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## Under analyzed

Kevin Plank, at least, is blameless for the sleepwalking pace of America's post-crisis economic expansion. For 20 consecutive quarters, Under Armour (UA on the New York Stock Exchange), the entrepreneur's pride and joy, has logged revenue growth in excess of 20% per annum. In the first quarter of 2015, it produced 25%. In the 12 months of 2014, it generated no less than 32%—which growth lifted the top line to a cool \$3 billion.

A downbeat conclusion would not seem inevitably to follow from these luminous data, though the analysis in progress is bearish. We are about to contend that Under Armour will meet its match in the fickle American consumer. As for the global investors who confidently buy UA at 84 times trailing net income and 75 times the 2015 estimate, they, too, may presently reconsider.

"What does it take," poses colleague Evan Lorenz by way of preface, "for a once excellent brand to become merely good? Sixteen months and a strong dollar may do the trick. In February 2014, Michael Kors Holdings Ltd. (KORS on the Big Board) reached a record high price of \$99.84 a share. At the time, two-thirds of the two dozen or so analysts who covered the company rated it a 'buy' at a trailing earnings multiple of over 30. 'From an upward EPS revision/surprise perspective, we still believe KORS is one of the best-positioned names in our coverage universe,' a pair of J.P. Morgan analysts declared on Feb. 5, 2014.

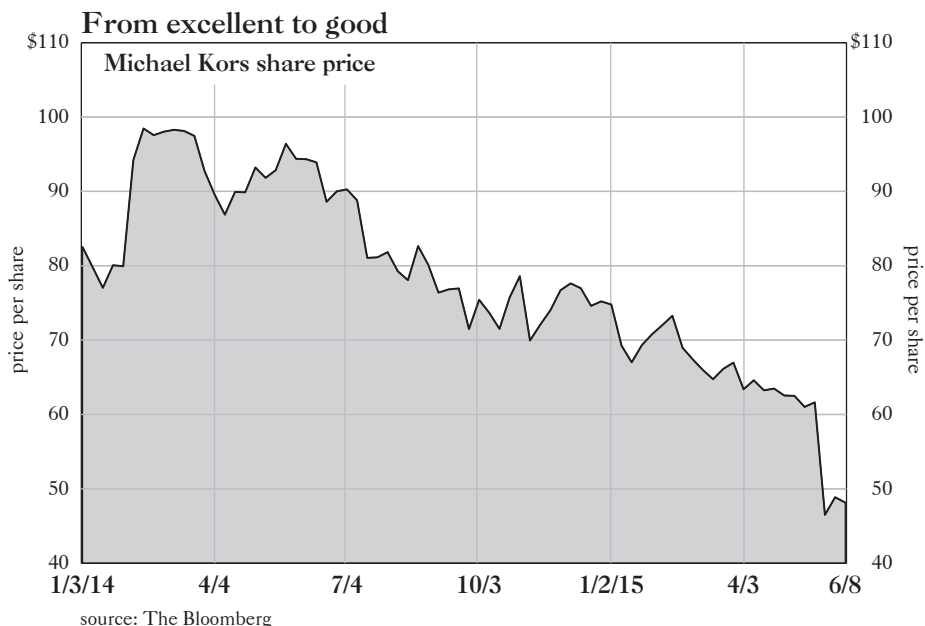
"Since then," Lorenz proceeds, "Kors' share price has been sawed in half. Though the handbag-cum-fash-

ion icon managed to report a 17.8% year-over-year sales increase for the quarter ending March 28, like-for-like sales in North American stores fell by 6.7%. The company blamed the mighty greenback. While few, perhaps, anticipated a 19% jump in the U.S. Dollar Index, the fancy Kors' valuation furnished little margin of safety. Now that the shares trade at the less demanding multiple of 11.3 times trailing earnings, only one-third of analysts rate KORS a 'buy.'"

On, then, to Under Armour, an icon of a different kind. From beginnings in his grandmother's basement, Plank has built not only a company but also a brand, and not only a brand but also an image. Mega-cap General Electric has bemusedly observed that its 2013

annual report was downloaded just 800 times. UA has disclosed no such count concerning its 2014 annual report, the cover of which features an arresting full-page photograph of the ballerina Misty Copeland, en pointe. Wearing only a little Under Armour, she seems a warrant against insufficient downloading.

