

28-Oct-2021

# Deckers Outdoor Corp. (DECK)

Q2 2022 Earnings Call

## CORPORATE PARTICIPANTS

### Erinn Kohler

*Vice President-Investor Relations & Corporate Planning, Deckers Outdoor Corp.*

### David Powers

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

### Steven J. Fasching

*Chief Financial Officer, Deckers Outdoor Corp.*

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## OTHER PARTICIPANTS

### Dana Lauren Telsey

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### Jonathan Robert Komp

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

### Camilo Lyon

*Analyst, BTIG LLC*

### Sam Poser

*Analyst, Williams Trading LLC*

### Jim Duffy

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good afternoon and thank you for standing by. Welcome to the Deckers Brands second quarter fiscal 2022 earnings conference call. At this time, all participants are in a listen-only mode. [Operator instructions] I would like to remind everyone that this conference call is being recorded.

I will now turn the call over to Erinn Kohler, Vice President of Investor Relations and Corporate Planning. Please go ahead.

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### Erinn Kohler

*Vice President-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 changes in consumer behavior, strength of our brands and demand for our products, changes to our product allocation, segmentation, and distribution strategies, changes to our marketing plans and strategies, changes to our capital allocation strategies, the impact of the COVID-19 pandemic on our business, our anticipated revenues, brand

performance, product mix, gross margins, expenses, and liquidity position, and our potential repurchase of shares.

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 Factor 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.

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

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## David Powers

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

Thanks, Erinn. Good afternoon, everyone and thank you for joining today's call. Deckers delivered another quarter of strong top line growth, made further progress towards key strategies, and continued investing to support long-term growth opportunities. Second quarter revenue of \$722 million represents an increase of 16% versus the prior year and 33% over the second quarter two years ago. Steve will provide additional second quarter context later in the call, but for now I'd like to highlight the strength of our first half as we build towards delivering an exceptional fiscal year 2022.

Six months into this fiscal year, Deckers has driven revenue growth of 35% over last year and earnings per share of \$5.37 compared to \$3.30 in the previous year. Performance in the first half exemplified the execution of key strategies, as HOKA achieved exceptional global growth, delivering back-to-back quarters above \$200 million, contributing 35% of total revenue, up from 28% last year, and UGG continued to diversify its product portfolio, growing double-digits across men's, kid's, and non-core women's footwear, as well as apparel and accessories, further establishing itself as a globally-relevant lifestyle brand.

The increasing global footprint of HOKA as well as the UGG brand's expansion beyond women's footwear are driving factors of Deckers evolution to a portfolio of powerful lifestyle brands. While we are building towards a bright future, Deckers is not immune to growing pains and global logistics pressures. Like everyone else, we have been experiencing logistics bottlenecks that have led to large volumes of our product in transit as of September 30. We currently view ourselves as less vulnerable than others due to our lower exposure to Southern Vietnam factory production.

Our bottlenecks are largely related to import congestion, which has primarily affected the UGG brand, as the second quarter historically represents peak levels of fall product arriving from overseas factories. While we successfully shifted more UGG shipments into the first half in response to anticipated logistic issues, we experienced significant delays in containers being processed and released at the ports during the second quarter. We are working diligently with our logistics partners to process these shipments and we'll continue to do so.

Steve will provide more details on the global logistical challenges we're experiencing and the actions we've taken to mitigate our risks later in the call. As we navigate through these challenges, we will leverage our omnichannel organization to ensure our brands are getting in front of target consumers with every opportunity to gain a share of closet with a prioritization of high-quality full-price sales.

Moving to the brand highlights, global UGG's second quarter revenue increased 8% versus last year to \$448 million. Performance was driven by the brand's diversified product assortment, reflecting a growing penetration of men's, kid's and non-core women's footwear, as well as growth in apparel and accessories. Direct-to-consumer mix remains well above pre-pandemic levels. However, the second quarter still primarily reflected fall product sell-in to UGG wholesale accounts.

As you may recall, sell-through of UGG product during last year's fall season was robust, which resulted in depleted marketplace inventories. This provided the opportunity for UGG to leverage its marketplace management strategy and reset wholesale inventories with its most diverse product assortment to-date. One of the key drivers of UGG product diversification and acquisition of new and younger consumers has been the brand's Fluff franchise. Fluff has been a leading element of brand diversification in the US over the past few years. The UGG product team has continued to infuse excitement and newness into the franchise with additional fun colors and patterns of the original Fluff Yeah, which remained the DTC acquisition style in Q2, and new outdoor versions such as the Oh Fluffita and Disco Slide. We're excited to see the franchise begin to resonate internationally as well with over 40% of franchise growth being generated outside of the US in the second quarter.

Another area of strength this year has been men's footwear, which increased revenue north of 20% in the second quarter. We've been encouraged by the steady increase in consumer adoption of the men's product line, as we invest to build awareness and consideration among male consumers. Development of the UGG Men's business is most prevalent in the US, where the brand continues to drive record high levels of consideration among 18- to 34-year olds, with popular products such as the Tasman, [indiscernible] (00:07:14) versions of the Scuff, and colorful versions of the Neumel. The Tasman in particular, with its hybrid slipper-sneaker attributes, is evolving into a very popular style, experiencing considerable growth in helping to make UGG a brand for the whole family. During the second quarter, the Tasman was a top five style with newly acquired male and female consumers.

With its increased adoption and relevance among younger consumers, the UGG team introduced a companion style to the Tasman known as the Tazz. As a platform version of the Tasman, the Tazz is already gaining the attention of consumers and was recently pictured on several high-profile models attending New York Fashion Week.

Beyond footwear, the UGG brand is entering its second fall season with its expanded ready-to-wear apparel collection. The team has done a fantastic job designing an apparel assortment featuring cozy fleece, sherpa, faux fur, and shearling wardrobe items at compelling price points that offer value to the UGG consumer.

In support of our commitment to building the lifestyle appeal of UGG, this September the brand launched its first-ever apparel-dedicated marketing campaign an influencer program to drive category awareness. The campaign has already generated over 500 million press impressions, including coverage on Vogue and InStyle.

In addition to the brand's strategic category marketing investments, UGG is expecting to further enhance its apparel and accessories relevance with the second and third product drops of the Telfar collaboration. These upcoming product drops feature hats, hoodies, robes, and other exciting products. These items will be featured online as well as our Selfridges' pop-up shop in the United Kingdom, which speaks to the UGG brand's successful repositioning and increased adoption in Europe as well as greater acceptance of UGG as a head-to-toe brand. UGG is making great headway attracting new consumers in EMEA as just under half of the brand's second quarter online purchases were new to the brand. Key styles driving consumer acquisition in the region were the Classic Mini, Classic Clear, and the Men's Ascot.

