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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for standing by. Welcome to the Deckers Brands Third Quarter Fiscal 2020 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 queue up for question. [Operator Instructions] I would like to remind everyone that this conference call is being recorded.

I would now like to turn the conference over to Erinn Kohler, Vice President, Investor Relations and Corporate Planning. Please, go ahead, ma'am.

Erinn Kohler

Senior Director-Investor Relations & Corporate Planning, Deckers Outdoor Corp.

Hello and 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, and earnings per share, 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 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 statements. Please note that throughout this discussion there may be references to certain non-GAAP financial measures for comparable prior year results. These non-GAAP financial measures refer to results before taking into account non-recurring charges that are not believed to be core to our ongoing operating results. Our non-GAAP financial measures are not adjusted for constant currency. While we did not have any non-GAAP financial adjustments for the third quarter of fiscal 2020, a reconciliation between our reported GAAP and non-GAAP results for the prior year can be found in our earnings release that is posted on our website under the Investors tab.

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

David Powers

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

Thanks Erinn. Good afternoon, everyone and thank you for joining us today. I'm proud to announce that our third quarter results exceeded expectations with total company revenue increasing 7% over the last year to $939 million and delivering earnings per share of $7.14. These results represent the largest revenue and earnings quarter in the history of Deckers Brands.

Our record performance was fueled by the strength of sales in our domestic UGG business partially aided by a forward shift in consumer demand, as well as higher than anticipated sales in both our HOKA ONE ONE and Koolaburra brands. We are very pleased that our third quarter results continue to evident success within the key initiatives that we are actively pursuing.

As a reminder, these include fueling HOKA growth, which experienced a 64% increase versus last year, reaching $93 million in a quarterly revenue for the first time. Building the UGG men's business, which increased by 10% over the last year, diversifying the UGG brand's product mix again, reducing reliance on core Classics and fostering emerging brands with Koolaburra growing 94% versus last year and capturing significant incremental market share.

With the diversification of the UGG brand sales mix, an explosive growth of both HOKA and Koolaburra the performance demonstrated in our largest quarter underscores the progress of our organization is making on these focused investments. I'm excited to share more detail on our evolution, so let's get into the brand highlights, starting with the Fashion Lifestyle group.

As a reminder the Fashion Lifestyle group consists of our UGG and Koolaburra brands. For UGG global sales in the quarter grew by 3% versus last year to $781 million, representing the brand's largest quarter in its history. Growth in the quarter for the UGG brand was driven by its domestics business, as US sales increased 8% over the same period last year. This domestic strength is highlighted by increased traction within the new male franchise, including meaningful contribution to the men's business as well as expansions across women's and kids, continued strength in the Fluff franchise and significant gains in the kids footwear business.

We continued to experience success within our UGG wholesale marketplace strategy in the US, driven by segmentation that offers differentiated consumer experiences across the breadth of our accounts and clean inventory in the channel through managed allocations, which has enabled the brand to open select new points of distribution, targeting younger and more fashion-forward consumers.

The strength in our UGG domestic business was partially offset by lower international sales, which experienced a 7% decline versus last year, which was in line with our expectation. While some of the weakness in the European market is related to macroeconomic events, we are in the process of addressing some brand-specific challenges that currently exist.

As we have stated, in our EMEA region, we are in the midst of a multi-year marketplace reset, intended to reignite brand heat, rationalize marketplace inventory, consolidate the account base to feature partners who enhance the UGG brand, and provide a more differentiated experience across consumer touch points.

In addition, the UGG team has begun to shift towards more localized marketing, PR, and digital marketing tools. We also recognized, there are improvements to be made in our Asia Pacific region and we will be taking a similar marketing approach as we work to build brand heat in our APAC region as well.

Taking a look at the UGG brand product offering. We continued to make strides in the diversification of our product line. For UGG men's in the quarter, this is the third consecutive year of double digit growth, aided by investments made to drive awareness and consideration. Men's was prominently featured in both the Neumel marketing campaign, and our holiday marketing campaign that featured the Marley family. As a results of these marketing efforts UGG men's experienced the mid-teens increase in brand consideration among all men and over 50% increase with fashion leading men according to YouGov.

The Neumel franchise continues to be a big driver of our men's success, as both heritage products and new derivative styles introduced during the fall season helped deliver strong results. In particular, the Neumel Zip and Neumel Flex sold through very well in their introductory season. We also executed two successful collaborations during the quarter, with leading lifestyle brand Heron Preston and BAIT. Both collaborations rapidly sold out of their respective pinnacle product offerings. As a result of the brand's increased focus on men's messaging, products seeding with global influencers and digital marketing efforts, UGG men's experienced a near 30% increase in 18 to 34-year-old consumer purchasing on ugg.com. The UGG product team has done a great job, building a franchise around the Neumel to complement the men's offer.

Turning to our UGG women's business, we entered the holiday season with a strong setup in the US, highlighted by a clean wholesale channel, dedicated allocation, and targeted digital marketing tactics. As a result the women's business performed well domestically based on accelerated momentum with the younger consumers. Similar to men's in the third quarter women's also experienced a near 30% increase in purchases with female consumers aged 18 to 34 years old in the US.

Younger consumers gravitated to both heritage styles, like the Classic Mini and Classic Short as well as newer styles like the Fluff Yeah Slide and while styles like Fluff Yeah were well-received globally, there is still work to be done to generate greater interest in the brand's diversified product offering in our international regions.

