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Deckers Outdoor Corp. (DECK)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for standing by. Welcome to the Deckers Brands Third Quarter Fiscal 2021 Earnings Conference Call. All participants will in a listen-only mode. [Operator Instructions] Following the presentation, there will an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Erinn Kohler, Vice President, Investor Relations & Corporate Planning. Please go ahead.

Erinn Kohler
Vice President-Investor Relations & Corporate Planning, Deckers Outdoor Corp.

Hello, and thank you, everyone, for joining us today. On the call is Dave Powers, President and Chief Executive Officer; and Steve Fasching, Chief Financial Officer.

Before we begin, I would like to remind everyone of the company's Safe Harbor policy. Please note that certain statements made on this call are forward looking statements within the meaning of the federal securities laws, which are subject to considerable risks and uncertainties. These forward looking statements are intended to qualify for the Safe Harbor from liability established by the Private Securities Litigation Reform Act of 1995.

All statements made on this call today, other than statements of historical facts, are forward-looking statements and include statements regarding the impact of the COVID-19 pandemic on our business and operations,

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business partners and industry; changes in consumer behavior in the retail environment; strength of our brands and demand for our products; changes to our product allocation, segmentation and distribution strategies; changes to our marketing plans and strategies; investments in our business; our anticipated revenues, brands performance, product mix, gross margins, expenses and liquidity position; and our potential repurchase of shares.

Forward-looking statements made on this call represent management's current expectations and are based on information available at the time such statements are made. Forward-looking statements involve numerous known and unknown risks, uncertainties and other factors that may cause our actual results to differ materially from any results predicted, assumed or implied by the forward-looking statements.

The company has explained some of these risks and uncertainties in its SEC filings, including in the Risk Factors section of its Annual Report on Form 10-K and quarterly reports on Form 10-Q. Except as required by law or the listing rules of the New York Stock Exchange, the company expressly disclaims any intent or obligation to update any forward-looking statements.

With that, I'll now turn it over to Dave.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

Thanks, Erinn. Good afternoon, everyone, and thank you for joining us today. I'm excited to dive into the details of an extraordinary quarter for the company and the exceptional results that our teams have delivered. But first, I would again like to stress the paramount importance of the health and safety of our employees, customers, communities and stakeholders, as they remain top of mind with everyone continuing to navigate the COVID-19 pandemic. On behalf of Deckers, I hope everyone is staying safe and healthy.

Our third quarter results include record-setting revenue of $1.078 billion and record earnings per share of $8.99. Revenue grew by 15% over last year's third quarter to deliver Deckers' first every quarter to exceed $1 billion. Performance in the quarter was driven by delivering relevant and compelling products that consumers are demanding, focusing execution to maximize demand captured through direct-to-consumer channels, engaging consumers with authentic and emotive product storytelling, executing marketplace management that set the table for high product sell-through, and our dedicated employees working tirelessly to deliver strong results despite the challenging environment.

To achieve these results, we overcame both significant operational hurdles as well as macro pressures related to the ongoing pandemic. Steve will be providing more contexts on these unique dynamics later in today's call.

We believe much of the strength we have seen in our business fiscal year to-date is the result of our continued execution and dedication to our long-term strategies, including driving year-round demand for UGG through a diverse product assortment; accelerating consumer acquisition online, which increased 87% year-to-date across our portfolio of brands; prioritizing 18 to 34-year-old consumers, which have accounted for the largest percentage increase in our US customer database this year, managing the wholesale marketplace strategically, which has continued to benefit UGG margins in the US and is progressing in EMEA; globalizing the HOKA ecosystem, evidenced by the acceleration of international markets; and spending responsibly to maintain high levels of profitability while deploying investments in these key strategic areas.

While this last year has led to unique circumstances, allowing our brands to capitalize on positive momentum, our underlying strategies remain central to Deckers long-term growth and profitability profile. As we adapt our operating model to these accelerated trends, we continue to recognize the need for additional infrastructure

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investments, allowing us to sustain strengthen our business. More to share on that front during our year-end earnings call in May.

I'll now walk you through the brand highlights from the quarter, starting with UGG. The double-digit global UGG growth rate in the third quarter was driven by the strength of the brand's diversified and compelling product offering, which has been embraced by a broader range of consumers, momentum with younger and fashion-forward consumers, targeted digital marketing and PR activations, increased purchase frequency from consumers shopping across multiple product categories, significant brand heat in the US with strong selling and sell-through across multiple wholesale accounts paired with exceptional DTC engagement, and traction with localized strategies for international markets beginning to rebuild brand heat within Europe and Asia.