Moving on to China, I'm pleased to report that UGG is making excellent progress, as the region posted the highest growth rate across the globe during the second quarter. Beyond significant revenue growth, UGG is experiencing success on a number of fronts in China, including launching a second regional-specific collaboration with designer Feng Chen Wang, which is helping UGG reconnect with the Chinese fashion consumer using a broader and more inclusive community of influencers to create a greater frequency of consumer touchpoints, building the DTC business by driving increased traffic and conversion at stores, and generating consumer excitement with bold new product offerings including key styles such as the Classic Clear, Ultra Mini, and the Oh Fluffita.

Looking towards the second half of fiscal 2020 for UGG, we expect to drive sell-through of the brand's diversified product assortment both with our wholesale partners and through our direct-to-consumer channels. We have confidence in the continued strong demand for the UGG brand and are actively working to mitigate macro supply chain challenges to deliver peak holiday season sales.

Lastly, on the UGG front, you may have seen a recent release that UGG brand president Andrea O'Donnell left the company to pursue a tremendous career opportunity and we wish her the best. Fortunately, we have a strong UGG team in place, which was recently bolstered by the addition of two vice presidents that will be leading the marketing and women's product teams. While we identify a new permanent leader for the brand, I'm excited to be overseeing the talented UGG team and build on their establishment of UGG as a global leading lifestyle brand that creates bold, exciting, and luxurious products for passionate consumers.

Shifting to HOKA, global revenue in the second quarter increased 47% versus last year to \$210 million. The HOKA ecosystem continues to experience exceptionally balanced growth across the brand's global points of distribution and portfolio of products. HOKA has maintained a strategic and thoughtful approach to distribution management. Our goal is to build an audience of consumers through authentic performance-driven product innovation, emotionally connected inclusive marketing, and a premium consumer experience across all the brand's access points. The brand continues its highly selective approach to distribution expansion and remains focused on building market share through avenues that have the resources to educate consumers on the benefits and differentiators of HOKA.

With that in mind and a focus on increasing brand awareness in key markets, HOKA recently opened pop-up retail stores in New York and Los Angeles as well the brand's first owned and operated stores in China. The HOKA retail strategy is in the infancy stage. The brand is testing multiple strategies and learning from our results and feedback to provide the ultimate consumer experience, which currently features community events and workshops designed to bring HOKA consumers together. Though too soon to make any definitive statements on HOKA stores, we have been very pleased with the initial response from a foot traffic, sales, and service perspective. HOKA is already benefiting from Deckers' organizational retail expertise developed in connection with the UGG brand. This wealth of experience is proving valuable in the early days of establishing HOKA store operations and highlighting the synergies gained by operating a portfolio of brands.

Once we land on the optimum consumer experience and concept for HOKA stores, we'll look to open additional locations in China first, to serve that mono brand market, and then begin exploring longer-term opportunities in North America and Europe.

A key piece of our long-term retail strategy is the development of a compelling apparel product line that can provide a broader consumer experience at our HOKA stores. Conversion to apparel purchasing is proving to be more successful in our stores than online, as HOKA has sold a higher percentage of apparel at retail compared to e-commerce since the stores have opened. While we are still very early in developing the HOKA apparel strategy

and product line, we are actively building an exceptional team to support this phenomenal brand's long-term opportunities. So, stay tuned.

On the digital front, HOKA was able to grow its consumer audience through a 97% increase in global acquisition online during the quarter. The brand has been prioritizing digital marketing avenues that target 18- to 34-year old consumers. As a result, HOKA DTC acquisition significantly over-indexes toward these younger consumers. We are pleased to see that the younger consumers are adopting the HOKA brand both through its heritage Clifton and Bondi styles, as well as through newer styles aimed at the demographic, such as the Mach 4 and the Rincon 3.

From an international perspective, DTC remains a much smaller proportion of the business, but HOKA is scaling its DTC mix very quickly, as DTC growth is significantly outpacing wholesale. Considerable gains in consumer acquisition and retention in the UK and Germany, two of the HOKA brand's key focus markets, are driving the exceptional growth rate of EMEA DTC. The EMEA region continues to be the HOKA brand's largest international region. Worldwide, HOKA is gaining momentum, and through the first half of this year, every global region has posted double-digit growth as compared to last year.

I also want to highlight the HOKA brand's recent announcement of a multi-year sponsorship for the UTMB World Series. The Ultra-Trail du Mont-Blanc, or UTMB for short, is the world's ultimate running trail circuit, which includes over 20 events on six continents in 2022.

Sponsoring the UTMB as the premier tactical footwear and apparel partner is a big marketing and promotional opportunity for HOKA. We will leverage this partnership to build awareness of the brand's globally-relevant performance-driven products, a big thank you to the HOKA marketing team for making this sponsorship a reality.

Heading into the final months of 2021, the HOKA team has been reviewing the consumer insights, market research, and product launch calendar for spring 2022 and input cost pressures to determine if there are strategic actions, we can take to navigate this dynamic environment. As we've done with our other brands, HOKA has identified specific products for which there is opportunity to increase price, to better align with competitive offerings, partially offset macro input cost pressures, and maintain the brand's premium positioning and relative margin strength versus peers.

The HOKA team also continues to review planned product launch dates and we'll make strategic adjustments to ensure healthy, full price sell-through of existing and future models, just as the brand has done in the past. HOKA is well-positioned to gain greater market share globally, as the brand expands consumer awareness through strategic marketing activations, including event sponsorships, pop-up retail, digital targeting, and forthcoming brand campaigns. Congratulations to the entire HOKA team on another stellar quarter. We look forward to continued brand execution for the second half of fiscal year 2022 and beyond, as HOKA builds to a multibillion-dollar leader in the performance lifestyle space.

With respect to channel performance in the second quarter, global wholesale revenue increased 21% versus prior year and plus-23% versus two years ago. Wholesale comparisons continue to be unique as we're lapping some disruption in the prior year and currently facing macro logistics pressures and bottlenecks that have altered shipment timing as compared to historical patterns. UGG and HOKA drove wholesale growth as UGG is refilling depleted marketplace inventories while gaining incremental volume in new categories and HOKA continues to gain market share globally.

