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Deckers Outdoor Corp. (DECK)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for standing by. Welcome to the Deckers Brands Third 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.

And I now like to turn the call over to Erinn Kohler, Senior Director, Investor Relations and Corporate Planning. Please go ahead.

Erinn Kohler
Senior 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 facts 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, cost savings and operating profit improvement, as well as statements regarding our 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 of 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 and Quarterly Reports on Form 10-Q. 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 statement.

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. Today, we are excited to share the results of our fiscal third quarter. Our performance was well ahead of the guidance we provided last quarter and demonstrates the progress we continue to make on the strategies we laid out two years ago. We delivered sales of $874 million compared to guidance of $805 million to $825 million and non-GAAP earnings per share was $6.59 versus guidance of $5.10 to $5.25.

For the past few quarters, we've been talking about the improvements we're making across the business, including bringing compelling product to market, implementing thoughtful and controlled distribution strategies, elevating and segmenting product offerings, growing our non-UGG brands, and improving gross margins and operating margins. These exceptional results underscore how well our teams have executed on each of these fronts.

Importantly, the results go beyond just our UGG brand. While the third quarter has traditionally been viewed as an UGG quarter, we achieved impressive growth with our HOKA ONE ONE and Koolaburra brand. These two brands significantly contributed to the growth of our business and further emphasize the progress the entire Deckers organization continues to make towards organically growing our brand portfolio. I'm incredibly proud of these accomplishments and very pleased to share our results.

Now, let's get into some of the details for the quarter, starting with the results produced by the Fashion Lifestyle Group. UGG sales were $761 million in the third quarter, up 3.6% to last year and driving the majority of our upside to guidance. We communicated a strong global marketing campaign for the brand's 40th anniversary alongside a very compelling product line. Overall, placing our core product in U.S. wholesale accounts was well-received by consumers, and our strategic approach to product allocation and segmentation created high full-price sell-through rate. Along with the great selling as well as further improvement in our supply chain process, inventory levels significantly improved and we are very pleased with how we exited the quarter.

The revenue beat in the quarter was largely attributed to: accelerated growth in our UGG Men's business as well as noncore styles in UGG Women; better full-price selling in domestic wholesale as we control the distribution of our core Classics, introduce select new points of distribution, and won with consumers, which led to additional reorders, fewer cancellations and less promotional activity than we anticipated in our guidance; improved performance in our domestic DTC channel with better than anticipated selling in both retail and e-commerce; cold weather in October and November aided in creating early demand with strong full-price sell-in and sell-through; and some early distributed shipments in Europe, which were originally planned for the fourth quarter.

This upside was partially offset by a challenging international environment with lower than anticipated sales in our APAC region, in particular as we saw weakness in the region within our DTC channel, which fell below expectations for the UGG brand, and continued weakness in the European marketplace, which we believe is a result of region-specific factors, including struggles in the UK as Brexit talks continue and recent labor strikes during the quarter. We foresee continued challenges in the economies of these region and we will take this into account as we look towards next year. However, with the early success we've had with controlling the U.S. wholesale marketplace through our allocation and segmentation strategy, we are exploring ways to implement this approach in other global markets to improving the selling and heat of the brand internationally.

The evolution of our UGG product line is producing growth in key focus areas as planned, specifically UGG Men's where we experienced significant gains with styles like the Neumel, which continues to capture market share with the younger consumer, and the increasingly popular Tasman Slipper, which more than doubled in volume versus prior-year quarter. We are also seeing success of men's boots outside of the brand's core styling. We believe there is meaningful opportunity to reach a wider array of male consumers with broader wearing occasion as evidenced by performance of styles, such as the Hannen and the Seton. At the same time, several new women's styles also continued to gain traction, with high demand for the Fluff Yeah Slide and the Neutra Sneaker.

Again, complementing our strong lineup of products during this year's fall season, we successfully executed our domestic wholesale core Classics allocation and segmentation strategy. This resulted in an intentional shift of dynamic within the brand's revenue in the quarter. Specifically, the mix of product sales for the brand in the quarter resulted in men's increasing its penetration of brand sales rising to 15%, total women's Classics moderating to about 48% with core Classics units sold into the marketplace below last year's levels. Women's non-Classics increasing as a percent of total brand sales, driven by success in new styles including significant growth in the women's shoe category, which nearly doubled in volume versus the prior year.

This shift in the UGG brand's revenue composition demonstrates that we're continuing to make progress and becoming less reliant on core Classics styles, allowing us to showcase the breadth of what the brand can offer [ph] with success (00:07:48). Coming off another strong holiday season, we plan to fuel the UGG brand momentum through new product collaborations, increased social media presence and celebrity influencers. According to the NPD Group's Retail Tracking Service, UGG was the number one women's U.S. fashion footwear brand in the three months ending December 31, up 11% from last year and commanding 8% of the market. Additionally, in the same time period, UGG was the number six men's U.S. fashion footwear brand, up 18% from year-ago level.