Drafting off the success of both women's and men's, our global kids' footwear business grew by 20% versus last year. The kids business benefited from strong partnerships with key wholesale accounts, that are helping to expand consumer touch points and undoubtedly saw a positive impact from our holiday marketing campaign that emphasized the brand's offering for the whole family. The exposure and positive response to the family campaign led to the success of take down styles from women's and men's, including the Fluff Yeah Slide and Neumel.

The brand's results underscore the progress being made towards a more diversified product mix. As at a global level, the brand grew year-over-year with men's increasing as a percentage of brand sales, women's non-Classic increasing as a percent of brand sales, and total women's Classic products, which includes core and derivatives purposefully declining as a percentage of brand sales with the balance of the business, including kids and non-footwear experiencing gains.

Diversifying the UGG brand's revenue composition remains stop of mind and we'll continue to focus on amplifying our heritage styles, while complementing the product offering with exciting new products rich with brand DNA. Overall the UGG brand had an exceptional peak season and I'd like to congratulate the team on a well-executed third quarter.

Turning to Koolaburra, global sales in the third quarter increased by 94% versus the prior year to $39 million, delivering a few million above our guided expectations. This growth was driven by gains in market share within the domestic wholesale marketplace. Additionally this fall Koolaburra introduced the men's and toddlers assortment for the first time and both product lines displayed strong sell-through with our wholesale partners. Congratulations to the entire Koolaburra team on a fantastic quarter of record-breaking revenue. Both UGG and Koolaburra have done an impressive job capturing holiday demand with great products, strong marketing, and a clearly differentiated target consumer.

Shifting to the Performance Lifestyle group, which is comprised of HOKA, Teva and Sanuk, HOKA brand global sales increased by 64% versus last year to a record $93 million. HOKA experienced growth both domestically and internationally across all channels of distribution. The HOKA brand acquired new consumers online through brand discovery, while also seeing a migration of consumer replenishment.

In the third quarter HOKA nearly doubled the number of consumers on hokaoneone.com. The HOKA brand has made great strides in creating a seamless consumer experience through the entire brand ecosystem, which includes a strong network of wholesale partners and direct-to-consumer channels.

At the same time, our marketing efforts are focused on building brand awareness and driving consumer demand by highlighting the experiences made possible by HOKA products. The third quarter featured the launch of the HOKA brand's Time To campaign, which tells real stories of human experiences with HOKA. The campaign kicked off with the Time To Reimagine video, which has garnered significant impressions across social platforms, helping drive more than 50% increase in brand search interest according to Google Trends.

From a product perspective the brand's iconic Clifton and Bondi lifestyles continued gaining market share in the US around the specialty channel. According to NPD's retail tracking service HOKA claimed the number two brand ranking based on dollars over the summer and has maintained this position each month since, while gaining share at a steady pace. While these gains are driven by the HOKA brand's strong partnership with wholesale accounts, the direct-to-consumer business continues to grow at a rapid pace.

For the third consecutive quarter the direct-to-consumer business doubled over the prior year. Helping to drive these gains HOKA has also doubled the number of DTC purchasers aged 18 to 34. This has been aided by the introduction of the Rincon and Carbon X styles as both have over-indexed with the younger consumers as compared to the brand average.

The HOKA products and e-commerce teams have done an impressive job of collaborating to align on product launch timing to ensure the brand is consistently driving traffic to the website. During the quarter, the brand launched an update to its flagship trail running shoes, the Speedgoat 4. The launch propelled the style sales to more than double last year's third quarter volume, with over half the volume coming from international regions.

The HOKA brand is also beginning to experience traction from the trail category beyond the Speedgoat. The Tor Ultra, featured as part of the brand's collaboration with the Lifestyle brand opening ceremony, has sold well across both domestic, direct-to-consumer, and our Asia Pacific wholesale channel.

In terms of the HOKA brand's international business overall, the brand has reached an inflection point as for the first time units sold internationally for the quarter were higher than units sold domestically. We think this speaks well to the global opportunity and runway for HOKA.

Moving to Teva and Sanuk, global sales in the third quarter were in line with expectations at $17 million and $8.5 million respectively. While Teva was down year-over-year due to a shift in the timing of European distributor orders, the brand is now on track to deliver its full fiscal year. During the fourth quarter, Teva will be announcing a significant brand update to coincide with the launch of its Spring 2020 product line.

Meanwhile the Sanuk brand declined, as anticipated in our guidance, as it continued to face headwinds from the challenging [ph] service (00:14:13) specialty channel as well as the brand's decision to exit warehouse distribution. The Sanuk team remains focused on exploring healthier distribution opportunities in an effort to reposition the brand.

With respect to our Q3 channel performance, global wholesale sales increased 9% versus the prior year, driven primarily by domestic expansion in UGG, HOKA and Koolaburra as well as international expansion of HOKA. It is worth noting that for the second consecutive year, our third quarter domestic wholesale revenue grew by double digits.

International wholesale was slightly up versus the prior year due to growth in HOKA being largely offset by the UGG reset in EMEA as well as negative pressure from foreign currency exchange rates.

From a direct-to-consumer perspective, comparable sales increased 5% versus the prior year with total direct-to-consumer sales up 6% versus the third quarter last year.

E-commerce continues to drive gains in the DTC channel, which has been led by the strength of UGG and HOKA. The UGG brand's DTC growth was primarily driven by domestic sales online, which included moving our annual UGG Closet event up by one week compared to last year in order to improve our ability to capture end-of-season demand.