From a direct-to-consumer standpoint, global revenue increased 3% versus last year and plus-79% versus two years ago. HOKA drove the majority of DTC growth as UGG remained pressured by exceptional demand last year that resulted from pandemic tailwinds benefiting the brand online. While UGG DTC declined as compared to last year, the brand is still plus-37% above pre-pandemic second quarter DTC volume. HOKA DTC increased 81% versus last year, which is on top of the prior year's triple-digit increase, reflecting the brand's consumer acquisition gains and greater repeat purchasing from existing consumers.

Before handing off to Steve, I want to take a moment to recognize our company, brands, and employee's recent activities on the sustainability, ESG, and DEI fronts, which we believe are a positive contributor to our company culture, local communities, and consumer passions for our brand. A few key highlights from our recent achievements include UGG introducing its Icon Impact Collection, which was thoughtfully designed using low-impact materials in combination with offsets to make the collection carbon neutral; Teva launching the ReEmber collection that features 100% recycled ripstop upper material; all of our brands reducing their per-pair emissions in fiscal year 2021 as compared to fiscal year 2020; and our employees around the globe participating in another Art of Kindness Week, during which we collectively donated over 4300 hours, contributing to 317 organizations around the world. A big thanks to our employees for their continued dedication to giving back.

Additionally, I'm excited to announce that our 2021 Corporate Responsibility Report will be released next week. The report contains a great deal of information on Deckers corporate social responsibility journey, including the filing and approval of science-based targets and the setting of robust carbon reduction targets. I'd encourage you all to take a look, as this report highlights the passion and commitment of our company and our employees to do good and do great.

With that, I'll hand the call over to Steve to provide further details on our second quarter financial results, status of the dynamic supply chain challenges the industry is facing, as well as our updated fiscal-year 2022 outlook.

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## Steven J. Fasching

*Chief Financial Officer, Deckers Outdoor Corp.*

Thanks, Dave and good afternoon, everyone. We're excited by the demand our brands continued to exhibit through the first half of this fiscal year. As Dave covered, UGG is setting up the holiday season with its most diverse product assortment to-date and HOKA is delivering exceptionally balanced strong growth and market share gains across regions, channels, and categories. While the supply chain remains a headwind to overcome, the performance of our brands thus far is the result of our team's dedication to executing Deckers long-term strategies as we manage through near-term disruption. The strength of our brand portfolio, our flexible operating model, and robust balance sheet gives us confidence in our ability to successfully navigate the evolving marketplace.

Now, let me get into the second quarter results. Second quarter fiscal 2022 revenue was \$722 million, representing a 16% increase versus last year and a 33% increase versus two years ago. Q2 growth versus last year was driven by our two largest brands. UGG and HOKA, as UGG wholesale increased 19% versus last year, as we shipped more product into the channel, though we did experience pressures from port delays, and HOKA continued to deliver impressive growth across all channels with an increase of 47%.

Gross margins for the second quarter were down 30 basis points versus last year to 50.9%. The decreases compared to last year was related to increased usage of air freight for the UGG and HOKA brands and higher than prior-year proportion of wholesale shipments as we refill marketplace inventories and lap disruption from the prior year. With positive offsets coming from favorable brand mix as HOKA continues to increase as a percentage of total company sales, favorable foreign currency exchange rates, and fewer closeouts at a higher margin rate.

SG&A dollar spend for the quarter was \$239 million, up 25% from last year's \$190 million. Higher spend was primarily driven by greater marketing expense to fuel brand, highlight new categories, and increase localized content, increased compensation costs as we onboard new talent to support our growing organization and higher variable expenses related to increased volume for our warehouse, logistics, and IT.

Our tax rate was 20.1%, which compares to 20.6% last year. This all resulted in diluted earnings per share of \$3.66 for the quarter, which compares to \$3.58 in last year's second quarter. The \$0.08 increase versus last year was primarily driven by revenue growth of the UGG and HOKA brands with offsets from increased SG&A spend primarily related to increased marketing and head count supporting the growth of the business.

Turning to our balance sheet, at September 30, 2021, we ended September with \$746 million of cash and equivalents. Inventory, including units in transit was \$636 million, up 31% from \$484 million at the same time last year, and we had no outstanding borrowings. During the second quarter, we repurchased approximately \$54 million worth of shares at an average price of \$406. That brings the year-to-date total share repurchase as of September 30 to \$136 million at an average share price of \$356.08. And as of September 30, 2021, the company had \$675 million remaining under its stock repurchase authorization.

Before discussing our updated outlook for fiscal year 2022, I'd like to provide some context on the current state of our supply chain, our disruption mitigation efforts, and trends we are seeing. Starting with footwear production, I can confirm that majority of our products are produced in Vietnam. However, due to the location of our factories, which are primarily in Northern Vietnam, as well as the seasonality of our business and strategic product prioritization, we do not expect factory shutdowns that occurred in the second quarter to cause a material negative top line effect on our full-year fiscal 2022 guidance. To put this in perspective, less than 10% of our Vietnam production today is done in the southern region, which experienced shutdowns during the second quarter.

However, our team successfully shifted a material portion of this production to alternative existing partner factories by leveraging our dual-sourcing strategy, which allows us to manufacture same styles in multiple factories. While we were able to nimbly shift production locations, the expected timing of these receipts will be later than we previously planned, though still expected within the current year.

As part of our ongoing sourcing strategy to support the growth of our brands and in an effort to further mitigate impacts into fiscal year 2023, we have secured additional production lines in new geographic locations with our existing partners and have also onboarded new long-term strategic factory partners. In addition, we plan to carry more inventory this year and into next year, as we do not anticipate any near-term resolution to the global supply chain disruption and it will also act as a hedge to inflationary pressures expected in FY-23.

From a logistics standpoint, we are not unique in that we are dealing with significant delays at ports related to not only prolonged processing times for shipped cargo, but also a shortage of trucks, chasses, and drivers. While the challenges at the Port of Los Angeles and Long Beach have been widely reported, the issue is not isolated to those ports, and port constraints have postponed shipments to our warehouses in Q2. In a typical year, roughly 20% of inventory is in transit at the end of September. But this year, with the bottlenecks that we've experienced, approximately 45% of our inventory was in transit. Even with product beginning to move off the water as well as packed and staged at the warehouse, some of our wholesale partners are experiencing labor shortages and logistic constraints in their own operations, which is further hindering our ability to deliver shipments in a timely manner.