Performance in the UGG brand was also aided by favorable weather condition, in particular in the U.S. with weather turning cold early in the season. These external variables sparked incremental opportunity, allowing us to sell product early in the quarter with high sell-through rates at full-price experienced in wholesale accounts as well as in our own DTC channel. These conditions improved reorders and minimized in-season cancellations, resulting in less promotional activity than in past years and reducing the amount of inventory being sold through closeout avenue, with the combined impact of these items significantly lifting both our top line results and profitability.

Koolaburra also made impressive strides in the quarter, performing above expectations and gaining significant market share in the family value channel. We saw success with the brand in existing accounts as well as new wholesale partners for the season, with strong consumer demand and sell-through. We are actively building the positioning of the brand in the marketplace for next year and we're managing strategic placement with a clear vision of the brand's positioning.

Now, turning to the Performance Lifestyle Group. Within our Performance Lifestyle Group, the HOKA ONE ONE brand generated standout results and made significant gains versus the prior year, growing nearly 80% in the quarter. While the third quarter has not traditionally been the largest quarter for the brand, HOKA exceeded expectations and delivered its biggest revenue quarter ever with $57 million in sales for the period. This upside is flowing through to our updated full year projection, putting the brand at an estimated $220 million for the full year fiscal 2019, representing over 40% growth versus fiscal year 2018. Not only did the brand surpassed revenue expectations in the period, but it did so at a very profitable rate with gross margins coming in above prior forecast. This was mainly driven by strong full-price selling at volumes above prior guidance.

The Clifton and Bondi franchises continue to sell well in the run specialty channel with the brand once again increase market share, retaining the attention of the loyal runner, as well as attracting the attention of new consumers. Product highlights aside from some of the larger volume core styles include: the Gaviota which has experienced fast growth, in particular gaining strength in popularity with our female consumer focused on stability running and offering premium, support, rebound and durability; continued growth with the popular Speedgoat trail running shoe; and the Arahi, known for providing dynamic stability while staying true to the brand's offering of maximum cushion with minimal weight. Looking ahead, we're excited about the launch of new offerings in the brand's [ph] Sky Collection (00:11:08), which we're confident will show that HOKA can be relevant in the hiking category. Along with the continued strength of its core run specialty product, the brand has strong momentum to close out another successful year.

Now, moving to the performance of our DTC channel. Our global DTC business delivered $392 million of revenue in the quarter, representing an increase of 2.6% versus the prior-year, with DTC comps up 1.4%. We experienced a strong start to the season, mainly in the U.S., with strong full-price selling and minimal promotions throughout the holiday season. Additionally, we saw a meaningful growth with our non-UGG brand, specifically HOKA and Koolaburra. We captured the audience of new consumers on our e-commerce channel as we continue to target younger consumer by offering new ways to connect with our brands and purchase through their online experience.

According to YouGov, UGG brand impression among 18 to 34-year-old woman reached an all-time high in Q3. In the calendar year, 1.9 million new consumers made purchases directly through our DTC channel across all of our brands for the first time. Overall, with these results being well above our prior guidance, I'm excited to see the business achieving some of our long-term goals well ahead of schedule. We recognize that certain favorable dynamics that played a part in this past quarter's outcome may not always be attainable in future years. Nevertheless, I'm proud of the team's Q3 fiscal 2019 execution as we were able to attack our seasonal strategies and capture excess demand in a controlled marketplace.

With that, I'll now turn the call over to Steve to provide more details on the financials.

Steven J. Fasching

Chief Financial Officer, Deckers Outdoor Corp.

Thanks, Dave, and good afternoon, everyone. As you've heard, our results for the quarter are exceptional, and now I'll take you through them in greater detail and provide an updated outlook for the fourth quarter and our full year fiscal 2019. Please note, throughout this discussion, where I refer to non-GAAP financial measures, I'm referring to results before taking into account restructuring charges and other amounts that our management believes are not core to our ongoing operating result. 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 third quarter. As Dave mentioned, we achieved sales and profitability that was well-ahead of our prior guidance, reaching a record third quarter result of $874 million in revenue and $6.59 in non-GAAP earnings per share for the period. Revenue was above our prior high guidance by $49 million, contributing to the revenue beat we saw success in our key areas of focus, including noncore Classics styles within UGG, as well as strengthen our HOKA and Koolaburra brand.

Specifically, the incremental revenue volume above guidance was primarily driven by approximately $18 million in UGG domestic wholesale with higher than expected sales in UGG Men's and Women's noncore styles, including women shoes, $15 million from less promotional activity for the UGG brand driving increased full-price selling seen in the top line results as well as improved gross margin, $8 million from HOKA as the brand continue to see rapid expansion of market share in the run specialty channel, $2 million from Koolaburra as in-season reorders were strong, as well as some early European wholesale and distributor shipments originally planned for the fourth quarter. These highlights of accelerated sales were partially offset by some weakness seen internationally within our DTC channel as the regional economies within Europe and Asia continued to face macro headwind.

