Q3 Fiscal 2019 Earnings Commentary

The financial measures discussed below include both GAAP and adjusted non-GAAP financial measures. During the third quarter of fiscal 2018, the Company adjusted the provisional amount recorded for the mandatory one-time transition tax under the U.S. Tax Cuts and Jobs Act, resulting in the recognition of an additional tax expense of $5.2 million. The adjusted financial measures for the third quarter of fiscal 2018 exclude this adjustments.

Please see the section captioned "Reconciliation of Non-GAAP Financial Measures" included in the accompanying financial tables, which includes more detail on the GAAP financial measure that is most directly comparable to each non-GAAP financial measure, and the related reconciliations between these financial measures.

This earnings commentary should be read in conjunction with the Company's quarterly report on Form 10-Q filed with the Securities and Exchange Commission ("SEC") on, or about, December 11, 2019 and its annual report on Form 10-K filed with the SEC on March 27, 2019. These reports are available at www.sec.gov.

The below narrative compares the third quarter of fiscal 2019 to the third quarter of fiscal 2018, unless otherwise noted.

Sales

- **Total net revenue** increased 23% to $916.1 million, with the increase primarily resulting from:
  - the opening of 53 net new company-operated stores since Q3 2018. We opened 22 net new company-operated stores in Asia, 19 in the U.S., seven in Europe, three in Australia/New Zealand, and two in Canada;
  - a total comparable sales increase of 17% on a constant dollar basis, comprised of an e-commerce increase of 30% and a comparable store sales increase of 11%;
  - net revenue from company-operated stores we opened or significantly expanded subsequent to Q3 2018, and are therefore not included in comparable store sales, increased net revenue by $61.1 million; and
  - an increase of $8.5 million in other revenue.

  The increase in net revenue was partially offset by a decrease of $6.8 million, or 0.4%, due to foreign exchange.

- **Company-operated store revenue** totaled $579.5 million, or 63.3% of total revenue, compared to $476.9 million, or 63.8% of total revenue, in Q3 2018.

- **E-commerce revenue** totaled $246.7 million, or 26.9% of total revenue, compared to $189.4 million, or 25.3% of total revenue, in Q3 2018.

- **Other revenue**, which includes outlets, temporary locations including seasonal stores, sales to wholesale accounts, license and supply arrangements, and warehouse sales, totaled $89.9 million, or 9.8% of total net revenue, compared to $81.4 million, or 10.9% of total net revenue, in Q3 2018.

Store Count

- **New stores**: We opened 19 net new company-operated stores in Q3 2019 including nine in the U.S., seven in Asia, and four in Europe. We had one company-operated store closure in Canada.

- **Total company-operated stores**: At the end of Q3 2019, we had 479 total company-operated stores compared to 426 at the end of Q3 2018. At the end of Q3 2019, of the 479 company-operated stores, 369 were in our comparable store base, including 242 stores in the U.S., 49 stores in Canada, 32 stores in Australia/New Zealand, 27 stores in Asia, and 19 stores in Europe.

Gross Profit

- **Gross profit** was $505.0 million, or 55.1% of net revenue, compared to $406.8 million, or 54.4% of net revenue, in Q3 2018. Gross profit increased 24% compared to Q3 2018.

  The increase in gross margin was primarily the result of:

  - an increase in product margin of 120 basis points which was primarily due to lower product costs, a favorable mix of higher margin product, and lower markdowns; and
  - a decrease in occupancy and depreciation costs as a percentage of revenue of 10 basis points.

  This was partially offset by an increase in costs as a percentage of revenue related to our distribution centers and our product departments of 40 basis points, and an unfavorable impact of foreign exchange rates of 20 basis points.

Selling, General and Administrative Expenses

- **SG&A expenses** were $329.2 million, or 35.9% of net revenue, compared to $270.9 million, or 36.2% of net revenue, in Q3 2018. The leverage of 30 basis points in our SG&A rate was primarily the result of 60 basis points of leverage on operating channel and corporate costs, partially offset by 30 basis points of deleverage in foreign exchange.

Operating Income

- **Operating income** was $175.8 million, or 19.2% of net revenue, compared to $135.9 million, or 18.2% of net revenue, in Q3 2018.

Income Tax Expense

- **Income tax expense** was $51.8 million compared to $43.5 million in Q3 2018 and the effective tax rate was 29.1% compared to 31.6% in Q3 2018. The adjusted effective tax rate for the third quarter of fiscal 2018 was 27.8%.

Net Income

- **Net income** was $126.0 million, or $0.96 per diluted share, compared to $0.71 per diluted share in Q3 2018. Adjusted diluted earnings per share for the third quarter of fiscal 2018 were $0.75.

Share Count

- Our diluted share count for the quarter was 130.8 million compared to 133.1 million in Q3 2018.
- During the third quarter of fiscal 2019, we repurchased 44.5 thousand shares at a cost of $8.0 million.