Additionally, on the international front, we have experienced numerous start-up challenges during our 3PL distribution center transition in Europe and expect there will be continued pressures as they refine their systems and delivery levels. While the transition has been difficult, especially in light of the challenging global logistics environment, this is a critical investment to create long-term capacity that will facilitate anticipated growth in the UGG and HOKA brands for years to come. We will continue to work closely with our provider to assist with improving throughput as their operations come up to speed.

From a freight expense standpoint, the entire industry continues to face higher costs for ocean containers. In addition, as production and port delays persist on top of delays arising from production shifts in Vietnam, we will continue to utilize elevated levels of air freight, which is considerably more expensive, whenever it is needed to maintain strategic product launches. As Dave mentioned, the HOKA brand is implementing targeted price increases for specific products, which will help partially offset higher air freight costs, but we will still expect there will be some level of gross margin compression. As with the rest of our peers in industry, we're dealing with a number of challenges. But I have the utmost confidence in our employees and their resilience to overcome these hurdles.

With that context in mind, we are adjusting our outlook to reflect these supply-side risks. For the full fiscal year 2022, we are reiterating our expected top line revenue growth of 18% to 20%, which equates to revenue in the range of \$3.01 billion to \$3.06 billion, including expectations of HOKA growing 50-plus percent over last year, with confidence the brand can eclipse \$875 million of revenue; UGG growing high-single digits, reflecting pressure on the prior high end of the range due to shipment disruption; Teva still growing in the high teens range; and Koolaburra and Sanuk expected to be approximately flat to last year.

Gross margin is now expected to be approximately 51.5%, which is lower than our prior guidance due to prior pressures from increasing costs related to ocean containers and greater utilization of air freight as port congestion and trucking scarcity has worsened. SG&A is now expected to be approximately 34% of revenue, reflecting our operating model's agility in this dynamic environment to flex our variable spend with targeted temporary reductions. We anticipate these expense adjustments will help offset further gross margin pressure, allowing us to maintain the prior high end of our operating margin range at 18%. We are lowering the bottom end of the operating margin to 17% to reflect current port congestion conditions that may necessitate more air freight. We still expect a tax rate of approximately 23%.

Taking into account the risk factors I have mentioned, along with the share repurchase executed in the second quarter, we are expanding our earnings per share guidance range for fiscal year 2022 to now be in the range of \$14.15 to \$15.15. While we have tried to incorporate what we know at this point, our full-year guidance does not anticipate any further significant supply chain disruption, excludes one-time charges, and does not contemplate impact from additional share repurchases.

Although supply chain pressures have grown across the entire industry, we remain confident in maintaining our prior top line revenue guidance, as our brands continue to experience exceptional marketplace demand. Actions our teams have taken to preserve this outlook include bringing in greater levels of inventory earlier to mitigate delays and inflationary cost pressures; utilizing our dual-sourcing network to offset factory closures and disruption; adding production capacity and further diversifying our country-level exposure of factories and partners; increasing air freight usage to ensure our brands are opportunistically gaining market share in this competitive environment; strategically evaluating and leveraging our brand's price elasticity; and remaining nimble in responding to new challenges as they arise.

A combination of these efforts has enabled us to maintain the top end of our operating margin outlook, while expanding the range of our earnings guidance to reflect the current challenges of the supply chain environment. Deckers continues to deliver strong growth with excellent levels of profitability and is operating from a position of strength.

Thanks, everyone. I'll now hand the call back to Dave for his final remarks.

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## David Powers

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

Thanks, Steve. The company's performance over the past 6 months highlights the strength of our brand portfolio and value of our operating model. Our largest brands, UGG and HOKA, are delivering compelling growth in the midst of historic levels of supply chain disruption. In spite of this turmoil, the company continues to generate strong cash flow and enables our leadership team to continue making key strategic investments that will contribute to Deckers' long-term growth and success.

Our focus remains to increase global awareness and adoption of HOKA, as we work towards building a powerful multi-billion-dollar performance brand, build the global adoption of UGG across a diverse set of consumers, categories, seasons, and regions, and acquire consumers direct into our ecosystem with the goal of scaling our DTC mix of business to 50% of revenue over time.

We are proud of our employees' continued progress on these key initiatives and appreciate their buy-in to make our collective organizational success a reality. In the last 18-plus months, which are unprecedented in modern history, our employees have proven the value of our collaborative and winning culture. This reflects in both our financial performance, but also in the progress we continue to make on the ESG and DEI fronts. I'm delighted to share that the culture of Deckers is being recognized outside of our organization as well. Earlier this month, Deckers was ranked sixth on Newsweek's list of the 100 Most Loved Workplaces. On behalf of the board and the management team, I'm extremely proud of this distinction, as we continue to live our values by fostering a positive environment that allows employees to come as you are. Recognition like this matters a great deal, especially when we are building our workforce for the future.

For more on our global efforts supporting Deckers culture and values, I would once again encourage everyone to take a look at our 2021 corporate responsibility report that will be released next week. I'd like to thank you all for joining us here today and to thank all of our stakeholders for your continued support. We look forward to sharing Deckers continued bright future with you.

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

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. We will now begin the question-and-answer session. [Operator instructions] At this time, we'll pause momentarily to assemble our roster. Our first question comes from Dana Telsey from Telsey Advisory Group. Please go ahead.

**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*

Q

Good afternoon, everyone and definitely tricky navigating everything. Seems like you're moving through it. As you think about the navigation of these supply chain headwinds and you mentioned the percentage of goods in transit was 45% at the end of September, what does that cadence look like going forward? How do you see that developing? And how much is pressure from the wholesale partners impacting your inventory levels and getting goods? Then I just have a follow-up.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Sure, Dana. This is Steve. And I'll take a first stab at it and then Dave can jump in. I think, in terms of cadence, how we're looking at it is, you as we've said in the script, we're going to be buying more inventory this year, because while we don't know exact timing and we're focused on the year, we do want to make sure that we have goods in place to sell. So, as we see it, our ending position at Q2, we had about the same amount of inventory in the warehouse a year ago, even though we had that 30% increase. So, we're going to continue to process that inventory. There is a bit of a domino effect that the delays are going to impact other inbound inventory. So we're very focused on processing what we can through the port congestion. And we'll supplement it with air freight where appropriate, especially around product launches. And so, we're going to continue to do that.

I think the strategy of buying more inventory early on, at the beginning of this year, was the right strategy, and so, the inventory is not the issue, demand is not the issue, it's just our ability to process inventory, work through port congestion, as we said, trucks and chassis, as well as working with our wholesale customers to get them to pick it up, because they're experiencing similar challenges with arranging trucks and drivers.