I'm very pleased by the execution of all of our brands to deliver Deckers' largest quarter in history. I'm looking forward to closing out another strong year of performance as we remain focused on delivering the fourth quarter.

I'll now hand the call over to Steve to provide more details on our third quarter financial performance as well as an updated outlook for the fourth quarter and full fiscal year.

Steven J. Fasching

Chief Financial Officer, Deckers Outdoor Corp.

Thanks, Dave, and good afternoon, everyone. As you just heard, our third quarter performance exceeded our expectation and speaks to the strength of our brands. The disciplined approach to investing in our brands has been a major driver of the organization's success this year as we've been able to drive brand awareness with HOKA, build brand heat with UGG, including an emphasis on men's, and an increase in our engagement with consumers in the digital marketplace, all while maintaining top-tier levels of profitability.

I'll now walk you through the third quarter results in more detail and provide an updated outlook for the fourth quarter and our full year fiscal 2020. Revenue was $939 million, up 7.4% versus last year and $39 million above the high end of our guidance range of $885 million to $900 million.

Of the better-than-expected revenue, approximately $8 million was driven by the HOKA brand with tremendous results across the globe with our wholesale partners as well as direct-to-consumer channels. $7 million was delivered by better-than-anticipated domestic UGG business driven by net in-season reorders and led by the strength in kids business, the Neumel franchise and the Fluff franchise, and approximately $3 million driven by reorders captured in the Koolaburra brand.

With the balance of the upside performance, largely timing related, as we captured sales earlier in Q3 that were previously anticipated in Q4 with approximately $15 million coming from the UGG DTC business and $5 million from earlier UGG wholesale shipments. While we saw a growth domestically in the UGG brand beyond our expectations, we continue to see challenges, as anticipated, in the UGG brand's international business, which was impacted by both brand and macro issues in our European region.

Gross margins were up 30 basis points over the last year to 54.1%. The gross margin result was approximately 100 basis points above our implied guidance with the beat coming from lower promotional activity than planned in our UGG domestic wholesale business, delivering strong sell-in and high full price sell-through for a third consecutive year.

While the strength of the UGG domestic wholesale margins paired with increased revenue drove improvement above our expectation, we remain mindful of the dynamic promotional environment we continue to face as we did experience higher promotional activity in our international markets for the UGG brand as compared to last year.

From an expense standpoint, our dollar spend was up 11.8% to $251.9 million compared to last year's GAAP spend of $225.4 million and up 10.6% compared to last year's non-GAAP spend of $227.8 million. As a percentage of sales, expense delevered versus the prior year, which was aligned with our implied guidance as we continue to invest in our key initiatives.

The impact of these results drove earnings per share of $7.14 compared to last year's GAAP earnings per share of $6.68, last year's non-GAAP earnings per share of $6.59, and our guidance range of $6.30 to $6.40. The $0.74 beat to the high-end of our guidance range came from approximately $0.25 from sales in late December previously anticipated for early January, $0.25 from lower promotional activity in the UGG domestic wholesale business, $0.15 from better than expected HOKA results, and $0.10 from higher reorders in the UGG and Koolaburra brands domestic wholesale business.

For the quarter our tax rate was 21.4% compared to our anticipated tax rate of 21%.

Our balance sheet at December 31 remained strong as cash and equivalents were $617 million. Inventory was $366 million, up 7% versus the same point in time last year and we had $6.6 million in short-term borrowings under our credit line as compared to $600,000 last year.

With the delivery of the financial results that I've just shared with you our third quarter execution has allowed us to, once again, raise our expectations for the full fiscal year. As we look forward we place the higher importance behind controlling our distribution in UGG, focusing on growth opportunities within the UGG brand, and fueling HOKA momentum across the globe.

With that said, in our updated outlook for the fourth quarter of fiscal 2020, we expect sales to be in the range of $392 million to $402 million and earnings per share in the range of $0.35 to $0.45.

Fourth quarter revenue guidance compared to last year includes brand expectations of HOKA expected to increase in the high 40% range, Teva expected to increase in the mid-to-high teens inclusive of the planned distributor business shift into Q4, Koolaburra up high teens, Sanuk down approximately 50% due to the previously mentioned exit of the warehouse business in the quarter, and UGG expected to be down approximately 8% to 11% due to ongoing reset and pressure in Europe, the previously mentioned timing shift into Q3, and while it's still early a component of risk related to the potential lower DTC demand related to current travel restrictions in China.

In addition fourth quarter earnings per share guidance is further impacted by planned expense growth as we continue to fuel our growth initiatives and lower gross margins primarily due to the Teva brand's European distributor shift, and continued currency pressure.

Moving to the full year outlook with the over-performance of the quarter, we are now raising our outlook for the full year. For our fiscal year 2020 guidance, we are increasing revenue guidance to now be in the range of $2.15 billion to $2.16 billion, an increase of $20 million on the high-end of our previous guidance range.

Our updated outlook at the brand level includes, UGG revenue still expected to be flat-to-up low single digits, HOKA revenue is now expected to reach approximately $350 million, Teva revenue is still expected to be approximately flat, Sanuk revenue is still expected to be down in the mid 30% range, and Koolaburra revenue is still expected to grow approximately $70 million.

