

Under Armour, Inc. (UAA): Buy @ \$23.00

Buy Thesis: We are upgrading our Rating from a Sell to a Buy and raising our Price Target from \$18 to \$23. We believe 2H17 will be a transition period for UAA as it transforms from a performance sports apparel/footwear company to a more casual, lifestyle oriented brand. We do not believe current CEO Kevin Plank has the background to execute the transition successfully. However, we do believe newly appointed President/COO and former CEO of the Aldo Group, Patrik Frisk, has the credentials and the vision to transform UAA to a global brand.

Our Back-to-School channel check shows why UAA footwear sales in North America have been underperforming. First, UAA’s brand image mostly appeals to a narrow demographic group – Men and Boys. Second, Basketball still remains the overwhelming favorite category followed by performance running. To regain lost share, UAA has to appeal to a wider audience group – Women and Girls. To capture this demographic segment, UAA needs to broaden its apparel and footwear portfolio to incorporate more casual “streetwear” selections.

TABLE 1: Under Armour 2Q17 Results

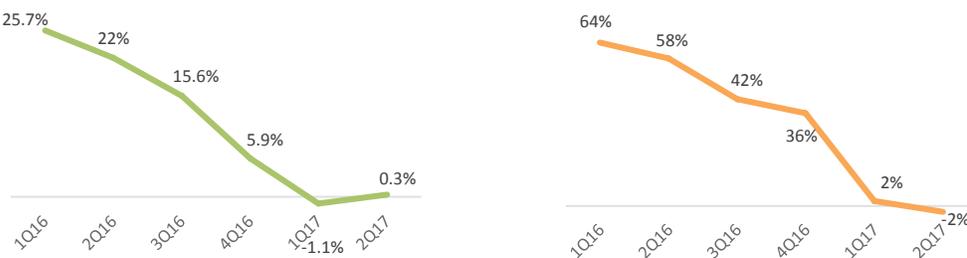
| 2Q17 Results | | | 3Q17 Guidance | | | 2Q17 Results | | | 3Q17 Guidance | | |
|--------------|-------|--------|---------------|-------|--------|--------------|-------|--------|---------------|-------|--------|
| EPS | Cons. | Result | EPS | Cons. | Result | Total Rev. | Cons. | Result | Total Rev. | Cons. | Result |
| -0.03 | -0.06 | beat | n/a | 0.26 | n/a | 1.09B | 1.08B | beat | 1.47B | 1.64B | miss |

Source: Under Armour, Inc. and Estimize.com

I. North America Revenue Decline driven by Weak Footwear Sales

Under Armour’s North America sales growth declined quickly and steadily last year and may have bottomed in 1Q17 with sales declining 1.1% y/y. The weak revenue growth continued through 2Q17 as sales remained flat at 0.3% y/y (see Figure 1 left). Consumer demand is weak because UA’s products are not in trend with the current consumer tastes and preferences.

FIGURE 1: North America Sales Growth (left) and Footwear Sales Growth (right)



Source: Under Armour, Inc.

Footwear sales which used to be a stellar category for UAA, declined precipitously in 4Q16. However, we believe the sudden drop in UAA’s footwear sales was partially caused by industry headwinds – in particular, sneaker sales to Hispanics in the U.S. slowed down significantly during 4Q16 (see Figure 1 right).

According to the *NPD Consumer Tracking Service*, sales of sneakers to Hispanics in the U.S. have slowed down dramatically starting late last year and still continue today. Hispanics represented ~23% of sneaker sales in 2016 and grew mid teens, accounting for almost all of the growth in 2016. However, since the start of 2017, sneaker sales to Hispanics have declined to high teens. No other cohort has seen this kind of a slowdown.

Why are Hispanics buying fewer sneakers? According to a recent comment made by Robert Kaplan, (President of the Federal Reserve Bank of Dallas) to *USA Today*, millions of immigrants have become more likely to save than to spend, and this will affect consumer spending and GDP growth in the short term.

