

Under Armour, Inc. (UA): Buy @ \$50.00

Buy Thesis: We believe Under Armour is one of the Best Growth Companies in the Consumer Discretionary Space with the Potential to Grow Revenue north of 25% y/y this year. Unlike its closest competitor, Under Armour has so far successfully navigated the difficult macro conditions in the North American market in 1H16. Moreover, the company is well positioned for the Growth in Mobile E-commerce and several Growth Catalysts like Athleisure, Women's Apparel (a \$1B business in 2016) and Partnerships with Leading Online Department Stores (Kohl's/JCPenney) could re-accelerate and sustain top-line growth through 2016 to 2017. The stock trades at a premium with a forward P/E of 50.6x which we believe is justified given its high growth rates.

TABLE 1: Under Armour 2Q16 Results

2Q16 Results			3Q16 Guidance			2Q16 Results			3Q16 Guidance		
EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
0.01	0.01	in-line	n/a	0.26	n/a	1.0B	1.0B	in-line	1.2B	1.5B	miss

Source: Under Armour, Inc. and Estimote.com

Under Armour's 2Q16 results disappointed the Street's high expectations as both revenue and EPS were in-line and next-quarter sales guidance came in well below the Street's projections (see Table 1). After eight successive quarters of +25% y/y growth, UA projected next quarter's top-line growth to be at a mere 20%. Moreover, net income fell 58% y/y in 2Q to \$6.0M compared with \$15.0M in the prior-year quarter. Gross margin for 2Q also decreased by 73 bps. to 47.7% compared with 48.4% in the prior-year period.

Weak results and tepid 3Q guidance were likely the result of the bankruptcy by Sports Authority, a major wholesale partner (with 63 stores) of Under Armour. Management reported a \$23M impairment charge against operating income which equaled an EPS loss of (~3 cents) driven by Sports Authority. Furthermore, gross margin was also negatively impacted by the Sports Authority liquidation as UA inventory was sold at a deep discount.

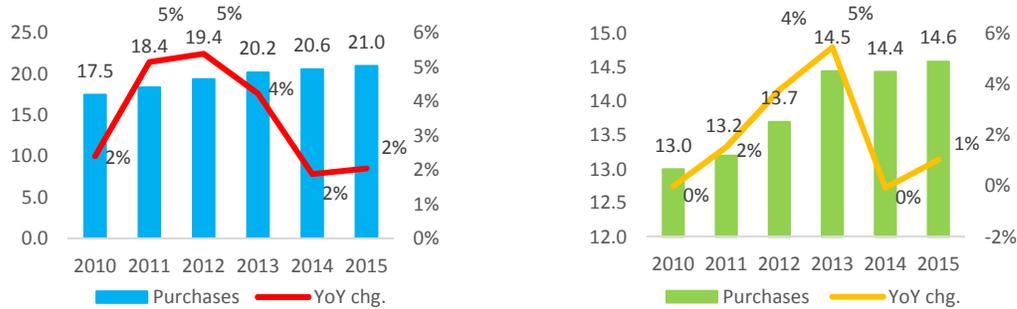
2Q16 Highlights

- Wholesale revenue was up 27% to \$635M, while direct-to-consumer sales were up 28% to \$321M
- Apparel revenue gained 19% to \$613M (Sports Authority liquidations a factor)
- Footwear revenue rose 58% to \$243M, led by the Curry line of basketball shoes
- Accessories sale were up 212% to \$101M
- Global revenue increased 68% during the quarter to represent 15% of total revenue
- Gross margin fell 70 bps to 47.7%, due in part to sales mix; higher SG&A expense was also in the mix
- Full-year guidance: 2016 revenue of \$4.925B and operating income of \$440-445M

I. Under Armour Weathering U.S. Macro Headwinds in 1H16

The U.S. market has seen some headwinds in consumer purchases of both sports footwear and clothing (see Figure 1). Growth in U.S. consumer footwear purchases slowed down markedly from 4% in 2013 to half the growth rate of ~2% in both 2014 and 2015 (see Figure 1 left). Footwear makes up 24% of UA’s total revenue and is one of its fastest growing segments. UA seems to be defying the macro headwinds in footwear purchases. After growing at 57% y/y in 2015, footwear sales have not shown any signs of slowing down, growing at 61% y/y in 1H16.

FIGURE 1: U.S. Consumer Purchases (\$ Billion) of Sports Footwear (left) and Sports Clothing (right)



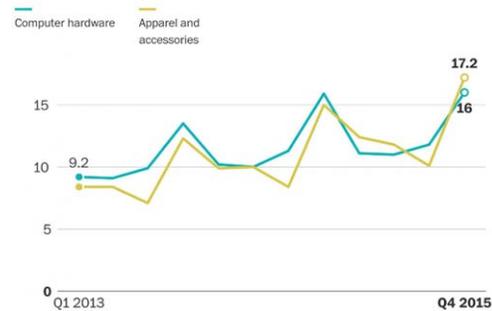
Source: Statista, 2016

U.S. consumer purchases of sports clothing have also been weak. After growing 5% y/y in 2013, sports clothing growth was flat in 2014 and only 1% y/y in 2015. Apparel makes up 61% of UA’s total revenue and its growth has slowed down somewhat in 2016. After growing at a 22% clip in 2015, apparel sales growth decreased to 19.5% y/y in 1H16.