The UGG brand success, particularly in the US, is a result of the brand's long-term evolution as a leading global lifestyle brand through infusing brand DNA into new and expanding categories. More specifically, over the past four years, UGG has established an impressive resume of collaborations that have helped rebuild the brand's fashion credibility.

This includes recently announced collaborations with British Designer, Molly Goddard, and New York-based designer, Telfar Clemens. Combining buzz-worthy collaborations, design innovation and strategically manage distribution through product allocation, segmentation and differentiation, UGG has significantly reduced its reliance on core products while significantly expanding other categories.

Evidencing the success of this strategy, during the third quarter, women's Classic product volume remained flat year-over-year, while the brand experienced growth across every other major category, including women's non-classic footwear, highlighted by slippers and the Fluff franchise; men's footwear, particularly the Neumel franchise and Heritage slippers; kid's footwear through fun variations of popular men's and women's product; and the new ready-to-wear collection, which was a resounding success this season and will be expanded upon next fall with additional products and partnerships.

With this transformation beyond core products, the UGG consumer is becoming younger and more diverse. During the third quarter, UGG experienced a 44% increase in customers aged 18 to 34-year-old in the US, which was the largest increase of any group and represented the largest percentage of total customers.

As UGG continues to expand its audience with younger consumers, it has been critical to enhance the brand's e-commerce engine and digital marketing expertise. The UGG e-commerce platform has continued to evolve as part of Deckers' overall digital transformation, but it has also become a strategic driver of the product development process through exclusive products. By creating products exclusive to DTC, the UGG team is able to both develop special events that drive traffic as well as create a faster feedback loop to enhance future product success with targeted consumers.

Momentum with younger consumers has been amplified by UGG earning year-round attention from the emergence of the Fluff franchise. Historically, many consumers search for UGG products as weather turned colder. However, with the evolution of Fluff, which features year-round product, UGG is remaining top of mind with consumers. In fact, UGG brand search interest increased 18% for the entire calendar year 2020.

We have also observed Fluff as a compelling acquisition vehicle for driving repurchase decisions in other categories. Specifically, our data highlighted many consumers who purchased Fluff earlier this year returning to purchase the Classic Clear Mini this fall. With more frequent attention from consumers and effective utilization of

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consumer insights and data analysis, over the last nine months, we've witnessed an 89% increase in repeat purchases as compared to the same period last year.

With more consumers making multiple purchases, the value of the more than 2 million new customers acquired so far this year becomes even more impactful to the future growth trajectory of the UGG brand. As the UGG customer database grows, so does the strength of its insights provided by our centralized marketing teams. For example, consumer insights revealed that 18 to 34-year olds in the US were the driving factor behind the Neumel becoming a top global style for UGG in the third quarter. While volume growth of the style was impressive, even more exciting was the increase in 18- to 34-year-old purchases of the Neumel who more than doubled over last year in our domestic DTC channel.

With the insights developed around the Neumel consumer, we believe that the recently introduced men's Fluff product will also resonate well with this consumer. First launched in November, the men's Fluffit and Fluff You styles were modeled by NBA legend, Dennis Rodman, in the UGG brand's Chaotic Fun campaign. The UGG team is excited by the positive PR impressions gained from men's Fluff, which sold out in its initial allocation online and is selling well with key wholesale partners.

From a regional standpoint, as expected, growth in the third quarter was driven by the US, where according to YouGov, UGG reached new all-time highs in brand consideration, purchase intent, brand impression and brand buzz among women aged 18 to 34. Over the past three years, the UGG brand's domestic business has added nearly $200 million to the third quarter alone, which we feel as a result of our successful strategy to build brand heat and tightly manage our segmentation and diversification efforts.

While a great deal of the domestic strength this year has been driven by owned e-commerce performance, and this continued in the third quarter, pairs sold at UGG domestic wholesale partners during the fall season increased 42% versus last year. Because of the UGG marketplace strategy, wholesale success was broad-based. Given the strength of our sell-through at our wholesale partners this fall, UGG experienced very little promotional activity, and season-ending inventories in the market are at a historically low level.