So, overall, would have liked to have done more, but we're dealing with what we have. And I think we have a good strategy to approach it.

**David Powers**

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

A

Yeah, I would echo that. And I think, as Steve said, we were proactive in getting ahead of this with increasing our production at the end of last year, going into the beginning of this year, making sure we had plenty of goods to sell, knowing that prices are going to go up and that supply-chain challenges could persist. That's proving to be true. The good news is the inventory is on its way. We have a large number on the water in transit and we feel confident that we'll have the inventory, particularly as it relates to UGG in Q3, in the marketplace going into the peak season, whether that's at wholesale or DTC, we'll be prepared for the busy season of UGG. And then the next piece of that is just preparing for Q4 for UGG, but also really HOKA when this business starts ramping up.

So, it's a day-by-day navigation of when it's going to be here, how it's going to get her, but we have incredible relationships with our factory partners, we have incredible relationships with our wholesale partners, and we're all in this together to get the inventory out to the consumers in the best position as we can.

**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*

Q

Thank you. And then pricing?

**David Powers**

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

A

Your follow-up?

**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*

Q

Yeah, the follow-up was about pricing.

**David Powers**

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

A

Yeah.

**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*

Q

Are you taking...

**David Powers**

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

A

Yeah.

**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*

Q

...price on HOKA and UGG, and if so, how much? How do you see that evolving?

**David Powers**

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

A

Yeah. So, we didn't do a lot of price increases, generally speaking, for this current fall. HOKA has taken prices up surgically, I would say, with their big styles starting in spring introductions. And that's embedded in the guidance. And then for fall 2022, we will be taking prices up for the UGG brand. And I'm confident that based on the strength of the brand and the consumer sentiment in the market, we have the ability to do that. And fortunately, a lot of the inventory that we have coming in the pipeline is on a lower cost basis than it will be next year. So that works to our advantage. But we will be taking price increases going into FY 2023, starting in the fall with UGG.

**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:** Our next question comes from Jonathan Komp from Robert Baird. Please go ahead.

**Jonathan Robert Komp**

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

Q

Yeah. Hi, thank you. First question just on the UGG, the update to the UGG sales guidance for the year and bringing down the top-end, could you maybe just comment how that looks across channels, wholesale versus D2C? And not looking for guidance into the next year, but how long do you expect some of these challenges to continue as we think into next year?

**David Powers**

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

A

Yeah, I'll let Steve answer that. The challenges with UGG, really, it's not a demand challenge at all. We still have very strong demand from our consumer and our wholesale accounts are telling us that they, generally speaking, still wanted the product. So, it's more about the ability for us to get product out of the distribution network due to the bottlenecks in Q2. But the demand is very strong. So, it's just a matter of getting caught up. But Steve, do you have...?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah, I think, Jon, in terms of the guidance and how we're looking at UGG, we shaved a little off of the top end, and I think that has to do, as we said, around the disruption that we're seeing and the port congestion. So, inability to get some product on time we think is going to put some pressure on our ability to sell to that high-end. That's going to be, I think equally felt as we look at it now. The dynamics that we don't know yet is really how the selling season plays out.

So, assuming things improve from where we were at the end of Q2 and we're able to get more product to process through our warehouse, we'll be able to process those wholesale orders. Again, then depending on what happens there, will determine how we handle DTC business. So we could see an increase in our DTC business with improvement in product, but that will be dependent too on how much honestly we ship really in the next kind of month-and-a-half. So, hard to say kind of how the channels work out, but we're going to be prepared that if there is some disruption to shipping in our wholesale customers, we'll pick that up through our DTC channel.

**David Powers**

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

A

Yeah.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

So, we're remaining pretty flexible on that. Hard to say exactly how that plays out. Just a little bit of caution because of the disruption that we've seen. Again, the domino effect of when that's going to and how that's going to play out, but we will be prepared to pick up any of those wholesale sales that may get missed with our own DTC business.

**David Powers**

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

A

Yeah, we saw that last year. When there was scarcity in the marketplace for wholesale, we saw consumers going direct to our DTC channels, mostly our website at the time. Hence the challenge on the comp this year in that channel, but I think, as I said, going into November, December, we have the inventory and we'll be ready, depending on how the consumer wants to shop.

**Jonathan Robert Komp**

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

Q

Okay. That's very helpful. And then one follow-up on gross margin, the full-year outlook, the change, is that all related to freight? And could you maybe further quantify what you are embedding now? And then when we look at the implied second half gross margin, it looks maybe 150 basis points or more below the second half of fiscal 2020.

So, just want to maybe ask how you are thinking about the pricing that you are planning, how that might offset the expected inflation, and what's the right way to think about the baseline for gross margin going forward?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah. Sure, Jon. So, before we guided to just under, I think 53%, we're now about 51.5%. That difference is really increased ocean freight as well as more air freight. And so, if you look at the first half of the year, the first half of the year, a lot of that inventory was transported before we're seeing the increases around ocean freight. So, we're anticipating a much bigger hit in the second half related to ocean freight increases. So, the inventory that's in transit and flowing in now is coming in at a higher freight cost, then also supplementing it with more air freight that we expect to experience in the second half.

So, the price increases that we're implementing with HOKA will help offset, but it's still relatively small in the big scheme of things. So, yes, it's able to help mitigate it to a very small extent, and that less than 150 basis point margin hit on the year that we're now projecting is really ocean freight increases, largely that we expect to experience in the second half as well as some supplemental air freight that we did do and will do more of in the second half.

**David Powers**

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

A

Yeah, we've taken a conservative approach on it. So, could improve, but right now from where we stand today, calling the ball, this is what we think is prudent.

**Jonathan Robert Komp**

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

Q

Okay. And just to clarify, your pricing strategy throughout next year, do you think it's enough to trend more back towards your 2021 levels of gross margin, or should we be thinking back towards 2020 more sort of the baseline going forward?

**David Powers**

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

A

That's the goal, is to get it back. And so, the price increases, discussions that we're having in the UGG brand are pretty broad-based, including some kind of core classics in the mix. Still early days, but that's how we're thinking about it, get back to normalized levels.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah, and I think, Jon, on that, early to tell, right? And it will depend on when we begin to see normalized freight around containers. So, what we're experiencing this year, hopefully we aren't going to necessarily see on an ongoing basis, so that the sooner we can get back to a more normalized level, that will be tailwind on the margin front.