Turning to the remainder of the P&L, we are increasing our gross margin expectation to now be approximately 51.5%, as we are passing through the lower promotional activity experienced in the third quarter and increasing our projection for the fourth quarter. SG&A as a percent of sales are still expected to be slightly below 36%. We are raising our operating margin to now be at or slightly better than 15.5%. And we are raising our expected earnings per share to be in the range of $9.40 to $9.50 on a share count of approximately 28.7 million shares with the full year tax rate still projected to be approximately 20.5%.

Our updated guidance represents flowing through just over 50 basis points of improved operating margin, predominantly driven by the better than expected gross margin experienced in the third quarter. This improved outlook for the fiscal year, which equates to a $0.45 raise in our earnings per share on the high-end of our guidance is driven by $0.25 from a lower promotional environment, $0.15 from the HOKA brand, and $0.05 from an improved outlook on the margins in the fourth quarter.

Our guidance for the fourth quarter and fiscal year 2020 excludes any potential non-GAAP charges, as well as the effect of any future share repurchases.

During our second quarter earnings call in October, we provided an annual update on our sheepskin pricing. Due to current events I would like to remind everyone we expect no change to our sheepskin costs for fiscal 2021. As is our normal course of business, we have contracts in place which are used to mitigate the impact of volatility within such commodity prices. Again please note that sheepskin costs are one component of our gross margins and this update does not constitute gross margin guidance for next year.

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. As we are now in the final quarter of fiscal 2020, we are on track to deliver another year of accelerating top line revenue growth, with our raised full year guidance representing a 6% to 7% increase over the last year. Our results continue to demonstrate that our strategies are working and are at the foundation of our organization's continued evolution. This groundwork will enable us to approach opportunities ahead with confidence and I look forward to updating you our next year's plans during our year-end earnings call in May.

In closing I'd like to share my appreciation for the collaborative efforts demonstrated by the entire Deckers organization and delivering our largest quarter in history. Thank you to all of our stakeholders for their continued support.

With that we are now ready for Q&A. Operator?

QUESTION AND ANSWER SECTION

Operator: We will now begin the question and answer session. [Operator Instructions] Please limit yourselves to one question and to one follow-up. [Operator Instructions] And our first question will come from Jonathan Komp with Baird. Please go ahead.

Jonathan Robert Komp

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Hi, thank you. I just wanted to start maybe on the margin performance and maybe a broader question about the environment during the holiday. I mean, it didn't particularly look like weather was helpful, but yet UGG outperformed and the margin was strong. And so maybe just starting with why you think the margin exceeded your expectations? And then, how to think about the fourth quarter, especially given the tough gross margin comparison there?

David Powers

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

A

Yeah. Hey, Jon, this is Dave. I'll give you some context and I'll let Steve get into the specifics on that. But I think if you go back to the way the UGG team has been managing the brand and the marketplace with clean distribution, quality distribution, and the diversification of product away from Classics. And we've said this before, we believe we're becoming less weather-reliant. That said, we did have pockets of upside based on weather throughout the quarter. But just I think what we've seen is the diversification of the product and how we're engaging with the consumers to drive that beyond just weather-related products that we've had to struggle with in the past, and are also seeing healthy margins, because full price sell-throughs were strong. Particularly in North American market, we didn't chase top line, but promotional activity and you're seeing some of that carry over into Q4.

So while the marketplace was challenged and department stores struggled in places, the strength of the brand, the diversification of the product, and then just focusing on full price quality sales for the health of the brand short and long term versus chasing the top line, those all contributed to it. We started off January a little bit soft in the North American wholesale channel and DTC as well, just based on consumer trends. But we've held clear on not promoting the brand at the expense of top line, and are seeing that in the results.

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

A

Yeah, Jon. So, this is Steve. As Dave said, I think what we saw was compelling product in the marketplace. We did have a nice setup, so that definitely helped. Having clean marketplace also helped. So, going into the quarter cleaner in the wholesale channel was a good setup for us. And then, we did have a nice start into the quarter. So from what we implied in our guidance, what we had in our guidance, we did better on the promotion side. That was largely driven in the domestic component of the business. We did have some promotion related to the international. But from what we were thinking would happen, we did – it was about 60 to 80 basis point, probably a little bit better in the quarter than what we had thought related to the promotion. And then, just a note on Q4, with kind of a strong clean sell-through, we've increased our margin on Q4, so we removed some of that conservative promotional that we had factored into Q4.

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

A

Yeah. And then the last thing on Q3 is it was also helped by the strength of UGG men's at 10% growth as well as kids augmenting some of the diversification efforts.

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

Q

Great. And then maybe just looking forward for the UGG brand, I guess, two questions. One, just when you look at some of the non-cold weather, seasonal categories so that sneakers and sandals of men's, some of the other categories, maybe just highlight some of the drivers you have coming up for UGG there. And then, just separately, the Europe reset, maybe any kind of status update on kind of where you think you are versus how long do you think the reset actions may still be ongoing?

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

A

Yeah, as we mentioned in the script, there is a couple franchises that are merging within the UGG brand, that are really resonating within younger consumer and providing what we think is healthy long-term opportunity. And the first is the Neumel franchise. We've been building that in the men's business over the last couple of years and we had a major campaign called Neumel Nation this fall, which helped tremendously to drive that business as well as iterations in men's.

We've also expanded that now into women's, and it's become a top lifestyle in the women's business and into kids. So it's resonating with a younger, more diverse consumer and that's creating some excitement in the brand, and that's a franchise that we'll definitely continue to build on, both domestically and internationally.

