

Under Armour, Inc. (UAA): Sell @ \$18.00

Sell Thesis: We are downgrading Under Armour from Hold to a Sell and reducing our Price Target from \$22 to \$18. We believe FY2017 will be the Year of Diminished Expectations for UAA as the company tries to navigate the athleisure terrain which runs counter to their core brand image as a peak performance/athletic sport company. We also foresee challenges in implementing an effective product segmentation strategy (premium brand offerings in DTC vs. generic brand offerings in mid-tier retailers) which could likely hurt gross margins in the near term. This is because UAA's product portfolio (apparel and footwear) is not as diverse as Nike or Adidas, for example. Lastly, we believe Adidas and Nike could gradually take both mind share and wallet share from UAA in North America as the popularity of the Curry Basketball franchise continues to fade with no replacement in sight for the near term.

TABLE 1: Under Armour 1Q17 Results

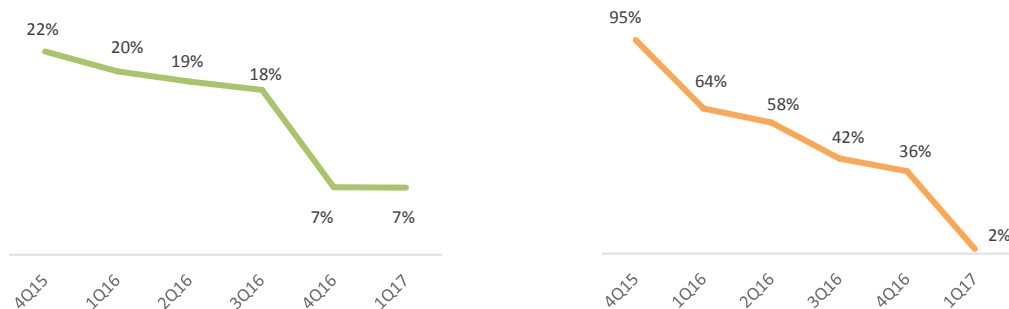
1Q17 Results			2Q17 Guidance			1Q17 Results			2Q17 Guidance		
EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
-0.01	-0.04	beat	n/a	-0.04	n/a	1.12B	1.11B	beat	n/a	1.10B	n/a

Source: Under Armour, Inc. and Estimize.com

I. Apparel Sales Flat and Footwear Sales Sinking

Product category sales remained tepid in 1Q17 pointing to the difficulty Under Armour has in adjusting to the new athleisure terrain. UAA footwear (24% of total revenue) is narrowly focused on the Curry basketball franchise, which has the highest profit margins, while its running footwear closely resembles Skechers' high-performance athletic footwear both in looks and colorways. Moreover, there also seem to be some similarities between UAA's casual lifestyle footwear and Adidas' athleisure footwear.

FIGURE 1: UAA Revenue Growth: Apparel (left) and Footwear (right)



Source: Under Armour, Inc.

We believe the lack of product differentiation in UA’s casual lifestyle footwear offerings has caused overall footwear sales to sink abruptly to 2% y/y growth in 1Q17 from a robust 36% y/y growth in 4Q16 (see Figure 1, right).

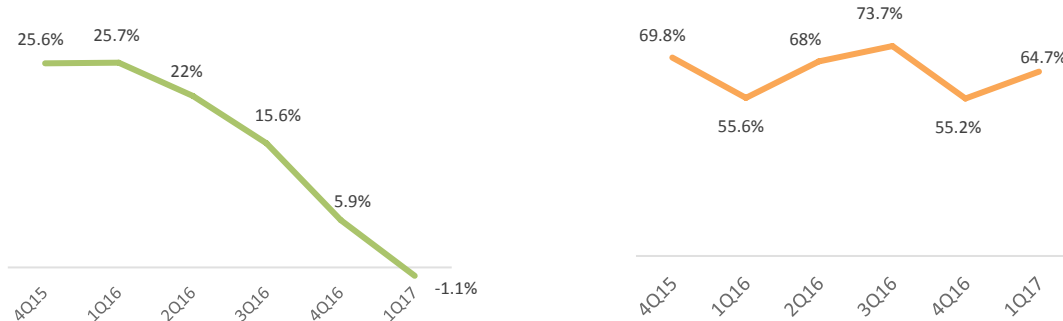
Apparel sales (64% of total revenue) were also tepid at mid-single digit growth in 1Q17, down significantly from a healthy 20% y/y growth in the same period last year (see Figure 1, left). While management blames it on the bankruptcy of The Sports Authority, the launch of generic apparel products at Kohl’s Department Stores was supposed to generate the same amount of shelf space as The Sports Authority. Furthermore, the primary customer base at Kohl’s is the middle-class suburban housewife – ideal for Under Armour which remains underrepresented in the women’s athletic apparel space.

However, Kohl’s is also known for heavy promotional activity and anecdotal evidence showed a price war brewing between Nike and Under Armour as soon as Kohl’s started offering UAA apparel and footwear. Moreover, some data checks by *Piper Jaffray* showed that Nike continued to outsell Under Armour in Kohl’s and that both brands have become heavily promotional. This could explain why apparel sales growth failed to gain traction in 1Q17.