II. Online Sportswear Apparel/Shoes Outperforming E-commerce

We believe that there is a broad secular growth trend in apparel and e-commerce sales that might help sustain Under Armour’s top-line growth momentum for both 2016 and 2017.

FIGURE 2: Digital Commerce Sales by Category (Quarterly, \$ Billion)



Source: ComScore

ComScore analyzed which shopping categories drew the biggest online sales in 2015. Computer hardware, i.e., personal computers and tablets, has been the leader for at least a decade. But last year, for the first time, spending on apparel and accessories took first place in e-commerce sales. In three out of four quarters in 2015, apparel and accessories brought in the most dollars. For the year, clothing generated \$51.5B in online sales, slightly edging out \$51.1B spent on personal computers and tablets (see Figure 2).

This trend is mostly driven by companies such as Amazon (AMZN) and the proliferation of delivery services that facilitate the movement of goods from the warehouse to consumers’ doorsteps as well as the convenience of return, refund and exchange of items. These factors encourage consumers to rely on e-commerce rather than making trips to the shopping malls.

According to *ComScore*, apparel is also among the categories that is benefiting from the explosive growth in smartphone shopping. *ComScore* stated that many of the categories that registered strong increases in online spending last year were those where the purchases were not “highly considered”, meaning that customers did not spend much time researching before buying. Furthermore, these purchases were especially conducive to being made on a small screen. Therefore, as the majority of online shopping is being done on mobile devices, these “non-highly considered” categories are getting a tailwind from the change in consumers’ shopping habits.

III. Growth Catalysts: Athleisure, Women’s Apparel and the Mid-tier Department Store Channel

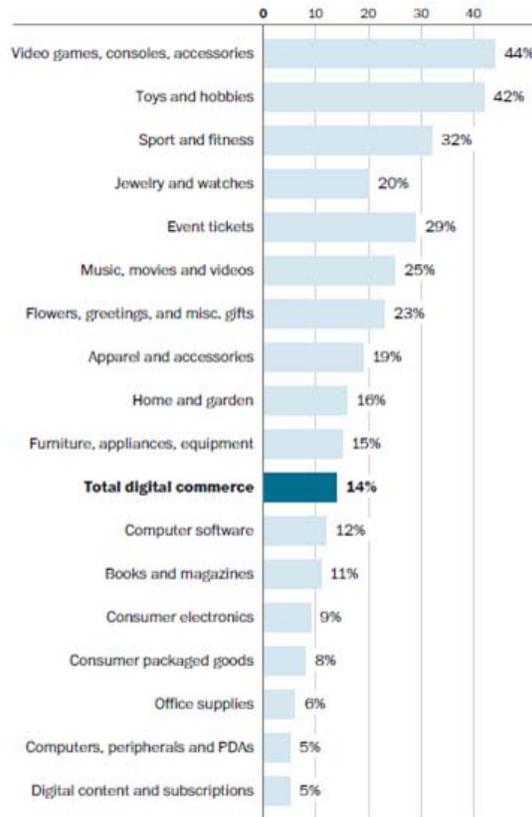
In the 2Q call, Under Armour outlined its growth strategy of increasing its market reach to women shoppers through the Athleisure (athletic + leisure) category as well as developing more wholesale partnerships with mid-tier department stores like Kohl’s Corporation (KSS) and J. C. Penney Company, Inc. (JCP). We believe this strategy makes sense, as the sports and fitness category as well as apparel and accessories have outperformed the growth in digital commerce in 2015.

FIGURE 3: Growth in 2015 Online Retail Sales (Y/Y % Change in Dollars Spent Online, by Category)

Figure 3 shows the categories that grew the fastest and the slowest from online retail sales in 2015. Note the sport and fitness category grew at 32% y/y and apparel and accessories grew at 19% y/y. Both categories outperformed the digital commerce average growth rate of 14% in 2015.

Critical to UA’s growth strategy is the wholesale partnership with mid-tier department stores like Kohl’s which has 1,100 stores across the U.S. In the 2Q call, management announced that in early 2017, UA footwear, apparel and equipment would be available at Kohl’s stores and the Kohls.com website in the Women’s, Men’s, Kids’, accessories and footwear categories.

Kohl’s has been one of the fastest growing online retailers among department stores. It grew its web business by 30% last year to \$2.8B and has been an e-commerce leader with a 5-year CAGR of 29% in web sales. The factors behind its growth in e-retailing last year included a major push behind programs that allow consumers to buy online and pick-up in the store or ship from the store, a strategy that appeals to its shopper base. Moreover, Kohl’s has been successful in building its mobile e-commerce sales.



Source: ComScore

We believe a UA-Kohl’s partnership is a win-win for both sides and has the potential to re-accelerate and sustain UA’s top-line growth momentum for 2017.

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Analyst Certification

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