Revenue compared to last year was higher by $63 million. The increase to last year was driven by UGG, up $26 million from approximately $10 million of planned wholesale orders that shifted out of Q4 and into Q3 related to earlier introduction date of product this year, $6 million of earlier European wholesale and distributor orders as compared to a year ago and our expectation for the quarter, and due to a change in online revenue recognition this year, $12 million, that last year was deferred to Q4. HOKA was up $25 million globally and higher domestic sales also contributed from our Koolaburra brand.

Gross margins for the quarter was 53.8%, also significantly better than expected and up 160 basis points versus last year. The majority of this improved result was driven by a less promotional environment and fewer closeout sales which in turn helped drive higher full-price selling. In addition, we also benefited from our supply chain initiatives as we continued to implement improvements on our processes and deliver efficiencies.

On expenses, our non-GAAP SG&A was $228 million, up 3.4% to last year, but below implied guidance. The increase to last year was driven by an increase in variable sales expense related to the higher revenue in the quarter, as well as the planned increase in marketing spend as compared to last year. And as we continue to deliver on our operating profit improvement plan, we achieved improvement in our SG&A profile. The combined impact of these results drove net income above guidance by $40 million with major contributions coming from $12 million from a less promotional environment than previously anticipated, $8 million from improved gross margins from continued supply chain improvements, $7 million of profit from higher sales driven by strong full-price selling, increased reorders and fewer cancellations, $3 million from an improved tax rate, $2 million from earlier European shipment, and the majority of the balance coming from operating expense efficiencies driven by overhead and back-office support leverage.

Non-GAAP diluted earnings per share was $6.59 compared to $4.97 last year and our guidance range of $5.10 to $5.25. The beat to our high-end guidance was driven by approximately $0.40 due to a less promotional environment, $0.25 from additional supply chain improvement and higher margin, $0.25 from incremental sales from higher reorders and fewer cancellations, $0.25 driven by operating expense efficiencies in the quarter, $0.14 from a favorable tax rate and reduced share count, and $0.05 from early European wholesale and distributor shipment. The non-GAAP adjustment in the quarter of $2.4 million in operating expense was primarily due to the net impact of a one-time legal credit. For the quarter, our tax rate was 20%.

Now on to our balance sheet, which continues to remain strong at December 31, cash and equivalents were $516 million compared to $493 million this time last year. This increase includes using $286 million to repurchase shares over the past 12 months. Inventory was $342 million, down 14% compared to last year and short-term borrowings of $600,000 was flat to last year. During the quarter, the company repurchased 249,000 shares of our common stock for a total of $27 million. As of December 31, 2018, the company had $89 million remaining under its $400 million share repurchase authorization. In light of our results and the confidence in our strategies to produce strong cash flow over time, the Board of Directors approved an increase of $261 million to the company's stock repurchase authorization as of January 29, 2019. Combined with the previous outstanding amount of $89 million, this brings the company's total stock repurchase authorization up to $350 million.

Now, moving on to our outlook. For the fourth quarter, we expect sales to be in the range of $360 million to $374 million and non-GAAP EPS between breakeven to $0.10. The expected revenue range for the fourth quarter includes year-over-year impact as we previously mentioned related to the planned $10 million of wholesale orders that shifted out of Q4 and into Q3, the $6 million of early European wholesale and distributor orders that shipped in Q3 this year, and the change in online revenue recognition this year, hence the expected reduction for the quarter compared to last year. In addition, we have planned for some incremental strategic marketing spend in the fourth quarter and see this as an opportunity to continue to build momentum and drive brand heat that supports our growth initiatives.

For fiscal year 2019, we are updating the financial guidance that we provided on the October call. We now expect sales to be in the range of $1.986 billion to $2 billion. Our outlook at the brand level has been updated to include: UGG sales are now expected to be roughly flat to last year; HOKA is now expected to be up in mid-40% range; Teva is now expected to be up low-single-digit; and Sanuk is expected to be down mid-single-digit.

Turning to the remainder of the P&L. Gross margins are now expected to be above 50.5%, which includes certain one-time benefits achieved this year. SG&A as a percent of sales are now anticipated to be below 36.5% and operating margins are now expected to be in the range of 14.5% to 14.7%. And we are raising our non-GAAP diluted earnings per share which are now expected to be in the range of $7.85 to $7.95 on a share count of approximately 29.9 million. Our guidance for the fourth quarter and fiscal 2019 excludes any potential non-GAAP charges as well as the effect of any future share repurchases. Also, we had a tax adjustment in the third quarter which reduces our expected tax rate for the year and our guidance for fiscal 2019 now assumes an expected tax rate of approximately 20%.

Additionally, we do not currently expect any impact to our business from the currently imposed tariff, but we will continue to monitor tariff decisions and work closely with our supply chain operations to identify risk mitigation strategies should future tariffs begin to impact us. As we have previously mentioned, we have been actively shifting our production outside of China and we currently have less than a quarter of our production being done there.