II. North America Sales – UA’s Largest Market – in Negative Territory

North America sales (78% of total revenue) is in negative territory, down by 1.1% y/y in 1Q17, after growing 25.7% y/y in the same period last year (see Figure 2, left). The North American market has become heavily saturated with Nike, Adidas and many other sportswear manufacturers entering the athleisure space. As the competition heats up, product differentiation and brand image becomes key to maintaining premium pricing and profit margins.

FIGURE 2: Revenue Growth: North America (left) and International (right)



Source: Under Armour, Inc.

However, while UAA management talked about investing heavily in supply chain systems and infrastructure in order to bring their product quickly to market, the company clearly has not invested enough from a fashion or style perspective in order to differentiate their footwear and apparel from their competitors. Clearly, UAA footwear is heavily dependent on the *Curry* Basketball franchise to drive footwear sales. While this strategy was effective two years ago, consumer preference has changed much since then.

Product endorsements are also heavily skewed towards sports celebrities and sport teams. UAA can gain a much higher ROI by soliciting endorsements and style/fashion ideas from cultural icons in the fashion

and music industry, just like Adidas did, when its retro sneaker “Stan Smith” was endorsed by multiple fashion designers and Hollywood actors, leading to wide adoption by millennial consumers.

While North America growth has deteriorated, growth in international markets (22% of total revenue) continues to remain robust. In particular, Asia-Pacific (7.7% of total sales) grew at 60% y/y in 1Q17 and EMEA (9.2% of total sales) and Latin America (3.4% of total sales) also grew at 55.2% y/y and 30.5% y/y respectively. We believe Under Armour still has significant runway for additional growth abroad.

Disclosure Information

Analyst Certification

The authors of this report, hereby declare that: (i) all of the views expressed in this report accurately reflect their personal views about any and all of the subject securities or issuers; (ii) no part of any of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report; and (iii) no insider information/non-public price-sensitive information in relation to the subject securities or issuers which may influence the recommendations were being received by the authors.

Disclaimer

By accepting this report (which includes any attachment hereto), the recipient hereof represents and warrants that he is entitled to receive such report in accordance with the restrictions set forth below and agrees to be bound by the limitations contained herein. Any failure to comply with these limitations may constitute a violation of law.

This report is strictly confidential and is for private circulation only to clients of Viola Advisory, LLC. This report is being supplied to you strictly on the basis that it will remain confidential. No part of this report may be (i) copied, photocopied, duplicated, stored or reproduced in any form by any means or (ii) redistributed or passed on, directly or indirectly, to any other person in whole or in part, for any purpose without the prior consent of Viola Advisory, LLC.

Viola Advisory, LLC, its affiliates and related companies, their directors, associates, connected parties and/or employees may own or have positions in securities of the company(ies) covered in this report or any securities related thereto and may from time to time add to or dispose of, or may be interested in, any such securities.

The information contained in this report is prepared from publicly available data and sources believed to be correct and reliable at the time of issue of this report. This report does not purport to contain all the information that a prospective investor may require and may be subject to late delivery, interruption and interception. Viola Advisory, LLC does not make any guarantee, representation or warranty, express or implied, as to the adequacy, accuracy, completeness, reliability or fairness of any such information and opinion contained in this report and accordingly, neither Viola Advisory, LLC nor any of its affiliates nor its related persons shall not be liable in any manner whatsoever for any consequences (including but not limited to any direct, indirect or consequential losses, loss of profits and damages) of any reliance thereon or usage thereof.

This report is general in nature and had been prepared for information purposes only. It is intended for circulation amongst Viola Advisory, LLC's clients generally and does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may receive this report. The information and opinions in this report are not and should not be construed or considered as an offer, recommendation or solicitation to buy or sell the subject securities, related investments or other financial instruments thereof.

The views, recommendations, advice and opinions in this report may not necessarily reflect those of Viola Advisory, LLC or any of its affiliates, and are subject to change without notice. Viola Advisory, LLC has no obligation to update its opinion or the information in this report.

Investors are advised to make their own independent evaluation of the information contained in this research report, consider their own individual investment objectives, financial situation and particular needs and consult their own professional and financial advisors as to the legal, business, financial, tax and other aspects before participating in any transaction in respect of the securities of company(ies) covered in this report. The securities of such company(ies) may not be eligible for sale in all jurisdictions or to all categories of investors.

Risk which may impede the achievement of our Price Target

This report was prepared for general circulation and does not provide investment recommendations specific to individual investors. As such, the financial instruments discussed in this report may not be suitable for all investors and investors must make their own investment decisions based upon their specific investment objectives and financial situation utilizing their own financial advisors as they deem necessary. Past performance of the financial instruments recommended in this report should not be taken as an indication or guarantee of future results. The price, value of, and income from, any of the financial instruments mentioned in this report can rise as well as fall and may be affected by changes in economic, financial and political factors. If a financial instrument is denominated in a currency other than the investor's home currency, a change in exchange rates may adversely affect the price of, value of, or income derived from the financial instrument described in this report. In addition, investors in securities such as ADRs, whose values are affected by the currency of the underlying security, effectively assume currency risk.