Opening the document, one reads about UA's line of branded athletic performance apparel, footwear and accessories—Heatgear, Coldgear, Allseasongear and, of course, Under Armour itself. One reads, too, about the company's ambition to marry cleats and workout clothing, on the one hand, with social media on the other. Plank et al. call this stratagem Connected Fitness. As a compression shirt is to a



sweatshirt, so Connected Fitness is to one's high school gym teacher. Under Armour, its fans contend, is on its way to becoming high-tech.

In the first quarter, apparel accounted for 69% of revenue, followed by footwear (20%), accessories (8%), license revenue (2%) and, bringing up the rear, fitness application software (1%). Wholesale channels—of which the most important is Dick's Sporting Goods—produce 75% of UA's top line. The UA Web site and 153 UA-owned retail stores generate the remaining revenue. All but 13% of sales are produced in North America.

While only slightly more than half of the 34 analysts who follow UA rate the company a "buy," the pack collectively ratifies the vision of unchecked growth. In aggregate, the spreadsheet builders forecast compound growth in sales and earnings of 22% and 26%, respectively, through 2019. The power of compounding implies that revenues will reach \$10 billion by 2020, up from the aforementioned \$3 billion in 2014.

"To put this pace of revenue growth in perspective," Lorenz points out, "Nike Inc. first reached \$3 billion in sales in 1991. It didn't top \$10 billion until 2003. Despite signing up some of the most illustrious athletes, teams and events—Michael Jordan, Tiger Woods, the 1996 Olympics at Atlanta, Manchester United—Nike's growth was anything but steady. Year-over-year revenue contracted twice, in 1994 and 1999, on the road to \$10 billion, during which journey, incidentally, Nike's common shares never traded at a multiple of trailing net income higher than 49.2 (that was in 1999 in the context of a 5.64%, 10-year Treasury note). In the decade till 2000, the stock changed hands at an average trailing P/E multiple of 19.7. Now the Street projects that Under Armour can make the move to \$10 billion from \$3 billion in half the time it took Nike and with none of the sales volatility (and, by implication, with none of the share-price volatility)."

If so, Stephen Curry, and the Under Armour Curry One shoe, have some work to do to catch up to the Nike Jordan phenomenon. Curry, the former Davidson College star, 2015 NBA Most Valuable Player and leader (and face) of the Golden State Warriors, is as active as a basketball player can be. Michael Jordan, legendary star of the

Chicago Bulls, retired in 1999. That is, Jordan retired from playing basketball professionally in Chicago in 1999. His product endorsement plays on. According to SportScanInfo, sales of Michael Jordan shoes spurred by 17% in 2014 to reach \$2.6 billion. LeBron James—"the King," mind you—sold a mere \$300 million of his brand. Kobe Bryant, with some 30,000 NBA points under his belt, sold \$50 million (sales of Curry's Under Armour shoe are unrecorded). Jordan basketball shoes remain unbeaten, untied, and unscored upon 16 years after the hero himself hung them up.

There's competition near and far, not least in women's apparel, where Dick's is unveiling its own private-label athletic brand. The thought occurs: Under Armour, a North American-focused company, might grow overseas. From a low base, the company has, in fact, made strides. In 2014 and in the first quarter of 2015, international sales leapt by 96% and 77%, respectively.

Continued expansion won't come cheap. Soccer, as we Americans are intermittently reminded, is the favorite sport of the others. The cost of sustained growth in Europe is the big-ticket sponsorship of an internationally famous soccer team.

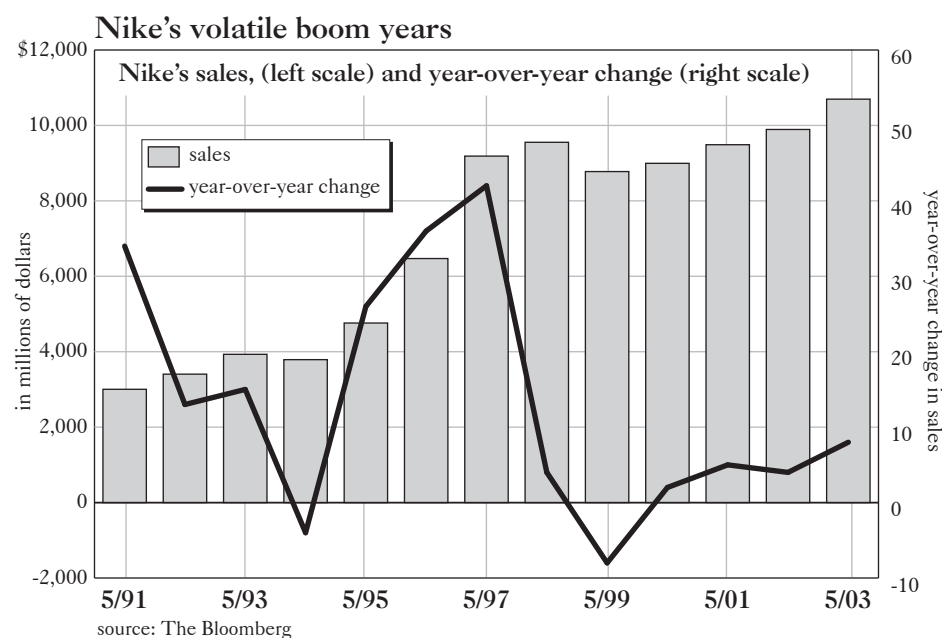
Under Armour has played the sponsorship game with some success at home. The price tag is higher in foreign parts. Thus, for perspective, UA generated \$130 million of European sales last year. Adidas pays \$115 million a year to sponsor Manchester United, the St.