The full year outlook for fiscal 2019 includes flowing through approximately $1.10 of our earnings per share improvement from the third quarter results driven by $0.40 of an improved promotional environment, $0.25 of higher revenue due to beneficial marketplace management aided in part by favorable weather conditions, $0.25 from additional supply chain improvements and higher margins, $0.14 from the updated tax rate as well as reduced share count, and $0.05 of the operating expense savings achieved in the third quarter.

While we are not providing fiscal year 2020 guidance at this point in time, I think it is important to outline several items that should be considered one-time occurrences in fiscal 2019 and will not necessarily be anticipated to repeat in future periods. These items year-to-date include the benefit from high full-price selling with reduced promotions and closeouts in our peak selling season significantly driving higher profit margin, reduced usage of airfreight during the year which may be needed in future period, and increased profits from higher sales achieved in the fall season from strong reorders and fewer cancellations in part aided by beneficial weather conditions.

Therefore, in a normalized year, we anticipate that future results may include lower operating margin levels as compared to this year. In addition, future margins may also be impacted as we invest in our growth initiatives including UGG Men's, UGG Women's spring and summer, and the HOKA brand, and supporting them with best-in-class digital marketing capabilities, product innovation and improved speed to market. We remained committed to staying on the course and executing on our underlying strategic initiatives as we continue to build our brands and grow the business.

Before handing the call back to Dave, I'd like to say how pleased I am with the results our team has been able to deliver this year-to-date, while demonstrating disciplined management of our brands and operation. We still have work to do before stepping into the next phase of our long-term plan, but I am confident that we are well-positioned and on track to do so. Again, we will not be providing an updated fiscal year 2020 outlook on this call, but I look forward to providing you with an update on our year-end call in May.

With that, I'll now turn it back to Dave for his closing remarks.

David Powers

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

Thanks, Steve. I think it is important to acknowledge that this quarter marks a significant point in our progression against our long-term target. As we have raised our guidance for the full fiscal year 2019 to include achieving up to $2 billion in revenue with operating margins significantly exceeding the target of 13%, as well as fulfilling the commitment to deliver $100 million of operating profit improvement, and we are now on pace to deliver a year ahead of plan.

In summary, our success for this third quarter was highlighted by a strong product offering rich with brand DNA and relevant to younger consumer base to new and existing wholesale account, thoughtful and controlled distribution through over UGG core Classics allocation and segmentation strategy in the U.S. wholesale marketplace, and favorable weather conditions for which we remained appropriately positioned to capture increased in-season demand. All leading to accelerated revenue growth in UGG noncore styles as well as impressive results in our HOKA and Koolaburra brands, much less promotional activity than prior years, driving significant gross margin profitability above expectation, and exiting the season with very low inventory in the wholesale channel, as well as reduced owned inventory versus prior year.

In closing, I would like to congratulate the entire Deckers organization for executing an incredibly strong third quarter and for their commitment our brand as we step into the next stage of our evolution. Thank you to all of our stakeholders for their continued support and to employees for their focus and passion for the business. I'm very excited about our results, but even more excited for what lies ahead.

With that, we are now ready for Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. And we will now begin the question-and-answer session. [Operator Instructions] And our first questioner today will be Camilo Lyon with Canaccord. Please go ahead.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.

Q

Hi. Thanks for taking the question and congrats on a fantastic quarter. Dave, I wanted to get your thoughts on how the conversations have unfolded with your wholesale partners with respect to the redivisioning of the assortment and how you started the season with more of a fashion-based products, and how they responded, and if they become the leaders, how you're now trying to reposition the Classics business and how that should influence in go-forward periods?

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

A

Yeah, great question. We've been working for quite some time to get our wholesale partners to adopt more of the line, beyond just the core Classics, because we believe there's real strength in that assortment, especially now that we're reaching a younger consumer and it's just a much healthier sustainable business over time. So, I'm super excited about how the allocation strategy worked in core Classics. We contained the amount of inventory that was in the channel. We're very thoughtful on which accounts we gave core Classics to and what quantities they had. And then, we supplemented that with segmented approach of non-Classics styling across shoes, slippers, boots, et cetera. And I think what you're seeing in this quarter is the results of that work playing out, aided a little bit by some early cold weather to bring traffic and excitement to the brand, but the sell-through rates on core Classics and in noncore Classics inventory were exceptional.

And so, the accounts are very pleased with how we've been controlling the brand in the marketplace, how we've been positioning new accounts with segmented product offerings, so everybody has something different and unique, and I think that that is strategy that played out extremely well for us in Q3 and one that we're looking to employ in the international markets starting in fall 2019. So, I guess to answer your question, the feedback from the accounts has been very positive. They all had a good season. As you saw, we had high full-price sell-through. We didn't have to discount to drive sales, even though we were in December, up against tough comps last year and exited the quarter extremely strong.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.

Q

That's great. So, would it be fair to say that clearly the weather was a benefit to the business and a benefit to all outerwear businesses this holiday season. But if it weren't for this very favorable weather pattern [ph] the business you touch that is still been an advantageous. Do you agree with that? Is that (00:30:00) really the learnings and the takeaway from this strategic shift that we should embrace?