The other one, which we've talked a lot about this year, is the Fluff franchise and that showed continued strength this past quarter. It's a big part of our focus going into Q4 and Q1 of next year. We have a lot of innovation in the pipeline that we think is going to be really exciting in expanding that franchise beyond just the current use occasion and also eventually getting some traction in the men's business as well. We actually had a lot of demand from our male consumer for Fluff Yeah products and expanding that into kids as well. So, those would be the two lead franchises.

In addition to that, we are going aggressively after the sneaker opportunity as we have been in key markets. We just had an exciting launch in Paris just recently with the Japanese retail partner and it's really continuing to ignite some excitement for the brand at the high-end PR level and with exciting collaborations and influencers.

With regards to EMEA, we've talked about this for a couple of quarters now. We're in the midst of a multi-year reset there. I'd say we're probably just getting through year one of that reset. It's very similar to what we went through with the US three or four years ago, cleaning up inventory, cleaning up distribution, focusing on controlling full price sell-through, the Classics. It's a little more challenging there, because we can't influence prices in the market like we can in the US, but we're working through that. There is also some macro issues happening in the UK, particularly in the Europe business right now with the retail and then Brexit, et cetera.

So, we're taking it slow. We're looking at this from a long-term perspective, controlling the marketplace. And as I said, we're not chasing discounting to keep the top line going. And so, that's what's great about the strength in domestic businesses, we can afford to make some of those resets in EMEA for the health of the long-term and we'll continue to focus on elevating that and maintaining the strength of the Classics business through the next couple of years.

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

Okay, that's great. Appreciate all the thoughts.

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

You bet.

Operator: Our next question will come from Tom Nikic with Wells Fargo. Please go ahead.

Matthew Gulmi Q
Analyst, Wells Fargo Securities LLC

Yeah, good afternoon, guys. This is Matt Gulmi on for Tom. Congrats on good quarter. Just couple of questions here, first on UGGs, how do inventories look at retail coming out of the holidays? And then, another strong quarter for HOKA, just wondering at what point you guys think about expanding distribution of the brand and then one follow-up on margins.

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

Okay, this is Steve, I'll take the UGG in the channel inventory, still good, it's up a little bit from where we were a year ago, but comfortable with the levels really that we're seeing. And the feedback that we've gotten really good and strong sell-through in Q3. So I think we feel good about where the inventory sit coming out of the quarter.

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

With regards to HOKA, this is an exciting story, not only for Deckers, but also for marketplace internationally. And as we've said in the call, in the script, we had success in the quarter in all regions, in all channels. The momentum of the brand is exceptional and we think things are going to continue to accelerate.

From a distribution standpoint I think one of the things that is working very well is to take control on distribution. So we don't have really broad-based distribution expansion plan in the short-term. We are exploring a couple of smaller options that we'll test in the short-term, but really, really, really focused on maintaining our positioning and taking more share around specialty channel globally, enhancing our outdoor distribution, REI is a critical and key partner of ours and we're having great success with them and others. And that playbook is being implemented also in Europe and our APAC regions, and then really driving replenishment and new acquisition opportunities to our own e-commerce site and the growth in that channel as you're seeing the business, but also in the margin, is very strong as well.

So we're going to continue down this path. We're calling it the HOKA ecosystem, where we showcase the brand and a tight elevated distribution at wholesale and drive additional purchases to our website and we're going to stay the course on that for a while.

Matthew Gulmi
Analyst, Wells Fargo Securities LLC
Q

That's very helpful, thanks. And then just last one on margins, there has been a lot of SG&A spend this year relative to recent memory, should we think of this year as peak investment year or how should we think about that?

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

Yeah, I think I'll take this one and Dave can jump in. I think one of the things that we have seen especially with a lot of the work that we've done, we have taken – as part of our profit improvement plan, we have taken a lot of expense out. As we're rebuilding brand heat, as we're moving into some of the new initiatives, we are investing in those initiatives and that's where you're seeing the increase in the current year and it's delivering results.

So we think the spend is appropriate this year. We'll give guidance on kind of how we're looking at next year, but we are investing more in marketing. So we're increasing that variable component of our spend and it's something that we're going to be able to watch closely, but it's an important part with the brands growing as rapidly as they are, that we continue to fuel that through marketing investment.

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

Yeah. And I would say overall we have an excellent handle on the SG&A across the organization and teams have done an incredible job of making sure we are tight in areas that we can leverage, but also identifying our key growth drivers across the organization which we've talked about in HOKA and UGG men's ultimately getting to apparel, Koolaburra.

And I think we're just in a unique position where we've right-sized the organization, we've very healthy mid-teen operating margins and we're allowed the opportunity to further invest in the growth of these brands, which we need to do. It's a very competitive environment. We're fighting for share in all of our channels. We have some challenges in EMEA that we need to work through and Steve and I and the teams are managing it very tightly. Shifting expenses from fixed to variable and being able to adjust based on the growth of the brands and the results we're seeing in revenue, but also the return on marketing spend.

So we're very happy with how things are going there. We're confident that we're making investments in the right places and we're seeing those returns and as long as that's the case, we're going to continue to fuel it.

Matthew Gulmi
Analyst, Wells Fargo Securities LLC

Q

Helpful, thanks guys. Congrats on the quarter.

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

A

Right, thanks.

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

A

Thanks, Matt.

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

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Good afternoon, everyone and congratulations on the results. As you think about the same-store sales that you generated this quarter, what were the components and complexion of the comps that were delivered? And lastly on the European business, what is your timeframe for the Europe business and what should we look at in terms of stepping stones to show the progress going forward? Thank you.