Internationally, UGG continues to see progress in the multiyear reset in EMEA. Over the last year, UGG has exited approximately 20% of wholesale accounts in Europe and significantly reduced the core Classic product in the marketplace. While revenue in Europe remained a strategic headwind in Q3, due to our ongoing marketplace reset and COVID-related challenges, margins improved as UGG drove a healthier product mix and reduced the need for promotional activity.

Overall, we feel the UGG brand is headed in a positive direction in Europe, evidenced by fiscal year to-date online consumer acquisition increasing 97% over last year. With favorable consumer acquisition and strength in strategic youth accounts in the region, we believe UGG could return to growth in EMEA next fiscal year.

With the holiday season behind us, we are now shifting our focus towards growing brand heat and consumer attention for the spring and summer seasons. Clearly, the strategy we have implemented over the past few years in the US continues to pay dividends, and we are excited by this year's progress with international markets.

We still have investments to make in order to rebuild brand heat in these international regions, but feel increasingly positive that our strategy to build diversified product acceptance through fashion credibility is working. Congratulations to the UGG team on executing a fantastic quarter.

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Shifting to HOKA, global performance was driven by strength and momentum across the brand's entire ecosystem. Among all access points, building the brand's online consumer acquisition and retention has been a primary focus for HOKA. Through optimized digital marketing and geo targeting, HOKA has managed to increase consumer acquisition online by 117% fiscal year-to-date, while also doubling consumer retention year-over-year.

With a growing audience online and dedicated consumer replenishment trends, HOKA has been able to cross the $100 million DTC revenue mark in just the first nine months of fiscal year 2021. With this acceleration online, DTC revenue now represents nearly 30% of HOKA revenue fiscal year-to-date up from 21% last year.

Importantly, HOKA is also firing on all cylinders with wholesale partners, as the brand has doubled both awareness and consideration among consumers outside of core runners. According to the NPD Group's Retail Tracking Service, HOKA dollar sales in the US run specialty channel increased 19% for the three months ending December 2020 compared to the same months over the prior year. This growth is despite overall dollar sales of adult running shoes sold through this channel decreasing 4% for the three months ending December 2020.

For calendar year 2020, the brand's top three strategic wholesale accounts sold more than $100 million of HOKA product at retail value, highlighting both the strength of these relationships and the relative size of the HOKA brands direct-to-consumer business.

As we have discussed in the past, we are constantly evaluating HOKA distribution to ensure optimized consumer access points. Earlier this year, we began testing Dick's Sporting Goods with a limited number of doors and product. And so far, the partnership has been mutually beneficial.

This spring, HOKA will be slowly increasing its door count with Dick's and will continue to evaluate as appropriate. Ideally, testing these additional access points for HOKA will expose the brand to a larger audience as we work to build further awareness and consideration.

During the quarter, HOKA growth was powerful across the globe in every region, and we have been encouraged to see the brand's international growth rate continued to outpace domestic. While revenue dynamics remain in favor of domestic due to the differences in distribution models, 54% of units in Q3 were sold internationally. This speaks to the HOKA brand's global appeal and opportunity overseas as the brand expands.

From a product standpoint, HOKA continues to be recognized with awards for its innovative technology and designs. Some of the awards received during the third quarter include the Clifton Edge being named Best Running Shoes in the Rolling Stone Essentials 2020, the Bondi 7 being named Best for Long Runs in Outside Magazine's Best Running Shoes of 2021, Winter Guide, and the HOKA GORE-TEX SHAKEDRY run jacket being named Best Running Jacket in the 2021 Women's Health Fitness Awards.

We are proud to see not only core Heritage HOKA products like the Bondi receiving recognition, but also new product innovations like the Clifton Edge and Shakedry Run Jacket obtaining acclaim. We are still in the very infancy of HOKA apparel, but it's promising to see such a positive response so early in the development process.

On the innovation front, HOKA has been working to bolster its Fly Collection, which represents the brand's roster of speed shoes. We believe these lead with speed shoes are an important acquisition vehicle for younger consumers. And I'm excited to share some of the HOKA brand's recent and upcoming launches in the category, including the Rocket X, which launched in Q3, the Carbon X 2, which launched in January, and the Mach 4, which launches in March.

