to the opportunity both in men's and women's for incremental growth going forward.

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

Okay. Great. And then maybe one other related to the margin picture, kind of a bigger picture question not maybe specifically on the first quarter but just over the last several quarters given the progress you've made towards the 13% operating margin goal. Steve, I'm wondering if you have any color, kind of bigger picture, where the opportunities might be to drive upside versus those targets over time and how you're thinking about both the potential drivers and also maybe kind of the timing over the next few years, if you're able to capture any of those?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah, I think, good question, Jon. I think as we're looking at it, one, we're confident in the progress that we've made and I think the quarter kind of, again, demonstrates the path that we're on marching to that long-term target where we've said, by FY 2020 13% operating margins. So, I think first off we want to get there, we're well on our way.

We've identified really the areas that are going to help drive that. It's more corporate efficiencies, some of our retail store optimization will drive that improvement. So, that's kind of top of mind, continuing to drive that.

I think beyond that, it's still early. We're going to still work through our long range plan, but as we then begin to look beyond that and see some sales growth, there's more efficiencies within our overhead spend and then an ability to lever that spend as we get to more kind of more robust revenue growth. So first off, kind of let's get to our targets that we've set, we're well on our way, lot of confidence about how we're getting there, what we're doing and then beyond that kind of finding efficiencies, but then creating leverage as we get to more robust revenue growth in the future.

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

A

Yeah. And just to add on to that. I think as Steve said, committed to the 2020 targets of 13%, we're laser-focused on that. And beyond that it'll be a balance of continuing to show earnings accretion, but at the same time making sure that we're investing in the opportunities and the brands through our omni-channel network that we built globally. We see tremendous opportunity still in the brands, particularly HOKA, the main growth driver. And we want to make sure that we are feeling that opportunity as well as maintaining a healthy operating margin.

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

Q

Understood. Thank you. I'll pass it on.

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

A

Okay. Thanks.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Thanks, Jon.

Operator: Our next question will come from Jim Duffy of Stifel. Please go ahead.

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

Q

Thanks. Hello, everyone. Steve, you're off to a good start.

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

A

Hey, Jim.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Hey, Jim. Yeah.

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

Q

The...

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

[ph] Hopefully, Jim (00:31:24).

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

Q

I'm hoping you can speak to expectations for share repurchase? I believe the $400 million objective you'd set a timeline by the end of fiscal 2020. Do you still expect to be on that timeline?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. We haven't given kind of any more details on that, but yeah. Absolutely, we're on that timeline. Yeah, we continue to see that as an attractive way to return value to shareholders. When you look at the numbers and what we're delivering, we think it's a great way to deliver some of that value back to our shareholders so, on track for that. As you mentioned, we have $241 million left as of June 30 and with the intention that that would be completed by the end of FY 2020.

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

Q

Okay. Great. And then the strength in spring/summer styles, I'm curious to the seasonal relevance of those. With the traction you're seeing there, are those products that you think could make a contribution into fiscal second quarter and fiscal third quarter as well be additive to the volumes?

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

A

Some of them. The real key drivers of the growth were in sneakers and sandals. And so, we have a great sneaker called the Sammy that has showed continued strength over the last couple quarters and also goes into early Q2 into beginning of Q3, with new iterations of that. The Tye sneaker is another example of something or a style that could be significant in that quarter as well.

And then some of the hybrid slipper/shoe styles such as the Haylie and the Lane, those are styles that have relevance in the quarter, but when you start getting into real UGG season, the impact they'll have on the top line will be less so important, but there are styles that have that kind of longevity that we can do meaningful business over couple quarters at a time.

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

Q

Great. Then the final one for me, how about just an update on the state of your retail operations? Thoughts on fleet management, are you guys feeling any differently about your own stores as part of the go-to-market strategy?

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

A

You know maintaining the strategy that we talked about, we're continuing to drive towards optimizing the fleet. The long-term targets are fleet, four-wall contribution above 20%. We're well on the way to do that. Pleased with the progress the teams have made around optimizing labor, elevating the presentation and storytelling in the store, improving the inventory of the merchandizing through SKU count management and logistics to the store. So, we're still charging forward with that plan, and I also think that we're making good progress on some lease negotiations that are helping out, improve the profitability of those stores. And so, the targets that we've set late – about 18 months ago we're executing against that; at this point, evaluating it but no real change in long-term strategy.

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

Q

That's very good.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

And I just think – yeah, Jim, on that we are seeing improvements in the retail store performance so...

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

A

Yeah, yeah.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

...part of the performance that you're seeing come through, too, is driven by improvement that we're seeing on the retail front. It's driving DTC.

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

A

And traffic for the last couple quarters is improving to the levels it has been. It's not necessarily positive every quarter yet but at least it seems to be leveling out and we're getting some gains through ASP and conversion.