Capital Expenditures

- **Capital expenditures** were $78.5 million in Q3 2019 compared to $72.7 million in Q3 2018. The increase was primarily the result of an increase in capital expenditures related to new store openings, store renovations and relocations, and e-commerce technology investments in Q3 2019 compared to Q3 2018.

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Balance Sheet Highlights

- Cash and cash equivalents were $586.2 million at the end of Q3 2019.
- Inventory increased 26% to $627.1 million at the end of Q3 2019 compared to Q3 2018.

Forward-Looking Statements and Non-GAAP Reconciliations

Forward-Looking Statements:

This supplemental disclosure includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In many cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "outlook," "believes," "intends," "estimates," "predicts," "potential" or the negative of these terms or other comparable terminology. These forward-looking statements also include our guidance and outlook statements. These statements are based on management's current expectations but they involve a number of risks and uncertainties. Actual results and the timing of events could differ materially from those anticipated in the forward-looking statements as a result of risks and uncertainties, which include, without limitation: our ability to maintain the value and reputation of our brand; the acceptability of our products to our guests; our highly competitive market and increasing competition; our reliance on and limited control over third-party suppliers to provide fabrics for and to produce our products; suppliers or manufacturers not complying with our Vendor Code of Ethics or applicable laws; an economic downturn or economic uncertainty in our key markets; increasing product costs and decreasing selling prices; our ability to anticipate consumer preferences and successfully develop and introduce new, innovative and updated products; our ability to accurately forecast guest demand for our products; our ability to safeguard against security breaches with respect to our information technology systems; any material disruption of our information systems; our ability to have technology-based systems function effectively and grow our e-commerce business globally; changes in consumer shopping preferences and shifts in distribution channels; the fluctuating costs of raw materials; our ability to expand internationally in light of our limited operating experience and limited brand recognition in new international markets; our ability to deliver our products to the market and to meet guest expectations if we have problems with our distribution system; imitation by our competitors; our ability to protect our intellectual property rights; our ability to source and sell our merchandise profitably or at all if new trade restrictions are imposed or existing trade restrictions become more burdensome; changes in tax laws or unanticipated tax liabilities; our ability to manage our growth and the increased complexity of our business effectively; our ability to cancel store leases if an existing or new store is not profitable; increasing labor costs and other factors associated with the production of our products in South and South East Asia; the operations of many of our suppliers are subject to international and other risks; our ability to successfully open new store locations in a timely manner; our ability to comply with trade and other regulations; the service of our senior management; seasonality; fluctuations in foreign currency exchange rates; conflicting trademarks and the prevention of sale of certain products; our exposure to various types of litigation; actions of activist stockholders; anti-takeover provisions in our certificate of incorporation and bylaws; and other risks and uncertainties set out in filings made from time to time with the United States Securities and Exchange Commission and available at www.sec.gov, including, without limitation, our most recent reports on Form 10-K and Form 10-Q. You are urged to consider these factors carefully in evaluating the forward-looking statements contained herein and are cautioned not to place undue reliance on such forward-looking statements, which are qualified in their entirety by these cautionary statements. The forward-looking statements made herein speak only as of the date of this disclosure and we undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances, except as may be required by law.

Reconciliation of Non-GAAP Financial Measures

Unaudited

Constant dollar changes in total comparable sales, comparable store sales, and direct to consumer net revenue

Due to the 53rd week in fiscal 2018, the below changes in total comparable sales, comparable store sales, and direct to consumer net revenue are calculated on a one week shifted basis such that the 13 weeks ended November 3, 2019 is compared to the 13 weeks ended November 4, 2018 rather than October 28, 2018.

	Total Comparable Sales[1,2]	Comparable Store Sales[2]	Direct to Consumer Net Revenue
Change	16%	10%	29%
Adjustments due to foreign exchange rate changes	1	1	1
Change in constant dollars	17%	11%	30%

[1]Total comparable sales includes comparable store sales and direct to consumer sales.

[2]Comparable store sales reflects net revenue from company-operated stores that have been open for at least 12 full fiscal months, or open for at least 12 full fiscal months after being significantly expanded.

Adjusted financial measures

The following table reconciles adjusted financial measures with the most directly comparable measures calculated in accordance with GAAP. The adjustments relate to U.S. tax reform. Please refer to Note 8 of the unaudited interim consolidated financial statements included in Item 1 of Part I of our Report on Form 10-Q to be filed with the SEC on or about December 11, 2019 for further information on these adjustments.

	Quarter Ended October 28, 2018		
	GAAP Results	U.S. Tax Reform	Adjusted Results (Non-GAAP)
	(In thousands, except per share amounts)		
Income tax expense	$ 43,534	$ (5,163)	$ 38,371
Effective tax rate	31.6%	(3.8)%	27.8%
Diluted earnings per share	$ 0.71	$ 0.04	$ 0.75