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Similar to the original Carbon X that was worn by Jim Walmsley while setting a new world record 50-mile time in 2019, the X 2 was launched with a world record-breaking 100K attempt. While Jim was a few seconds shy of the world record this time, he shattered the American record, and it was an incredible event to showcase the brand. We know Jim will be back for more record-breaking attempts and believe this event further demonstrates the global opportunity that lies ahead for HOKA and our supporting athletes. Congratulations to Jim on this incredible achievement and thank you for showing us what is possible with HOKA performance.

We believe that with continued innovation in the speed space, HOKA will continue to build awareness with consumers aged 18 to 34 in main consumer acquisition momentum, which fiscal year-to-date has increased 167% versus last year in the 18 to 34-year-old demographic in the US.

With just under $400 million in revenue fiscal year-to-date, we're confident HOKA will cross the $500 million revenue milestone for fiscal year 2021. We look forward to sharing more on the HOKA growth path on our year-end earnings call in May.

With respect to channel performance in the third quarter, e-commerce growth was exceptional, helping to drive our mix of DTC revenue to 48%, up from 44% last year. This is despite declines in retail and growth in the wholesale channel. From a comparable sales perspective, direct to consumer increased 34% versus last year.

Approximately 75% of our owned retail stores were open for the entire third quarter, although in most cases with limited capacity due to enhanced health and safety protocols. In total, global direct to consumer revenue increased 26% versus last year's third quarter. Performance was driven by consumer acquisition online, partially offset by a deceleration of retail resulting from macro pandemic pressures on store traffic.

Global wholesale revenue in the third quarter increased 6% as compared to last year. Growth in the quarter was primarily driven by global HOKA and domestic UGG, with offsets from international UGG related to marketplace reset initiatives underway.

In summary, global demand for HOKA, domestic strength in UGG, omni-channel execution and disciplined approach to strategic investment, and an incredible display of resiliency by our employees operationally led Deckers to double-digit quarterly revenue and earnings growth in the midst of a pandemic. On behalf of the entire leadership team, thank you to all of our employees across the globe. Your relentless resolve in getting the job done delivered these record results.

I'll now hand the call over to Steve to provide more details on our third quarter financial performance as well as some additional thoughts on the remainder of fiscal 2021 and beyond. Steve?

Steven J. Fasching

Chief Financial Officer, Deckers Outdoor Corp.

Thanks, Dave, and good afternoon, everyone. As you just heard, Deckers third quarter performance was incredibly strong and speaks well to the success of our strategies driving demand for our brands. While this year has been full of unique circumstances, our performance has been enabled by the work we have undertaken to transform Deckers to a digitally-led organization with strategically managed distribution channels and innovative product creation that consumers demand.

I am proud of our organization's ability to effectively manage our resources, overcome operational obstacles, manage with financial discipline and achieve exceptional results in the face of adversity. I am confident that as we

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move forward and beyond the pandemic, our brands and organization are positioned to emerge with continued growth opportunities, strength and discipline.

Before moving into our results for the quarter, I would like to start with a little context. Back on our second quarter earnings call, we laid out a number of tailwinds experienced in the first half of our fiscal year. These tailwinds included compelling products that are resonating with consumers in the current environment, accelerated adoption of e-commerce, our brands benefiting from consumer trends shifting toward casualization as people continue to work from home, and heightened awareness of HOKA.

With the results we just delivered, we were able to capitalize on these variables in the third quarter as well. We also discussed some potential headwinds that we anticipated could impact the third quarter as we stepped into our peak season.

To quickly summarize, the assumed challenges were: the potential for both owned and third-party shipping constraints; a second wave pandemic impact on operations; limitations resulting from inventory purchase reductions at the onset of the pandemic; and finally, higher shipping and warehouse costs related to increased safety and hazard pay as well as increased marketing costs to capitalize on brand momentum.

And I am pleased to say that through some advanced planning early in the quarter, hard work on the part of our employees, close partnership with many of our accounts and a dedicated consumer base, we were able to mitigate much of the anticipated impact.

More specifically, actions taken to address these headwinds were to bring on incremental shipping capacity with additional partners; create greater utilization of DC bypass shipments to wholesale customers; implement effective safety measures that helped limit our own retail store closures and allowed shipping to remain operational at our California distribution center for the duration of the quarter; in some cases, shift consumer demand for out-of-stock items to other available products; and a measured approach to managing spend during the quarter. Overall, the net impact of these factors helped to drive our exceptional results for the quarter and our business was aided by demand that drove much stronger revenue than anticipated.