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

Q

Very good. Thank you, guys.

Operator: Our next question will come from Dana Telsey with Telsey Advisory Group. Please go ahead.

Dana Lauren Telsey
Chief Executive Officer & Chief Research Officer, Telsey Advisory Group LLC

Q

Good afternoon, everyone. As you think about the wholesale business, any update or color on the international wholesale business and order trends versus what you're seeing in the U.S. wholesale business and order trends? Is there a difference and does it differ amongst the brands? And then also, can you talk a little bit about the international business regarding your other brands? I know that Sanuk was resetting itself and obviously some have higher or lower growth of international exposure on the e-commerce side. Thank you.

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

A

Yeah, Dana. This is Dave. I can speak a little bit. The international business has been healthy for us. I think from an order perspective speaking to Europe we're seeing continued strength and opportunity in the Germany market still a big opportunity from a reach and also penetration in that market for the UGG brand.

The U.K. tends to – is trending a little bit slower right now. They've had some macro issues going on in that marketplace. And we need to make sure we're investing enough marketing dollars to drive the opportunity in resetting the brand there as we have done in the North American marketplace so, we're focused on that.

China continues to be a strength for the UGG brand. Our own doors there, the e-commerce business, our partner doors, all performing well. We've made some investments in key celebrities to promote the brand in that marketplace and that's paying off and very pleased with the presentation of the brand in that marketplace.

Teva and Sanuk, obviously we did say, we pulled back on Sanuk to focus on North America. Similar story with Teva, although, we are seeing some opportunity in Europe and Japan as well but we're not really aggressively going after those opportunities in lieu of the opportunity that we see with HOKA. HOKA strength in Europe is strong on a growth perspective. Still a lot of opportunity from a volume perspective to have a bigger impact. But the order books are very healthy there as well as Japan.

And so, I think really it's consistent by market where Germany seems to be a real strong opportunity for both brands of course, and then China. But the UGG brand is more challenged if anywhere in the U.K. market at the moment.

Dana Lauren Telsey
Chief Executive Officer & Chief Research Officer, Telsey Advisory Group LLC

Q

Got it. And then just as you think about the order trends of UGG and the pull forward that you have, is this just a onetime shift or is sell-through better than expected driving faster reorders?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. I think, yeah, as we look at it, we saw some of this happen last year actually in the quarter. We actually saw a little bit more last year than this year. I think it's an indication of how clean the channel has been. And there is kind of a result of this sell-through that we're seeing. So, we're seeing sell-through, which is creating reorders and customers wanting product a little bit earlier.

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

A

Yeah.

Dana Lauren Telsey
Chief Executive Officer & Chief Research Officer, Telsey Advisory Group LLC

Q

Got it. And is your pricing changing at all? Any change in pricing that we should know for the upcoming season?

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

A

No. Nothing significant. We are in the process of bringing to market more competitive priced products, but that really starts in spring 2019. So, for Q3 this autumn/winter no major changes in pricing.

Dana Lauren Telsey
Chief Executive Officer & Chief Research Officer, Telsey Advisory Group LLC

Q

Thank you.

Operator: Our next question will come from Chris Svezia of Wedbush. Please go ahead.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Thank you, everyone, for taking my questions. And Steve, congratulations to you as well.

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

A

Yes.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

I guess first just on thoughts around cancellations and reorders as you go into holiday? I think previously you anticipated slightly higher cancelation rate versus reorder. Is that still the thought process or how do you think about that right now?

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

A

Yeah. That's still the thought process. So, no change in terms of that thinking.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. That's an easy one. Okay. Gross margin, I'll make it a little harder for you, Steve. So gross margin, I'm just curious, up 270 basis points in the first quarter. You said 100 basis points is FX. I would assume pull-forward of some business also potentially help that margin. Just how do we think about it going forward? You outperform Q1, you left sort of the outlook for the year unchanged.

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

A

Right.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Just maybe walk through cadence or any other color you can add about how we think about it?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. Sure. So, I think your – we saw a big jump in Q1. We haven't really assumed much change from what we said from the original guidance. So, kind of no change there. You won't necessarily see – you won't see the same level of FX, right? So, on Q1 it was a big impact. That was because the year-over-year rates were more significant in terms of the change. What we expect at current levels is we kind of get closer to what the other quarters were last year, so you're not going to have that same level of increase due to FX.

We still expect a little bit of improvement through supply chain initiatives. That's what's helping drive some of that improvement and in fact I think when we get to the back half – we haven't given details on that but there will be some FX pressure that will be a headwind for us kind of in the back half as it relates to FX.

So, that's kind of how you get to where we're at on a full year basis, not changing from what we've previously said. A little bit more supply chain initiative improvements that will happen over the next couple of quarters. As we get to the back half of the year there will be a little bit of FX pressure.