The *NPD Group* states that work/occupational footwear sales to Hispanics have improved while outdoor footwear sales were flat. Performance footwear (UAA’s core business) was hit the hardest, especially basketball, skate and running footwear. From a brand perspective, Vans (VFC), Nike (NKE), Skechers (SKX) and Brand Jordan were also negatively affected. Interestingly, Adidas and Puma have actually strengthened.

II. UAA Needs to Broaden its Brand Image

We did a Back-to-School (BTS) channel check in order to determine why UAA footwear sales in North America have been underperforming. Aside from the broader industry headwinds of slower sneaker sales to U.S. Hispanics, our findings indicate some company-specific challenges:

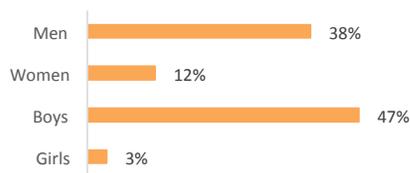
1. UAA’s brand image mostly appeals to a narrow demographic group – Men and Boys
2. Basketball is still the overwhelming favorite category for UAA followed by performance running
3. BTS footwear sales for UAA products were very promotional with widespread discounting

Short-term Challenge for Under Armour: The company needs to broaden its apparel/footwear portfolio to more casual “streetwear” selections. Until it does, UAA will have a hard time regaining North America market share that it lost to Adidas and Nike.

A. Limited Demographic Appeal

For our Under Armour BTS channel check, we did a search on Footlocker.com for their top-selling UAA sneakers in their retail stores and DTC channels. We only analyzed their first sample of 60 sneakers.

FIGURE 2: UAA Footwear Purchased: By Gender



Our findings showed that most Footlocker’s customers who purchased UAA footwear for the BTS season were Boys (47%) and Men (38%). Women customers only comprised 12% of buyers and Girls who purchased UAA sneakers only made up 3% of the purchase group (see Figure 2).

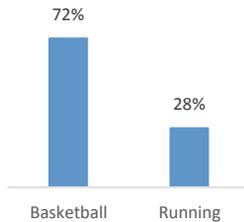
Source: FootLocker.com and Viola Advisory, LLC, 08/01/17

This is a big challenge for UAA that needs to be addressed in the short term. Women and Girls collectively purchase more footwear product than the Men and Boys groups. In order to re-accelerate footwear sales growth in North America, UAA needs to capture a bigger share of Women and Girls customer base.

B. Basketball Still the Overwhelming Favorite Category

Our BTS check showed that Basketball is still the overwhelming favorite category for UAA purchases followed by performance running. UAA basketball sneakers were the most sought after comprising 72% of total UAA purchases while performance running came in a distant second at 28% of total UAA purchases (see Figure 3).

FIGURE 3: UAA Footwear Purchased: By Use



This is also a red flag that UAA needs to address in the short term. According to the *NPD Group*, performance basketball and performance running are currently not in vogue for this year’s BTS season (and have been out of favor since last year). The current athleisure trend favors a more casual “streetwear” look but fitted with performance attributes like high-tech soles and comfortable, colorful upper knits. UAA seems to be lacking in this category, hence the low number of Women and Girls who purchase UAA footwear.

Source: FootLocker.com and Viola Advisory, LLC, 08/01/17

C. BTS Season for UAA Footwear was Heavily Promotional

TABLE 2: Discount Range and Percent of Total Discounts

| <i>Discount Range</i> | <i>% of Total</i> |
|-----------------------|-------------------|
| 16% - 20% | 38.3% |
| 28% - 37% | 38.3% |
| 44% - 57% | 12.8% |

Source: FootLocker.com and Viola Advisory, LLC, 08/01/17

Our BTS channel check showed that 78% of UAA footwear were marked down from the original sales price. This is not a surprise since BTS season is traditionally promotional in North America. The range of discounts vary with the first group of UAA footwear discounted by 16% to 20% and another group of UAA footwear discounted by 28% to 37% (see Table 2). A few sneakers were also heavily marked down by around 44% to 57%.

The exception was the newly released *UA Cam Newton CIN Trainer* for both Mens and Boys that was retailing for around \$119.99.

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