And then, on the air freight, additionally with the extra inventory that we're bringing in this year should provide a tailwind for us. But I want to be a little careful about getting too far ahead of ourselves on how much margin takeback we get next year.

**David Powers**

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

A

Yep.

**Jonathan Robert Komp**

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

Q

Understood, appreciate it. Thanks.

**David Powers**

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

A

Okay.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Thanks, Jon.

**Operator:** The next question comes from Camilo Lyon from BTIG. Please go ahead.

**Camilo Lyon**

*Analyst, BTIG LLC*

Q

Thank you. Good afternoon. Just a clarifying question first on the Q2 revenue number that you reported, it looks from our math that you had about \$75 to \$100 million of that delay in shipments. Is that about the right ballpark to think about in terms of what you experienced from a supply chain transit perspective?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah. I think, again, we're looking at the whole year having given guidance, but if you look at what we were expecting in terms of in-bound inventory that remained in transit, yes, you are right in terms of how much you could probably extrapolate of what we thought we could have turned on that inbound inventory, that got really hung up in transit during the quarter.

**Camilo Lyon**

*Analyst, BTIG LLC*

Q

Okay, great. And then, I guess the question is, it sounds like that's still in transit, that has not shipped out to wholesale, is that the right assumption there?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Correct. So when we say in transit, it means it has not arrived at our warehouse. So, it's in the process. So, either on containers or in the ports or on their way to the warehouse.

**David Powers**

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

A

For the month.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah, for the month, yeah.

**Camilo Lyon**

*Analyst, BTIG LLC*

Q

Yeah. So is it fair to say that that Q2 shift will be absorbed in Q3, or is that still uncertain?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Now, I would say, back to my earlier comment about a domino effect, we won't be able to make all that up. So there is a bit of a trickle down. So, I wouldn't add that mix back into Q3, because we're experiencing a domino effect, and as we're seeing, right, there is a continued backlog at the ports.

**Camilo Lyon**

*Analyst, BTIG LLC*

Q

Yeah, no, definitely. It's pretty pervasive. And I think it's gotten worse with each day that passes. Okay. So, you talked about taking on more inventory and you've said a few different times on the call that you are not concerned about demand trends. Can you just give us an examples of demand signals that you have been seeing probably most importantly at wholesale? And then secondarily, as we think about the comments around taking on more inventory to alleviate any further disruptions, how do you feel about – or what are the discussions, I should say, with your wholesale partners in terms of any cancellations that may have been discussed? And if that inventory does come back, reinstatement of those cancellations, or using your own DTC as the preferred mechanism to satisfy demand as you get deeper and deeper into the holiday season?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Sure, I'll start. And then, I'll let Dave go. I think, again, from a demand perspective, there's more demand out there than we can ship to, right.

**David Powers**

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

Yeah, right.

A

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

And that's the build in inventory that you're seeing and our ability to get product to wholesale customers. As a part of that port congestion and delay, we have had conversations with our customers and said, kind of, here are our new expected dates, do you still want product or not? In most cases, absolutely. They recognize how important both UGG and HOKA are to their businesses. And so, people aren't walking away from orders because they recognize their need to have that product on their shelves.

So, we're working through that with them. If they feel it's too late, we'll take some cancellations. And then that's our opportunity to fulfill those sales through DTC. And we'll take that at a higher margin. So, that's how our approach is.

A

**David Powers**

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

Yeah. And the signals from wholesales continue to be healthy. So, hence, that's why they're saying we want the product as soon as we can get it. We'll work with you. And we're getting creative on how we get product to these accounts, but the sell-throughs are healthy across the board for both brands. And as Steve said, there is more demand than we can fulfill at the moment. But we're confident that they're going to converge coming into the busy season, so we'll have the inventory depending on what channels where the consumer wants to shop.

A

**Camilo Lyon**

*Analyst, BTIG LLC*

That sounds great, especially with the weather forecast being for a non-linear winter and cold and snowy one, so it should be good. Last question, just on that inventory composition...

Q

**David Powers**

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

It will be.

A

**Camilo Lyon**

*Analyst, BTIG LLC*

...that you're taking on a bigger bet on, what are the styles that you are thinking about? Are you taking a bigger bet on just the core classics or is it a broader array of UGG product?

Q

**David Powers**

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

It's some classics, big part of it is product that we can carry over if necessary. So it's not liability product, generally speaking. And then some, obviously, the big seasonal sellers like the Fluff and the Clear, Numel, Tasman, those styles, that's where the meat of the inventory is and heading into spring, some new Fluff introductions, evolving into outdoor sandals. And then in HOKA, it's again driven by Clifton and Bondi, Rincon top five styles that are doing the business. A lot of the initial drops are kind of one and done until they get a new delivery coming in.

A

So, again, it's product that we know the consumers are going to want, when they can get it. And then if we need to carry it little bit over, it sets us up with a bit of a margin tailwind going into next year, because at a lower cost basis and it's product that we know we can sell at a later on in heading into FY23 if necessary.

**Camilo Lyon**

*Analyst, BTIG LLC*

Excellent. Best of luck, guys.

Q

**David Powers**

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

I think the bottom line there, Camilo, is we want the inventory in the country. We don't want it on a transit or in the factory. And so, that's been our stance, and staying aggressive on getting it here.

A

**Camilo Lyon**

*Analyst, BTIG LLC*

This may be the first time I will ever say, get as much inventory as you possibly can.

Q

**David Powers**

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

Exactly. Thanks.

A

**Camilo Lyon**

*Analyst, BTIG LLC*

Good luck, guys.

Q

**David Powers**

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

Thank you.

A

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

Thanks.

A

**Operator:** The next question comes from Sam Poser from Williams. Please, go ahead.

**Sam Poser**

*Analyst, Williams Trading LLC*

Thank you guys for taking my questions. Some of the questions...

Q

**David Powers**

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

Hello.

A

**David Powers**

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

A

...have sort of been answered. So, first of all, before we get started, can you give us the wholesale revenue or the direct-to-consumer revenue by brand, just so I ask it on the call, because I didn't do last time, so...

**David Powers**

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

A

Sure. Erinn.

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

You knew this was coming.

**Erinn Kohler**

*Vice President-Investor Relations & Corporate Planning, Deckers Outdoor Corp.*

A

Hi, Sam. So...

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

Hi.