And one of the things that we did see kind of in Q1 that also contributed was really good full price selling. One of the things that we have in our guidance, as you mentioned, was not changing the thoughts around promotion and closeout business. So, assuming more of that this year than what we had last year that will also be a headwind on some of the gross margins in the latter half of the year.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Got it. Okay. And then just finally, DTC. Just the comp expectations for the year, strong in Q1. Just how do we think about that for the balance of the year? What's your guidance again for the year?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. DTC comp for the year is still flat to last year. So, we had positive low-single-digits that we're guiding on Q2 and then kind of mid-single-digit, 6% DTC in Q1 and for the year kind of flattish assumption.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. Got it. All right. Thank you very much. I appreciate it, and all the best.

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

A

Sure. Thanks, Chris.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Thanks, Chris.

Operator: Our next question will come from Rafe Jadrosich of Bank of America Merrill Lynch. Please go ahead.

Rafe Jason Jadrosich
Analyst, Bank of America Merrill Lynch

Q

Hi. Thanks for taking my questions. I was hoping you could speak a little more about some of the momentum you're seeing in HOKA. And then are you driving the growth through category expansion or are you adding more distribution [ph] or doors? (00:42:37)

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

A

Yeah, I can speak to that. So, it's a number of things that are at play here. One is you're seeing some of our bestselling styles like the Bondi now on its sixth iteration, which has deeper penetration in existing accounts. So, we're continuing to take market share for example in the run specialty accounts in North America as well as Europe, as well as some expanded distribution coming out of Europe that is really starting to kick in. And that's the same for the Clifton, which is on its fifth iteration and a new introduction of product this year; the Torrent, which is our most accessible priced trail shoe that just launched, which is doing very well, and some of the Mach Collection that we delivered at the end of Q4 into Q1.

So, that new product or new introductions is helping us penetrate an existing distribution, and at the same time primarily driven out of the European market, we are broadening our reach both in channel but also country and market and reaching new consumers. And those two components of improving on existing bestsellers and then strategic introductions in the new categories focused on distinct consumers is what's driving the growth of that brand.

Rafe Jason Jadrosich
Analyst, Bank of America Merrill Lynch

Q

And then on – can you talk a little bit about the margins for HOKA? Is it profitable yet? And then how do you expect the margins to progress as that brand continues to grow?

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

A

Well, I'll let Steve speak to the margins.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. So, as we see with HOKA, very good gross margins. What we've said is kind of similar gross margins in the wholesale channel that we see with UGG, so very, very strong gross margins. As a mix of business has an impact on the overall business, so with HOKA having higher proportion of wholesale...

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

A

Yeah.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

...but in light channels HOKA matches up very well with our best-performing margin brands, especially UGG. And the other compelling component about HOKA clearly is, we get more return business and reorder business online. We get really good e-commerce margins through the HOKA replenishment cycle. So, really pleased with margins that we're getting with HOKA, and they are helping drive profitability in the business.

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

A

Yeah. And you know one of the advantages of the Deckers model, and the portfolio of brands and leveraging our infrastructure, is that we can run the HOKA business relatively lean in leveraging some of the operations that we already have in place for the UGG business over the years. The brand is profitable. It's doing very well from a profit expectation standpoint despite the over investment in marketing dollars. So, – which I think is important from a sustainability standpoint.

When you think about a lot of the digital brands that are having success right now in driving a lot of volume online, they're doing that at expense of profitability, because they're over investing in marketing. We're managing that closely. The teams are doing a great job of leveraging the marketing dollars in a big way, but also being efficient in how we develop product, bring it to market, and I think that's going to serve us well over time.

And the other component that will help over time with the margin, the net margin is higher growth rate in the e-commerce channel. At the same time, wholesale is growing, which we know is healthier margins as well.

Rafe Jason Jadrosich
Analyst, Bank of America Merrill Lynch

Q

Okay. And then one more on – follow-up on UGG. Can you update us on the – do a rationalization the wholesales of rationalization? Then at the end of the – the stores are closing this year, do you anticipate further, any further closures? And can you just update us on some of the newer distribution, like Macy's?

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

A

Yeah. That's – the rationalization, the heavy lifting, the real heavy lifting of that is most likely behind us. I think the teams are continuing to evaluate what the right amount of stores is for particularly North America. We have closed a few hundred doors over the last 18 months, and are really focusing on the top 15 strategic accounts that are driving the majority of the volume. We'll continue to do that. And I think naturally there'll be some accounts that will close on their own, just continuing through the marketplace disruption that's happening out there, and some that we will make a decision over time.