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

A

Yeah. I think like I said, the weather early on was a catalyst to kind of spur the excitement in UGG and in the product there. But it wasn't for the compelling product across the board that we've been working on for quite some time and this is really the first year you're seeing the full assortment and the segmented approach hit the market with some new distribution, we wouldn't have done as well as we did. And I think if you look at a high level, like we said on the call, in the script, this wasn't just an UGG story this quarter. HOKA did tremendously well, their best quarter ever, which traditionally Q3 isn't their largest quarter of the year. And I think you're starting to see the impact of HOKA and also Koolaburra, and the portfolio approach of this business have a bigger impact, and we all feel great about the fact that we're less reliant on core Classics and weather dependent in Q3.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.

Q

Great. And then just it's going to be my last question. So, last conference call, you alluded to getting close to committing to a mid-single-digit sort of long-term revenue growth target. Could you just help us explain what the components of that would be clearly to focus on this tremendous growth path? You mentioned future investments, continued investments in HOKA in the women's streamline and in the men's. Maybe if you could contextualize how we should think about those components of the business in context to the core Classics business and how we should think about the different growth rates for you to achieve that mid-single-digit [indiscernible] (00:31:46).

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

A

Yeah. I mean we're not giving, obviously, long-term guidance at this point, but I still and firmly believe that mid-single-digits is achievable in the long-term, over the next three to five years. We do have significant growth drivers that we've talked about. First and foremost, we're going to maintain the strength of the core Classics business. We don't see that as a major growth driver, but more of just a healthy annual business, so we can continue to build on. But UGG Men's will continue to be a growth driver, new categories outside of core Classics in women's, and also in spring and summer. HOKA will be significant and as we said before, we see that brand getting to $300 million to $500 million in the next three to five years. And I think when you add up all those components you get to a mid-single-digit growth level that we think is sustainable over the next three to five years.

Camilo Lyon
Analyst, Canaccord Genuity, Inc.

Q

Fantastic. Great job on the quarter again and good luck for the rest of the year.

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

A

Thanks, Camilo.

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

A

Thanks.

Operator: And our next questioner today will be Jonathan Komp with Baird. Please go ahead.

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

Q

Yeah. Hi. Thank you. I wanted to start just following-up on UGG and some of the upside. And Dave, if you could maybe talk a little bit more or give more detail on the shape of the quarter? You alluded to a little bit. But just some more color on how things played out? And then, also coming into this year and the start we've had, how things have trended and what that means for current inventory availability and kind of early order trend, if you would?

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

A

Yeah. I think I covered a lot of it. I think one thing that's important to note is, again, we started out strong in October and November. If you remember last year, we had extremely strong December and we planned that business conservatively going into this quarter this year. Fortunately, we started out the gates very strong with some of the new product that was hitting the marketplace, as well as some cold weather early in October which proved to be more of a catalyst to getting the business jumpstarted. But again, I think it was the strength of the men's offering across the board driven by the Neumel and Tasman styles and some of the fashion boots.

The Adirondack style in women's was a top-seller for us again, even though, we raised the price of that we still saw double-digit growth in that style alone versus last year. Shoes and sneakers in women's led by the Neutra Sneaker and slippers led by the Fluff Yeah franchise, those are normally not big drivers in the business, but we saw those really kicking in in October-November through existing and new wholesale distribution as well as online that created excitement for the brand, and I think had a halo effect on the Classics, but I think what the difference is this wasn't a Classics-led business this year, I think it was across the board strength and we maintained control over the marketplace through pricing. So, there was very little of any discounting going on.

We entered the season very healthy and clean from an inventory perspective. We maintained that through strong full-price sell-throughs and tightly managed reorders going in through December. And even though, December was a little bit challenging, we had enough momentum in the business to finish the quarter strong and made some decisions that actually we decided not to promote or drive closeout sales, even though we could have in some cases. And we felt it's better to maintain a healthy positioning in the marketplace, strong full-price selling for our consumers in our accounts, and then exit the quarter with healthy inventory levels going into Q4 and next year selling.

So, it played out nicely, and again, we've been working on this for a couple years, as you know, the segmentation and allocation and product assortment coupled with new brand positioning, and we're still feeling good about that positioning going forward. As far as Q4 goes, the weather has been up and down, playing a little bit of – have an impact on the business, in some cases, we still have some challenges internationally. Some of the ships of deliveries and our accounting principles that went into Q3 make this quarter look a little bit lower than we anticipated originally. But still strong sell-through, still good handle on the inventory in the marketplace; we're not doing a lot of closeouts, and then being bolstered by the strength of HOKA.

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

A

Yeah. Jon, this is Steve. Just to kind of add on to what Dave said, I think in terms of how we looked at the quarter for the way it played out, it pretty much played out the way we thought. And then, with less promotion, we saw some lift in revenue and then we saw some timing impacts. So, the timing impacts that we picked up in Q3 is really what's impacting Q4. Q4 hasn't changed from the way we looked at it, other than we shipped some product earlier in Q3.