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

A

Okay, I'll take the first one, Dana. So our DTC comp was up 4.7% as you know we don't break out retail and e-comm, but clearly e-comm performed very strongly. I think retail for the most part was kind of within our expectations, but down. And so, it's something that we're constantly looking at. It's something that we've talked about really for the last couple of years of how we're shaping our fleet and how we're improving performance. So, something that we're going to continue to monitor.

Clearly retail plays an important strategic element in how we go to market, and so that's going to be a continued area that we're going to look at, and it's something that we are working on and improving in some of the stores that have been underperforming. And for those that have underperformed, we've closed. So, that's something that we'll continue to monitor and work as we progress along.

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

A

Yeah, and with regards to the European business and just to clarify that is an UGG specific challenge that we're having in the EMEA region. I would say Dana, we're coming out of a year one of a three year reset. Obviously some declines that we had planned for and some challenges that I've mentioned, but I would expect to see really the real indicator of brand consideration in that marketplace, we track that on a regular basis and we'll do our best to keep everyone updated through our quarterly calls.

We have a lot of internal conversations around marketing. We're using local influencers versus global influencers. We're ramping up our digital marketing tools in that region to really drive excitement and brand consideration. And then I would say probably in FY 2021 you'll start to see the business level out with return to growth in FY 2022 at this point.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Thank you.

Operator: Our next question will come from Sam Poser with Susquehanna. Please go ahead.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Good afternoon. Thank you for taking my question. Can we talk a little bit about China and the consumer and what you're seeing initially with coronavirus as well as I know you don't have a lot of production there now, but also what you're seeing with the timing of production out of China as well?

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

A

Yeah. So I'll start with that and Dave can jump in. I think as we said we do have a factor in there a little bit on more of the demand side. From a supply side most of our product is coming out of Vietnam. So we haven't seen at this point any disruption from a supply side issue. As I said we have put in an element around the demand related to China and restrictions in China, as I also said it's still very early. So it's really hard to know where this is going to go and how it's going to end up, but at this point, with the majority of our supply coming out of Vietnam from a supply issue we're in good shape. But we'll see how things develop.

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

A

Yeah. I don't really have much more to add on to that. I think it's kind of wait-and-see, not just for us, in the marketplace what this does to the global Chinese consumer and impacts in other regions and the retail business as a result of that. We do have teams in Shanghai, we have team in Guangzhou, they are challenged but it seems that the rest of the business right now we think we've got quantified. There may be a little bit impact on internal kind of development work over next few months, but we don't see that as significant impact to the business going forward, but we're obviously going to continue to monitor it closely and also keeping a close eye on the health and well-being of our teams.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

And then secondly in regards to HOKA, what percent of that business is – well, I've a couple of questions there, what percent is domestic versus international and then is that – the entire DTC is digital, is that correct?

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

A

DTC is all digital at this point, yes, correct. Going back to the mix, Steve.

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

A

Yeah. On the HOKA breakout we haven't given specific numbers, but from a dollar perspective, I think, it's – we're about two-thirds, a little less on domestic and one third kind of international.

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

A

Yeah. And as we also mentioned, this is the first time that we saw our unit sales in the Europe or the international business eclipsed that in the US. And so keep in mind there it's largely much bigger portion of wholesale business than a large distributor business. So the average price on a product there is lower because of that, but we're excited about the unit growth, which means more shoes on more feet across the globe, which means adoption is increasing, it just gives us more excitement around the opportunity internationally.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

And when would you take – I mean when would you go to a JV and subsidiary there, and how – at what scale do you need to think about flipping it out of the distributor model and into a subsidiary or a JV model.

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

A

Yeah. Nothing to share there right now. We are continuing to evaluate opportunities for that long-term in all regions. And so right now we are staying the course and building brand health in our subsidiary market, supporting the distributors. We have actually done that with our Canadian market. So this will be the first year in FY 2021 that is fully owned by and run by us. We did that in Japan about three or four years ago and it's proved very successful. So it's something we are considering as we look at the long-term strategic outlook of this and making sure that operationally we are ready to do that if we get to that point.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

All right. Thanks very much and continue the success.

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

A

Okay. Thank you, Sam.

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

A

Thank you, Sam.

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

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hi, this is Peter McGoldrick on for Jim. Thanks for taking my question. I was first interested as HOKA continues to deliver upside to the plan, where are you seeing the increases in brand recognition? And then further, could you speak to the brand marketing and product strategy as you look to recruit younger consumers and has this evolved at all as you've grown with scale?

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

A

Yeah. I think to answer the question, two areas that we are seeing work well is new product introduction, so the Carbon X and the Rincon. Those are resonating with the younger consumer, consumers who want to go faster, but still want the overall benefits from the cushion experience that HOKA provides. So we're going to continue to do that. We're going to continue the formula where we're using real consumer experiences in HOKA product to tell that. So leveraging the Time To campaign, making sure that we're reaching diverse consumers as we have been and really cultivating younger consumers through some of the efforts that the field marketing reps are doing across the region, continuing to show up in the right events globally, staying authentic to the channel, continuing to innovate at a fast pace

And what's great now about the breadth of brand is it is being adopted by a large diverse consumer across the board and we are seeing growth and excitement and penetration into the younger consumer. So, we're just going to continue to cultivate that and you'll see that in increased marketing spend and the approach that we're taking. And the product pipeline, we'll continue to build on the successes that we've had in our core franchises of Bondi, Clifton and Speedgoat. The Carbon X product is going to continue to evolve and we're looking at great opportunities to expand that across the board. And we're very pleased with the introduction of the Rincon product and see that as a key evolution going forward as well.