But the real heavy lifting of that is behind us. I'm encouraged and excited about the strategic focus on the top 15 accounts. And then some of the new accounts that we've been cultivating, which I mentioned, Footaction and SIX:02, and this will be the first fall the UGG brand will be sold in the Footlocker banner. That hasn't happened before, so that's a great opportunity for us going forward. And some of the online players like ASOS in the European market, those accounts for us are small, but I think they present tremendous opportunity in being helped by the fact that we are cleaning up distribution in the marketplace and employing more of a segmentation product strategy into the marketplace as well.

Rafe Jason Jadrosich
Analyst, Bank of America Merrill Lynch

Q

Great. Thank you.

Operator: Our next question will come from Bob Drbul of Guggenheim Securities. Please go ahead.

Andrew Roberge
Analyst, Guggenheim Securities LLC

Q

Hi. Good afternoon. This is Andrew Roberge on for Bob. I guess our question is how are your brands performing with your online wholesale accounts? And can you quantify what that penetration level is of the wholesale? And maybe where [ph] it connect (00:48:39) over time? Thanks.

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

A

Yeah. I think generally speaking across all the brands in the online pure plays as well as some of the online accounts through some of our key wholesale partners, they're all doing well. But we are managing that closely, and making sure that we look at the full marketplace not just at a total level but also by an e-commerce with brick-and-mortar perspective.

Generally speaking, I don't have the specifics by brand that I can share with how much they're doing on third-party online business, but I can tell you that the UGG business, between our own e-commerce and third-party e-commerce including Amazon and Zappos, is roughly around the 50% level in North America. Very healthy and I think that's a strength that we can continue to build on going forward.

Andrew Roberge
Analyst, Guggenheim Securities LLC

Q

Okay. Great. And I guess our last question is, you guys talked about how part of your cost of sales improvement would come from moving production out of China. Can you just update us on where you are in that process? I know you talked about supply chain already but is that part of that and is there still more to be done there?

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

A

Yeah. It's a great question particularly as these tariff conversations continue to loom. We've been working over the last 18 months, David Lafitte our COO and his teams have done a great job of mitigating risk from a tariff perspective but also allowing us to gain some improvements in margin through the migration out of China. And I'm pleased to say that now we have about a third of our production is in China, which is a dramatic improvement from where we were a couple of years ago. That will continue to come down. We're still looking at opportunities to further migrate out of China. And so we're very pleased with how that's working.

And I will say, from a FY 2019 perspective if there were any changes in tariffs we feel that we've mitigated risks by bringing some inventory a little bit earlier in line with the quarter expectations. But the work the teams have done over the last 18-24 months to afford us some better margins and also to mitigate risk is very strong.

Andrew Roberge
Analyst, Guggenheim Securities LLC

Q

Great. Thank you.

Operator: Our next question will come from Randy Konik of Jefferies. Please go ahead.

Janine Stichter
Analyst, Jefferies LLC

Q

Hi. This is Janine Stichter on for Randy. A couple questions. I wanted to ask about inventory levels. They seem very lean so just any color you can give about how you're feeling about level of inventory. And then also I just wanted to get a little bit more color on the product segmentation strategy. You alluded to it but what inning do you think you're in here and what kind of response are you getting from your wholesale partners? Thank you.

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

A

Yeah. So, I'll just go back on the inventory. I think we answered most of that with the first question. But again, we see inventory moving in the right direction down a little over 1% this year compared to last year. Bigger reductions in UGG as we continue to improve the inventory management with our UGG brand. We did see increases with HOKA and Koolaburra but that's associated with the sales increases that we're seeing, as we build those brands and deliver more product in the upcoming quarters.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah and from a segmentation and allocation standpoint the feedback from our wholesale accounts has been very positive. This is a win-win strategic play for us because we get to have each account with something specific or special to them and their consumer and who they're going after. And also segment from a good, better, best perspective in the marketplace. So, for example, this fall we've segmented the Bailey Bow to premium doors and DTC versus a year ago it was in all accounts. So if anybody asks for it, we would sell it to them last year. This year, we're segmenting it to specific accounts, and that gives them something that's unique to their distribution that they can really get behind, and [ph] now segment (00:52:36) the marketplace overall.

So, it's working well for us. You know, again, we need to continue down the path of developing specific product for each of those accounts and each of those channels, which takes a little bit of time due to our go-to-market pipeline. But the early days of that work is proving to be successful and I think that's going to be a key way of working closer with our top 15 strategic partners, and better managing the marketplace for the long term.

Janine Stichter
Analyst, Jefferies LLC

Q

Great. Thank you.

Operator: Ladies and gentlemen, at this time we will conclude our question-and-answer session and this will also conclude the Deckers Brands First Quarter 2019 Earnings Conference Call. Thank you for attending today's presentation. You may now disconnect your lines.