So, exactly kind of what Dave said, with an allocation strategy in place, we sold to that, we sold above that in additional categories that gave us really to the upside kind of in Q3. And Q4, whist it take back from last year, when you take into account the timing that went into Q3, it's still pretty much what we planned, and then flowing through that full beat or at least about $1.05 of the beat from Q3 for the full year is just in kind of a reflection of how well our setup was for Q3 and the execution on our Q3.

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

Q

Understood. And maybe just a follow-up on the callouts around the Asia-Pacific business, I don't know if you can contextualize what you saw, a little bit better there, and any more commentary on what actions you might take to try to address whatever it is you're seeing?

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

A

Yeah. I think our goal is to always control what we can control. And I think I always look at kind of our international markets in the last couple years as probably year behind our strategies that we're executing first in North America. So, the marketplace management tactics that we just saw play out in Q3 in North America, we'll be rolling those out to the international markets starting in fall 2019. With regards to Asia-Pacific and the China business, there are some macro challenges in that marketplace with consumer sentiment. We had some weather challenges in the marketplace, particularly in southern China, and those are the major factors outside the brand itself.

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

Q

Understood. Thank you.

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

A

Okay.

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

A

Thank you.

Operator: And today's next questioner will be Sam Poser with Susquehanna Financial Group. Please go ahead.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Thank you for taking my questions. I just want to go back into – like, how would you weight it, would you weight the success you had with UGG in the quarter as more weather related or more of the segmentation brand control weighted?

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

A

Yeah. It's a great question and there is no exact number or breakdown to that. But from where we stand, it's more weighted towards the marketplace management of the brand and the focus on brand positioning and product. So, certainly, as you know, Sam, managing the inventory in the channel, the allocation of Classics is a big component of that in creating demand in the consumer and for the accounts, and then bolstering that with an exciting product offering that is segmented by consumer and channel and account, I believe, the majority of the upside is from that, and we're looking at it as aided by – the success aided by weather, but not driven by weather.

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

A

Yeah. And I think the other thing Sam too, talking just about the strategy of how well HOKA did, I think that further shows kind of how the strategy and the marketplace approach, not only with UGG, but HOKA is working too.

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

A

Correct. Yeah. Thank you.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

I have two more. Can you give us some idea of the year-over-year DTC versus – and the total wholesale EBIT, what – and I assume that they both were good, but probably it was a big beat on the wholesale line, I would guess.

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

A

Yeah. It's a bigger beat on wholesale, right. So, we saw stronger wholesale outperformance than we did in DTC. You're right, both did perform well, but also DTC was impacted by – I think, it's 11 stores closed this year versus last. So, on a year-on-year, we had headwinds with store closures related to retail. But again strong performance in DTC, kind of stronger performance in wholesale, so the proportion of our wholesale beat is bigger than the DTC.

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

A

Yeah. And the other piece to remember on that is, in December last year, DTC had an exceptional last couple weeks in the quarter driven by the cold weather that came late and we were unable to capitalize on that in wholesale, but we were able to capitalize it on – in DTC. We didn't have that same dynamic this year and we made the decision to not be as promotional in DTC this quarter.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

And then lastly, inventory levels, can you give us the year-over-year percent increase or dollars, however you want to do it, for UGG and for HOKA just so we can understand sort of where this inventory is?

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

A

Yeah. We don't normally break that out, but I can kind of directionally tell you. So, total company was down 14%, so ended the quarter at $342 million that compared to $396 million a year ago. The UGG inventory was down more than the company average. So, UGG inventory down more than the 14%. And HOKA, as we gear up for spring/summer and we have some new category introductions coming, we brought inventory in earlier, that was actually up year-on-year.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Okay. Thank you so much and continued success.

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

A

Okay. Thanks, Sam.

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

A

Thanks, Sam.

Operator: And our next questioner today will be Dana Telsey with Telsey Advisory Group. Please go ahead.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Good afternoon and congratulations on the very impressive results.

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

A

Thanks, Dana.

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

A

Thanks, Dana.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

As you think about the less promotional environment, how did pricing change, did pricing change on any of the categories and what are you planning for pricing going forward? And did you get gross margin improvement from all brands?

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

A

So, I'll handle the first one and Steve can handle the second one. We actually have been working on pricing for quite some time and particularly in North America to make sure that we're competitive against the competitive – our competition out there and also by account with some of the new segmentation. So, we feel that we actually had pricing set correctly. There were a couple styles that we made decisions to change, to be a little bit more competitive bringing those down, but we maintained healthy margins across the board regardless of category.

We don't see any significant price changes going into next year. What we're trying to do, going into next year and FY 2020, is to add more value into some of the product that the prices we have, more functional capabilities, such as waterproof capabilities and some of the fashion boots in women's. But pricing overall, we felt we were set correctly, we were competitive, a lot of value in the pricing for the consumer, and I think that played through in the full-price sell-through.