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you. Then on the sourcing situation, I know that you're locked in on sheepskin for next year. Given the drought and fire situations in Australia, can you help us think about any risks that you may be considering for fiscal 2022 or the size of any exposure there?

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

A

Yeah. So, normally, we give that update, but I can give you just a little bit of clarity. So, we're covered into 2022. So, we're fully covered for 2021 and we're comfortably covered for 2022. And we'll be able to provide more of an update. But the supply that we have locked in, we feel comfortable with the position that we have really definitely over the next year and well into 2022.

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

A

Yeah. In addition to that, keep in mind that we have been leveraging the development of UGGpure and materials as an alternative to pure sheepskin that's growing as a proportion to the line as we get into more diverse product and more fashionable product and different price points that balances out the demand for pure twin-face sheepskin, and it's also helping margin on retail opportunities as well.

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Then last one with holiday 2019 in the bag, can you give us an update on how big the core Classics franchise is and how much bigger that is than any emerging franchises like Neumel or Fluff or Fluff Yeah.

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

A

Yeah. So, total women's Classics, we've been hovering in the last few years below 50%. We're now trending closer to 40% – just above 40%. So, part of that is on purpose with how we're controlling distribution allocation of the women's classics franchise. And some of that is also bolstered by the fact that you are seeing success in men's and other areas such as the Fluff Yeah. And that strategy is working. We have more progress that we need to make in the international markets. Those are still a little bit more heavily penetrated, some of the – in the core Classics. But as the adoption of the Neumel and the Fluff and other categories increase in those markets and we finish out the segmentation and allocation work, we hope to see the same results in those international markets and being less reliant overall.

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right. Thank you very much.

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

A

Thank you.

Operator: Our next question will come from Paul Lejuez with Citi Research. Please go ahead.

Paul Lejuez
Analyst, Citi Research

Q

Hey, guys. Paul Lejuez. Just curious how you're thinking about the long-term margin in the HOKA business. And how you balance the pace of margin expansion with investments necessary in that business? And also curious on HOKA, what percent of the HOKA business is footwear versus other categories? And how do you see that progressing over the next several years? Thanks.

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

A

I'll answer the second question first and I'll let Steve answer the first one. Currently, HOKA is probably about 99% footwear. And when you look at the long-range opportunity in the brand and we've talked about getting to and beyond the $500 million point, there's a lot of runway still within just footwear.

We're incubating apparels, there's going to be a launch that's coming out in the next quarter, which is a DTC-only launch in the US to see what the appetite is for apparel and test. But the teams are 100% focused on evolving the footwear business, continuing to take market share. But we do see longer term, three to five years down the road, that this can be a much bigger brand beyond just footwear and we think apparel and gear is an opportunity within that as well.

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

A

And then, Paul, the way we're thinking about the margin, it depends on a number of factors. But clearly, on the domestic business where we have opportunity for margin improvement is with migration of more customers online and we have seen that happening, and that's helping drive some upside on the margin. So as we've talked about before, as consumers are introduced to the brand through the wholesale channel, there is a migration online as they get further down into repeat purchases. So, we're continuing to see that trend probably a little bit stronger than what we earlier identified.

And then, to the question earlier that we got, as we look at international markets, the further opportunity there is how we capture sales both from our owned markets and the wholesale distributor markets conversion to online business. So, a lot more opportunity to drive to higher margin business, but we're still growing the brand. So, we're bringing customers in. It's about how we're bringing customers in through all channels. And as they further engage with the brand, our opportunity is how we engage with them online and drive that margin further.

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

Yeah. And the mix of online business, as a percentage of the total, as that increases, obviously the margin gets exponentially better, and we're able to capture that consumer for the long-term lifetime value of that sale. And then, our digital marketing efforts and our return on digital marketing spend against our website is exceptional. So, we're going to continue to fuel that at the pace of the growth that we're seeing.

Paul Lejuez
Analyst, Citi Research
Q

Thanks. Can I just go back to the China question for a second? Can you just remind us what percent of your sales are in China? And I think you didn't indicate any sort of a percentage of your sourcing coming from China. Did you mean to imply that you don't have anything sourced in China at this point? Just curious what that percentage is. Thanks.

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

Yeah, just – right now where we're at with sourcing coming from China is just about 10%, maybe a little bit less, and so we factored that into the – what we've talked about earlier with the risk and then the long range view of the company and margin opportunity.

Paul Lejuez
Analyst, Citi Research
Q

Got it. As percent of sale?

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

10% of, yeah, shipments that are at risk coming out of that market. Anyway, as we know – as you know, the teams have done a fantastic job. I have to give them credit for migrating out of China over the last three years, not only have we quickly migrated to new markets in Vietnam and beyond, but the quality of our product does improve over time and the margins have improved as a result.

Paul Lejuez
Analyst, Citi Research
Q

Got it. And percent of sales in China?

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

A

I don't know if we've given that before.

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

A

Yeah, what we've said specifically to that is one kind of in the current quarter what we've factored in – China is still relatively small, in terms of international markets we've said about half of that's Europe, 40-ish percent of that is APAC. And when you look at APAC, it's now kind of split between China and Japan largely.

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

A

Yeah.