Louis Cardinals of foreign football.

Presumably, nobody is more familiar than Plank with this daunting arithmetic. He seems to have chosen an alternative marketing strategy. Since December 2013, UA has spent \$710 million in cash to buy a trio of fitness applications for mobile devices: MapMyFitness, MyFitnessPal and Endomondo. (In consequence, the UA balance sheet carries \$414.8 million of debt; the burden is easily borne, as operating income covered interest expense by a factor of 12.5 times in the first quarter.) At last count, over 130 million so-called unique users had logged on, the vast majority spending nothing for the privilege. The thinking has it that, through Connected Fitness, UA will become its customers' doppelganger. Insinuating itself into their minds, it will prompt new purchases while promoting brand awareness. By Plank's telling, Connected Fitness is the future.

Just how connected are these electronically tethered millions to the corporate starship? "On the first-quarter conference call," Lorenz relates, "Plank reported that the company's basket of apps logged more than 100 million workouts in January alone. Impressive? Recall that the company claims 130 million users across its network and that January is New Year's resolution month. The numbers suggest that the average UA user got off his or her couch less than once."

Just what this activity will tangibly



contribute is an open question. The company reckons that the apps will add \$25 million to \$30 million to the top line before the associated costs (which costs will shave an estimated 70 basis points off 2015 operating margins). If, as some claim, Manchester United has 659 million fans worldwide, it follows that sponsorship rights are costing Adidas \$0.17 per fan per year. Assume, for a moment, that people using UA's apps today continue to use UA's apps for the next 10 years—no sure thing in a world of rapidly changing technology. If Under Armour has 130 million unique visitors to its fitness apps, it then follows that UA is spending \$0.55 per visitor per year. Say what you will about soccer, about FIFA, or even about Man U.: The Manchester fans do reliably ring the team-apparel cash register. The propensity of UA app users to buy Under Armour clothing or Curry shoes is yet unproven. Besides, Apple is building a fitness application of its own, which may soon be competitive with the UA apps. "Health" is the name of the Apple offering.

Stock price multiples would be higher if only consumers would stop changing their minds. As it is, tastes do change, often without notice. "Back in the 1990s," recalls Matt Powell, a sports industry analyst at the NPD Group, a market research company, "Gap was a very important fashion retailer in America. People paid a lot of attention to what they said. They came out with a campaign after being a den-



im retailer for most of their history, saying everyone in chinos, or khakis. Khakis just don't look good with a pair of sneakers. The consumer switched over to wearing chinos and khakis and more dressy bottoms and stopped wearing denim, and it crushed the sneaker business." In the 12 months to May 31, 1999, Nike's sales tumbled by 8.1%.

Trends seemingly come out of nowhere. Who can account for it? A UA short seller advises Lorenz that the "sneakerhead" market (an eBay-hosted emporium of athletic footwear) has "rolled over." A Clemson University student named Mackenzie Pearson,

writing in the Clemson *Odyssey*, coined the term "dad bod" and started a national celebration of the kind of guy "who's not scared of a cheat meal, because he eats just about anything and everything." The untuned "dad body" is not Plank's core demographic.

With a \$17.4 billion market cap, UA is a large, liquid stock. With a short interest of 7.8% of the float, it is not a crowded short. The insiders are selling \$87.4 million's worth of stock at an average price of \$76.23 in the year to date. Why shouldn't you?

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