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

A

Yeah. And then just kind of on the amounts, Dana, what we said in the prepared remarks was we think the less promotional activity contributed about $15 million. We think in the quarter that's a little below kind of 200 basis points of improvement on the gross margin. As we kind of then extrapolate that out, that's not something we would necessarily plan kind of for next year. So, when I talked about my one-time adjustment, we think for the year, it's probably worth 100 to 150 basis points that we picked up, which is really a combination of better full-price sell-through as well as some of the airfreight benefits that we received last quarter, because we're looking out forward, again, we haven't given guidance. But we think we benefited in the current year probably around 100 to 150 basis points that we wouldn't necessarily figure into next years. It doesn't mean it couldn't repeat, but we wouldn't figure it in next year. Yeah.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

And then just one last follow-up. How has the new distribution performed, whether it's ASOS, Urban Outfitters, and how do you see your goal for that going forward?

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

A

Yeah. All well, across the board generally speaking, those have all performed well for us. We have some assortment opportunities in places like Foot Locker, where the core Neumel has sold well to their consumer, but we see opportunities for evolving that specifically for their consumer. But generally speaking, inventory levels and sell-through have been healthy and the accounts are pleased.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Thank you.

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

A

Thank you.

Operator: And our next questioner today will be Jim Duffy with Stifel. Please go ahead.

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

Q

Thanks. Good afternoon, guys. Terrific quarter.

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.

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

Thanks.

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

Thank you.

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

Steve, a question for you, the objective EBIT margin, you were talking about 13%. You're now looking at high-14% through fiscal 2019.

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

Yeah.

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

If I heard you correctly in response to Dana's question, you're thinking there is maybe 100 to 150 bps of give back in the gross margin. Are there organic areas of improvement in the gross margin that are going to be an offset to that?

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

Yeah. So, again, we are – as we indicated, we're not completely through all of the COG savings in our original plan that we articulated kind of two years ago. So, we do think there is some smaller incremental improvement that's still to come next year. So, while there will be – kind of we wouldn't factor in these one-time benefits that we saw this year, there will be a bit of a setback, but there will be smaller, not like what you've seen kind of in the last two years in terms of gross margin improvements, but there is still some opportunity for a little bit more improvement.

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

Good. And then, you've been tightening the belt for some time now. It sounds like some planned areas of reinvestment and you spoke to some of those. Is there additional savings, wraparound savings into fiscal 2020 that can be an offset for some of that reinvestment?

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

Again, the way we're looking at it and we haven't given guidance, but we think, as Dave mentioned, there is more top line growth. We think through kind of disciplined management of SG&A that we can achieve leverage. It doesn't necessarily mean, it's going down, but there can be some offsetting savings as we look out to next year.

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

Q

Okay, great. And then last one for me. Just updated thoughts on objective retail footprint, given what you saw coming out of the key selling season.

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

A

Yeah.

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

A

Yeah. We're continuing to make progress on operationalizing our fleet and improving store performance both on – more so on improving the operating contribution of that fleet and the teams have made great progress there. We've been doing a lot of renegotiating of leases when leases come up and that has allowed us to keep some stores open when we may have had them on the closure list. So, it's one of the things we're continuing to evaluate.

Part of that optimization is continuing to optimize labor, elevating the presentation and storytelling in store, getting new categories to activate such as men's and lifestyle, improving merchandising and renegotiating leases. So, we're moving away from setting a target of stores out there, but I think the goal is to make sure that the overall fleet is hitting our internal operating margin metrics that we've established and the teams are making good progress on that and it's something we're going to continue to evaluate as part of our overall strategy.

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

Q

Very good. Thank you, guys.

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

A

Yeah. Thanks, Jim.

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

A

Thanks, Jim.

Operator: And our next questioner today will be Chris Svezia with Wedbush. Please go ahead.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Good afternoon, gentlemen, and congratulation as well on a really great quarter.

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

A

Thanks, Chris.

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

A

Thanks, Chris.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

I just want to – just on the UGG brand, if I have this correct, so flat for this year right now is the outlook. But I recall because of the segmentation and some of the strategic alignment and some retail store closings, there was [ph] $50 million (00:48:53) in sales that kind of came out of that brand. So, if we kind of back into it, maybe we'll be up low-single without some of those changes. Is that sort of how we should think about the UGG brand as we sort of move forward the ability to generate low-single-digit growth or any color about any changes to segmentation strategies as we go into the next fiscal year that we should be mindful about?

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

A

Well, I think I'll speak to the changes in strategy, I would say no, I think we're going to continue to build on those strategies. I think the allocation and the hold back of Classics in the channel has proved to be healthy and created some demand across the brand in the marketplace. I think the segmentation, this is really the first full year where we've seen true product created specifically for accounts aiming younger consumer. That's played out really well. So, we're going to continue to build on that. And I think some of those new categories will start to be meaningful and help us get to that low-single-digit growth over time, while still maintaining a tight control of the core Classics business.

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

A

Yeah. And I think Chris just to add on that, what we've talked about it really is kind of execution on everything we've been talking about kind of especially the last year and kind of two years' figure. What we intended and I think what we successfully executed was really a strong allocation on segmentation strategy this year, and the idea was it was going to put some pressure on growth for UGG. We knew that. That's kind of the way we laid it out. The quarter had played out a little bit better, but with that strategy in place, what it did do was build sales in other categories, as Dave mentioned. And so, now going forward, we are building off that base. So, you're going to start to see that growth kind of coming next year.