Now for financial specifics. Revenue in the third quarter was $1.078 billion, up 15% versus the prior year. Performance as compared to last year was primarily driven by global UGG growth of 12% to $877 million, which was fueled by a domestic increase of 20%, partially offset by the continued international reset, but worth noting that we saw improving signs throughout the quarter, and global HOKA growth of 52% to $142 million, which experienced a 92% increase in DTC and a 40% increase with wholesale.

Gross margins in the third quarter were up 290 basis points over last year to 57%. The increase in gross margin was related to the strong full price selling environment of UGG as demand far outweighed supply, helping significantly limit any promotional activity; favorable channel mix as DTC increased as a proportion of the total business; very limited wholesale closeouts as demand outpaced supply for many styles; and benefits from favorable exchange rates during the quarter.

SG&A dollar spend was $285.2 million, up 13% from last year's $251.9 million. Higher spend was primarily driven by variable marketing, warehouse and logistic costs and performance-based compensation, partially offset by savings from lower travel and retail expenses. This all resulted in record earnings per share of $8.99, which compares to $7.14 in last year's third quarter. The $1.85 improvement versus last year, again, was driven by increased revenue volume seen from the growth in UGG and HOKA brands, a higher proportion of full-priced UGG revenue and a higher mix of DTC revenue, favorable currency rates and SG&A leverage in the quarter as

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revenue accelerated much faster than expenses, with some offsets from greater spend on marketing, warehouse and performance-based compensation as well as the combined impacts of a higher tax rate and higher share count.

Our year-to-date performance has delivered significant operating margin expansion in comparison to the same period last year. This has been driven by factors including DTC mix increasing significantly with the acceleration of our e-commerce business. And while we still anticipate growth going forward, the magnitude of the shift is not anticipated to continue; a historically low promotional environment resulting from very high demand, significantly minimizing both discounting and closeouts; and temporary operating expense savings with discretionary constraints employed early in the year at the onset of the pandemic.

With these benefits partially offset by rising freight expense that could go higher in the future and our strategic investment in marketing that we intend to continue fueling going forward. For the quarter, our tax rate was 22.2%, driven by higher mix of domestic and DTC business.

Our balance sheet remains strong, and as of December 31, cash and equivalents were $1.157 billion. Inventory was $305 million, down 17% from $366 million at the same time last year. And we had no short-term borrowings under our existing credit line as compared to $6 million last year. Our existing credit lines have an available balance of $474 million.

During the quarter, we did not repurchase any shares. Earlier this year, at the onset of the pandemic, we paused our share repurchase activity, but now intend to recommence share repurchase under the existing $160 million outstanding authorization in future periods. As we continue to navigate the global pandemic, we will not be providing specific guidance on the fourth quarter, but we do want to highlight a few considerations as we look to finish out the fiscal year.

We expect revenue to grow in comparison to last year's fourth quarter. More specifically, on UGG, we see growth with our domestic business as we lap last year's impact of delayed and canceled wholesale orders and physical retail store disruption at the onset of COVID-19. But we continue to expect pressure on our international wholesale business as we are still in the midst of a marketplace reset. And on HOKA, we expect global growth as the brand continues to drive year-round demand and continue to see expectations of annual revenue exceeding the $500 million milestone.

Then on costs. With the success we saw in Q3 and an ability to bring increased awareness to our spring/summer offerings, we plan to increase our marketing efforts. This will likely result in a significant increase in our marketing spend for the quarter. And as we continue to navigate the global pandemic, we continue to experience higher costs related to logistics and warehouse fulfillment. These include increased safety measures put in place at our distribution center, expedited freight to replenish inventory of depleted in-demand styles and accelerated spend to increase logistics capacity.

In addition, with these strong results, we will see higher performance-based compensation costs related to our higher level of performance for the year. Therefore, when factoring these considerations in and recognizing that Q4 represents one of our smaller revenue quarters, the spend increase will be disproportionate to revenue, all potentially resulting in a lower earnings per share for the quarter year-over-year, but still delivering strong results for the full year.

Before I hand the call back to Dave, I would like to say how pleased we are with our fiscal year-to-date performance. Our teams have done an enviable job managing through operational and macro challenges, while

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ensuring the long-term vision of the organization remains intact. Our brands are full of momentum, the company remains well positioned and we are prepared for the opportunities that lie ahead.