**Erinn Kohler**

*Vice President-Investor Relations & Corporate Planning, Deckers Outdoor Corp.*

A

...for global wholesale and distributor combined for each of the brands, for UGG, \$349 million; for HOKA, \$147 million; for Teva, \$19 million, for Sanuk, \$7 million, and Others \$23 million.

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

Thank you. And then, I just want to follow up on the inventory, and I concur with Camilo right now, which is shocking. But the question really is what does the inventory look like today? Like, if you took your inventory as of – that was \$636 million. Now, how much of that has actually left the building and what does that number look like today, both from a total and an in-transit? Like if you, just as of today?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah. So, I'm not sure I follow exactly what you're trying to get at, Sam. Let me try to answer and you can follow up.

**David Powers**

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

A

I think he's asking of that inventory that was in transit and sitting in the DCs.

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

Well, no, I mean I'm just saying you have \$636 million less 45% of that's on the water. But today what is your total inventory and how much of that is in transit? So, just exactly the same number, but as of today?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah, I think we'll not give that. I think your question is, is the in-transit that we had at end of September being processed? And the answer is yeah, we are processing some of that. Do we still have a higher proportion of in-transit today than we did a year ago? Yes. There is some improvement. So, clearly, with the seasonality of UGG, this is the time we're bringing in a lot of inventory, right? And that's what got caught up in some of this port congestion. It's going to take a little bit of time to clear that, and we're not seeing the improvements to move through that inventory at the port. That's why you're still hearing about ships lined up outside the Port of Los Angeles and Long Beach. So, we are where we're at in our business cycle and the seasonality of the UGG business, there is improvement. But we still have a ways to go, with in-transit of 45% compared to 20%, there's a lot of inventory to work through. And because we're not unique in this, everybody else is I think battling a similar issue. So, we'll be able to share more later, but hopefully we're going to start to see some improvements. We are seeing some just due to where we're at in line. But there are still some pretty significant congestions in the port.

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

And then one last thing. Just when you think about the \$349 million that you did in – of wholesale in the quarter, could we just – how should we think – I mean, is the \$400 million wholesale number, or in that let's call it [indiscernible] (00:53:05) higher number for Q3, is that a reasonable number to think about, given the movements around and so on? Or is that – could you give us some help there?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah. I think the way you're asking is similar to how Camilo asked his question was given how much inventory we had in transit, had we been able to process that in Q2, would that have driven our UGG number north to a number you're talking about? Yes, we would have. But we'll see what normal cadence is, some of that being us driving that wholesale replenishment in Q2. So that was a bigger number that we're working toward and continuing to work toward. But, yes, to answer your question, could we have done more had we had more inventory, yes.

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

But, no, I'm really talking about Q3. Am I thinking about \$400 million to call it \$420 million, is that a range that is reasonable of – sort of within where you're thinking about your wholesale business for the full year is, am I in the ballpark on that number? Are we – it's a big number. It's an important quarter. We can't really guesstimate DTC, but you sort of know what's where and you sort of know what you're thinking can get through?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah. I mean, I think, yes. Again, potential, we're not giving guidance on the quarter and we're still working through congestion at the port. But yeah,

**David Powers**

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

A

We could do that.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

I mean, we could do that. We could have done that last quarter.

A

**David Powers**

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

Yeah.

A

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

It's all dependent on ability to get inventory in and processed and out to our customers.

A

**Sam Poser**

*Analyst, Williams Trading LLC*

How much have you gotten in and processed in the last three weeks?

Q

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

Well, we haven't gotten into that, but we're processing more. Yeah.

A

**David Powers**

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

All right...

A

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

But again, I mean, it's....

A

**Sam Poser**

*Analyst, Williams Trading LLC*

Yeah. look, I understand. Look, I'm just trying to get my arms around the whole thing. So -...

Q

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

Yeah. And...

A

**Sam Poser**

*Analyst, Williams Trading LLC*

I mean, you definitely have a plenty of ammunition, it's just a matter of getting it through the process.

Q

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

That's right. That's right.

A

**David Powers**

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

A

And we're doing everything we can, and like I said, based on the guidance for the year, we think we can deliver what we said last quarter. And the mix might change between UGG and HOKA little bit, but based on how the trends are continuing, the demand being strong, we feel confident we can deliver the year.

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

Thanks very much and good luck.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Right.

**Sam Poser**

*Analyst, Williams Trading LLC*

Q

Happy holidays.

**David Powers**

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

A

Thanks, Sam.

**Operator:** The next question comes from Jim Duffy from Stifel. Please go ahead.

**Jim Duffy**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Thanks, hello. Thank you for taking my question.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Hey, Jim.

**Jim Duffy**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Hope you guys are hanging in there, doing well. I wanted to start just by asking, you've got a fairly narrow selling window for UGG. What's the risk that UGG product gets delivered too late in that selling window and becomes carryover inventory that's a burden on next year? What can you do to try to prevent that?

**David Powers**

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

A

Well, I think we're doing everything we can to prevent that scenario happening. The good news is we know from what we saw last year, when there was lack of inventory in the wholesale channel, that people came running to our DTC channel. And I think that gives us a lot of confidence. And we're gearing up for that in November-December should that be the case.

If for some reason we can't get all the inventory that we want out into the marketplace to the consumers and there's carryover, we do think that January and February are still going to be strong months for UGG. And I think in a lot of ways Christmas is going to be late this year for people. So I think there will be still an opportunity in Q4 to sell some of that product. But as I said, a lot of this is kind of core carryover product in the UGG brand that we can sell next year. And the benefit of that is that it will be a lower cost basis than any new inventory we start producing today for next year. So, it's a [indiscernible] (00:57:10) plan where we said, hey, we want to get as much inventory as we can in the pipeline. The demand continues to be super strong. We're going to do everything we can to make Q3 and the year with UGG. And if we don't, we have carryover inventory. We're willing to do that so that we have inventory to go into next fall, and as I said, at a better cost basis.

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**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

And just to add on that, Jim. It's a good question. I think couple of things I'll add. One, as Dave kind of said is, as everybody knows, with all the supply chain constraints going on this year that the holiday selling season is probably extended on both ends, right? People are being told buy more early. We're encouraging people to buy more early as well. They'll continue to buy up to the holiday season. And for those areas where people didn't get what they want, we expect that there will be demand in January. So, that's the way we're looking at it. That, to Dave's point, we're happy to fulfill that through DTC. If our wholesale customers want to do that too, we're happy to provide inventory. You can tell by our inventory number, we've got it coming in. We're going to be able to deal with it.