Paul Lejuez
Analyst, Citi Research

Q

Thank you, good luck.

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

A

Okay.

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

A

Thanks, Paul.

Operator: And our next question will come from Mitch Kummetz with Pivotal Research. Please go ahead.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Yes, thanks for taking my questions. Dave I was hoping you could give a little bit more color on the UGG men's business, I think you said it was up 10% in the quarter, what percent of total UGG is men's now? And then it sounded like Neumel was particularly strong. I don't know if you could speak to how much year-over-year growth you saw in Neumel, and then I have a follow-up?

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

A

Yeah. Right now men's it's tracking as we planned it. As you know, we've been talking about this for in the last few years now and migrating men's to a younger, more fashion-oriented consumer with different distribution away from the traditional slipper and classic business. We're now at about 15% of the total penetration. We think the potential there is closer to 20% over time, but it's really being driven by the Neumel franchise and some of the winter boots in that business.

So the Neumel has continued to resonate both at core distribution, but also at new distribution like Foot Locker and Footaction, real strength in Journeys. We've opened up some sport lifestyle distribution in the EMEA market, which is starting to perform well. It hasn't resonated to the same extent in Europe and Asia that it has in the US yet, but it's in early days of introduction to that consumer. So we're leveraging the marketing playbook that has worked well in the US, which is collaborations and high-level influencers and ambassadors for the brand, showing the product in a new and exciting way. We're going to continue down that path, at the same time we're seeing success in derivatives of that. The Harkland boot, which is a little bit slimmer and more appropriate to international consumer, leveraging the boot franchise, which is our leading winter boot and then leveraging existing styles like the Tasman slipper, which is also being worn by younger high school, college age students.

So we feel good about the reach of the consumer and the diversity of the product and the teams are working very fast to iterate as much as we can on these and take advantage of the opportunity. And as I mentioned earlier on, there is also opportunity, we think, in the Fluff franchise to translate that to Neumel consumer as well.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Got it. And then – that's helpful, thanks. And then Steve just really quickly on the Q3 bid, I think you've said that roughly $20 million of the sales upside was timing, $5 million of that was wholesale and I get that. You should be able to see if there are orders pulled forward or not, but then you also said that $15 million was DTC. I just want to have a better sense as to how you can tie – or how you engage the timing of DTC, how do you know that that's timing versus just outperformance in the quarter?

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

A

Good question. So one thing we did this year is we pulled forward our UGG Closet event. So, last year we had it in January. This year we've pulled it into the last week of December and we saw two things. One, we saw it perform, but we saw it perform better than what we expected. And we did see a corresponding low to the start of January. So that was the case where we saw product selling stronger in that last week, where we thought some of that might trickle really into the first part of January.

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

A

Yeah.

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

A

And so capturing that sale late in December and the low, we put the timing as people were buying the product earlier.

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

A

Yeah, because it makes sense.

[indiscernible] (00:56:52)

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Yeah, all right. Thanks, guys, good luck.

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

A

Okay.

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

A

Thanks, Mitch.

Operator: Pardon me, everyone, we will now take the last question of the call from Janine Stichter with Jefferies. Please go ahead.

Janine Stichter
Analyst, Jefferies LLC

Q

Hi, thanks for fitting me in and congratulations.

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

A

Thanks, Janine.

Janine Stichter
Analyst, Jefferies LLC

Q

Just one more on HOKA, so really impressive growth there, is there anything in terms of capacity constraints that would prohibit you from growing at the level that you've been growing in the coming quarters. And then also just one on Koolaburra, it's been a small brand, but obviously it's kind of becoming a little bit more noticeable and how should we think about the potential growth there? And then if you could just help us understand how much of the growth is coming from expanded distribution versus just better sell-through with your existing partners? Thank you?

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

A

Yeah, this is Dave, so on the capacity, it's a great question. And first, I would say, I give the teams a lot of credit, this – the explosive growth is a lot more than we had anticipated or planned for. So, the teams have been able to quickly chase not only production capacity, but materials and be able to keep the flow of inventory in those core products to the extent that we're not really missing sales, but we are capitalizing on the opportunity. And we've had great discussions internally on making sure that we are preparing for continued acceleration of that brand, working closely with our partners. The teams have been over in China within the last month and a half, working closely with our factory partners both on machinery to be able to produce the shoes, but also the capacity and we feel really good about our opportunity to continue this rate of growth.

With regards to Koolaburra, we're very excited about the reaction to the brand by the consumer how they are – how that brand is performing at retail and at the retail prices that the consumers are paying for it. We've had a great obviously initial launch over the last couple of years with Kohl's.

Footwear business is strong, we actually just launched, if you guys haven't noticed this fall we had our home launch with them through our license partner, which was also very successful at Kohl's, we're looking at ways to expand that as well.

We're not really looking to expand distribution for Kohl's, it's really around penetration and existing partners and then there's opportunity to expand the business in Europe. We had a soft launch this fall, things went well, we had some little bit of late deliveries on products, we didn't capitalize in the full opportunity. But it is going to be something that we're going to continue to go after.

And we are looking at this longer term as not just a footwear brand, but really a lifestyle brand and we're incubating business opportunities to be able to capture that now.

Janine Stichter
Analyst, Jefferies LLC

Q

That's helpful. Thank you very much.

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

A

Thank you.

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

A

Thank you.

Operator: This concludes our question-and-answer session as well as our conference. Thank you for attending today's presentation. You may now disconnect.