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

A

Yeah. And I also think that the success of UGG Men's in the quarter is a great indicator of some of the opportunity going forward as well. That has reached contribution of 15% of the total brand sales now, up from 13% last year. We still think there is significant opportunity in men's in with new consumer and in global distribution, and that's what we're going to continue to focus on to bolster the total line of the UGG brand as well.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. That's helpful. Thanks. And then just, Dave, I want to go back to your comments about some of these one-time benefit this year breaking from sort of the full-price sales, reduced uses of airfreight, et cetera, and just a comment about potentially lower operating margin. Is it fair to say that you would potentially consider reinvesting some of the operating margin benefit that you've seen, which has outperformed, back into the business, whether it's marketing, things of that nature or how should we interpret that comment? If you can give any color.

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

Yeah, absolutely.

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

Absolutely.

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

That's exactly the way we're looking at it. And I think again, this quarter somewhat demonstrates the opportunity that we have, not only with UGG and kind of the success that we saw on those areas, but again with HOKA and Koolaburra. And so, we do intend to use some of those dollars of over-performance to reinvest in the business to drive some of these growth drivers that we have.

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

Yeah. I think it's our responsibility to do that going forward for the long-term health of the brand and the business with sustainable healthy growth. We've proven that we have growth drivers and opportunities in HOKA and UGG Men's and noncore category products in Women's. Spring and summer continues to be an opportunity for us. We had a great meeting earlier this week about segmenting our marketing spend going forward differently by quarter and allocating against different categories globally. And I think with the additional marketing efforts targeted against the right consumer, there we can just continue to drive growth in the UGG brand. And in addition to that, I think we have some investments to make in IT and digital marketing. And so, we're going to balance the spend and the operating margin improvements over the next three to five years to be focused on healthy sustainable growth by returning good value back to shareholders and we think we're in a great position to start doing that.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Okay, sounds good. I appreciate it, and all the best.

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

Okay. Thanks, Chris.

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

Thank you.

Operator: And the next questioner today will be Mitch Kummetz with Pivotal Research. Please go ahead. I apologize. It is Laurent Vasilescu with Macquarie. Please go ahead.

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Q

Hello. Good afternoon. Thanks for taking my questions. Thank you for all the color on the revenue shift between 4Q and 3Q. I'm just curious, any thoughts on how should we think about the international versus U.S. revenue change for the fourth quarter? Should we assume the international was down mid-teens while the U.S. is flattish?

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

A

Yeah. I think the – when you say down, you're saying compared to last year, right?

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Q

Correct. Yeah.

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

A

Yeah. So, I think that's a fair way to kind of look at it.

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. Okay, very helpful. And then, on gross margins for the fourth quarter, it's implied to be slightly down if we take the annual guidance. Can you – is that the right way to think about in terms of maybe down 50 bps, and can you maybe talk about the headwinds and tailwinds for the entire fourth quarter?

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

A

Yeah. It's kind of more flattish to last year, and I think the way to look at that was, as we looked at the quarter, we saw a very strong January last year. This year January started out not as strong as the year ago. So, as you recall, there was a little bit of a different weather pattern last year versus this year. Last year, cold late-December carried through January. This year, we had a good colder kind of October-November, but warm December that carried through the beginning of January, and there's a lot of selling in January. So, we've included that really in our guidance of how we're looking at fourth quarter. So, it's not down as much as you said, more flattish to down a little bit, really taking that into consideration.

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. That's very helpful. And then, I wanted to follow-up on airfreight initiatives. I think, obviously, last quarter, there was a benefit. Was there a benefit this quarter? And then, asked in different way, how much do you airfreight as a percentage of your overall business and where do you think that goes over the next year?

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

A

Yeah. We haven't necessarily kind of given that. What we said last quarter, as you recall, we said there was about $6 million of airfreight that we had planned that we didn't use. And so, we think going forward, that won't necessarily always be the case. It's going to kind of depend on how we're bringing product to market, where the orders are, how quickly we need to bring product in. Clearly, we have gotten better, and we think there will be improvements from where we were a year ago. We think this year was an extremely clean year and will be a little bit conservative, because you know there's going to be certain styles, especially as we move beyond kind of the core Classics that there's going to be a need to bring product in quickly to the market. So, we'll be anticipating some of that.

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

A

Yeah. I think that's the right way to think about it. In the past, we've had to use airfreight to compensate for poor planning, our inventory management. I think we've addressed all that. And going forward, we're going to use it more strategically to chase businesses with fast-tracking product and getting after opportunities that arise in the quarter.

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Q

Okay, very helpful. Thank you very much and best of luck.

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

A

Thank you.

Operator: And this will conclude our question-and-answer session as well as today's conference call. Thank you all for attending today's presentation and you may now disconnect your lines.