So, I think that's our approach. The other component I think that's important on the inventory is that we're looking at carryover style. So, as we knew we were going to buy more inventory this year, we were careful with the inventory that we selected that we were buying more of, so that if we did have to carry some over, it would be limited in terms of seasonal styles or specific non-carryover styles that we wanted to limit.

So, again, we've been careful. I think it's, again, the right approach in terms of bringing more on to navigate some of the disruption that we're seeing. But that's kind of how we're seeing it play out and then we'll see what happens.

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**Jim Duffy**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Great. Thanks for that. And I wanted to ask you a quick one on HOKA, if I may. What we're hearing from some other players in the athletic category, they are going to be in a position of inventory deficiency in that March quarter, suggesting HOKA has great opportunity for market share gains. How will you think about market share gains and revenue versus margin and the tradeoff from using expedited freight and so forth to capitalize on that opportunity?

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**David Powers**

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

A

Well, I think certainly Q4 for us, our Q4 ending in March, is a big opportunity for HOKA. The order book is strong. Hence, you see our guidance maintaining. We have inventory on the way. We had minimal disruptions due to Vietnam production, but we've been dual-sourcing that. So, the product that's being made, it's just a little bit behind. Our priority is to maintain strength in the marketplace and steal share. And if we have to spend a little money to do that and protect Q4 top line, we think that's the right approach to do both short-term and long-term.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Yeah. And I think, Jim, also on that, we are buying more. We're more confident with HOKA, we're buying more inventory. That is one area that we are willing to spend more on airfreight to expedite that in. So that is absolutely a trend, if we see in Q4, we are going to be prepared to try to capitalize on.

**David Powers**

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

A

Yeah, we're going to continue to stay super aggressive on HOKA. It's a competitive marketplace. You have new commerce coming in including ourselves, that are stealing share from the heritage running brands. It's continuing to have incredible momentum for us. We do see this as a long-term multi-billion-dollar play, and we're not taking this quarter to quarter, but we don't want to miss any opportunity to steal share and get in on the feet of consumers globally.

**Jim Duffy**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Excellent. Thank you, guys. Appreciate you taking my question.

**David Powers**

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

A

Thanks, Jim.

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

Thank you.

**David Powers**

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

A

You bet.

**Operator:** The next question comes from Janine Stichter from Jefferies. Please go ahead.

**Janine Stichter**

*Analyst, Jefferies LLC*

Q

Hi, everyone. Thanks for taking my question. I wanted to shift gears little bit and talk about Europe. It sounds like the adoption there of the Fluff franchise has really picked up. Just curious what inning you think you're in and if you feel like it's following a similar path, the recovery we've seen in the US. And then, secondarily, just wanted to check on sheepskin costs, have you locked those in for next year yet? Thank you.

**David Powers**

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

A

Yeah, good questions. So, yes, we are seeing good momentum in both Europe and in Asia with the Fluff franchise being picked up this year more so than it was last year. So, the trend that started in the US is expanding globally. That's good news for us. And we do think that that franchise is going to continue to be a key part of the

brand going forward, including iterations that are in the pipeline to expand into a little bit more outdoor usage. But that is a new leg of the stool, so to speak for the UGG brand going forward.

As far as Europe goes, it's great that we are seeing that adoption, we're also seeing younger consumers coming into the brand, which is fantastic and we've been working on that for a long time. The unfortunate piece is that this year the demand is going to be higher than the supply, and that challenges the growth opportunity that we were hoping for in the transition and turnaround of that marketplace.

So, it might take a little bit longer before we return to full-time consistent growth. We were hopeful that we could do it this year, but I think some of the bottlenecks are going to slow that down. But it's definitely not because the demand is slow, it's really driven by the port congestion.

---

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

And then, Janine, it's Steve. On the sheepskin, we are not seeing a material increase cost in sheepskin. And I think just one important note to also make is that, as Deckers becomes bigger and bigger and the UGG product is much more diversified and HOKA becomes a bigger part...

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**David Powers**

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

A

Yeah.

---

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

...our dependence on sheepskin is a lot less than where it was historically. So, we're moving away with the proportion of sheepskin make-up of our COGS, but at this point, as we look out at next year, we are not seeing a material increase in our sheepskin cost.

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**David Powers**

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

A

Yeah.

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**Janine Stichter**

*Analyst, Jefferies LLC*

Q

Great. Thank you very much.

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**David Powers**

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

A

You bet.

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**Operator:** Our last question comes from Jay Sole from UBS. Please go ahead.

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**Jay Sole**

*Analyst, UBS Securities LLC*

Q

Great, thanks so much. My question is just about thinking about gross margins for next year, given the comments you just made about sheepskin, given the pricing that you are taking lapping air freight and some of the extra

costs that have been in the P&L this year, does it favorably change the way you are thinking about margins for next year?

**Steven J. Fasching**

*Chief Financial Officer, Deckers Outdoor Corp.*

A

On a normalized basis, no, it doesn't. I think this year we're getting hit with some headwinds. That should not reoccur in future, although we don't know the duration of this yet. So, I think that's going to be a dependent factor that we don't yet know. I would say, removing all the noise of the current year, we're not thinking about margins different. So, in terms of product margins, really no change. Where we have opportunity is increased proportion of our DTC business. And then, I think we'll see how the current situation plays out, and then when rates begin to normalize, and I think we'll then be in a better position to provide some outlook next year.

**David Powers**

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

A

Yeah. And you know what? What I said to the team is don't think of this as a short-term headwind, meaning, the increased costs in the supply chain. This is here to stay. I think it's going to be with us for at least a year or two. It may never go back to normal levels due to wage increases, material increases, shipping costs. So we are planning our business as though those new levels are going to remain.

The good news is, if things improve next year, then we have opportunity. And we're taking price increases to give us the margins that we need going forward despite the cost increase. So, that's how we're thinking about it. Again, we're staying aggressive. And if things start to ease up a bit on pricing, we'll be in better shape. And that's a combination of price increases that we're taking and also having some carryover inventory at a lower margin. And then, we'll be spending less on airfreight and other costs. And we can reinvest back into the business. It's not all going to fall to the bottom line. We're focused on the long-term and investing in our key strategic growth priorities. And so, that's really priority number 1, is talent, capabilities, and awareness for our brands. And then we'll manage through that.

**Jay Sole**

*Analyst, UBS Securities LLC*

Q

Got it, okay. That's super helpful. Thank you so much.

**David Powers**

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

A

Okay. Jay, thanks.

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

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