Thanks, everyone. And I'll now turn the call back to Dave for his closing remarks.

David Powers

President, Chief Executive Officer & Director, Deckers Outdoor Corp.

Thanks, Steve. To close today's call, I want to once again recognize our employees for staying committed to each other and to the success of our company throughout a year filled with uncertainty. I am so appreciative of how our teams rose to the occasion and enabled our brand to deliver exceptional results. Because of this hard work, Deckers boast two of the strongest brands in the footwear industry that are both leaders in their respective spaces of fashion and athletic performance.

While this year presented challenges and our strategies allowed us to capitalize on certain extraordinary circumstances, there is no doubt our brands benefited from a unique consumer environment where spending pattern shifted away from experiences and into products. As consumers look to brands and products that fit their needs for the current environment, we saw an acceleration of engagement with our brand.

And as Steve noted in his comments, we believe the results just delivered will not be sustained at these levels in the longer run as we return to a more normal environment and invest in our brands to continue to deliver growth globally. We will provide more insights regarding these investments in our fourth quarter call, but I think it's important to note in a year when we saw accelerated growth, little to no promotion and constrained corporate spending while navigating our global pandemic, these results are exceptional.

At Deckers, we like to say, as our organization performs well, it enables us to do good. With that in mind, we've continued to enhance our ESG programs and increased both our charitable contributions and our employee hours donated well above last year. Doing good and doing great is at the core of Deckers values and is the primary reason behind our leadership in the ESG arena.

Moving forward, I have the utmost confidence in our strategies, our portfolio of brands and exemplary operating model that now more than ever give credence to the long-term trajectory of Deckers brands. Thank you to all of our stakeholders for your continued support.

With that, I'll turn the call back over to the operator for Q&A. Operator?

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QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instruction] The first question comes from Camilo Lyon of BTIG. Please go ahead.

Camilo Lyon
Analyst, BTIG LLC

Q

Thanks. Good afternoon, everyone. Great job on the results today. Dave, just kind of dovetailing from what your last comments were, a question that we get a lot, is how do we think that you will lap the strong demand that you've seen in slippers this past year? And how do you pivot away from the work from home categories that you leveraged? Maybe if you could help us understand the categories and how the category shifted during COVID and how they might shift back when normalization occurs?

And then secondarily, on gross margin, with HOKA now starting to really gain momentum and the margins of that business reaching scale apparently, how should we think about your long run gross margin outlook when your channel mix stabilizes?

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yes. Thanks, Camilo. Those are great questions. And the strength – first of all, the strength of the quarter in UGG with double-digit growth, which I think we all are excited to see, we haven't seen that in some time, is really driven by a diversified product offering. So it's – in past years, we were talking about how much the Classics drove the business and how important weather was. And as you can tell, we didn't mention either of those specifically in the call. And that's because we're seeing broad-based success across all the categories in women's, but also in men's and kids and including apparel.

Slippers is certainly a driver of the success of the Fluff franchise, continues to grow and provide upside for us. But core heritage slippers as well, such as Tasman and Ansley and Ascot. But Classics, the core Classics business were relatively flat, and the growth came from non-classic boots, such as the Classic Clear, the Ultra Mini and the Neumel. In fact, the Neumel this quarter globally was the number one style across all genders. And in the US, the men's Neumel was the number one style for the quarter in US wholesale. So it's great to see that our diversification efforts are paying off.

Certainly, there is a level of tailwind from COVID and the work-from-home environment. But what's exciting to see is we are bringing in, as we mentioned, the younger consumer. They're shopping more frequently. We saw consumers come into the franchise in Q2 that purchased on our websites, the Fluff product, but they came back in Q3 and they purchased the Classic Clear.

And one of the things that I've learned in my tenure at the company here is that once a consumer is in UGG, they're always in UGG. And we're bringing in younger, more diverse consumers than we ever had before. And I think the long-term value of those consumers gives us real confidence that if the slipper trend does continue – start to wane or the tailwind from COVID and work from home slows down a little bit, we have new consumers that have now fallen in love with the brand in a different way than our prior consumers that were just for the Classic and went on occasion. It's much more fashionable now.

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Obviously, the collabs and the brand heat and the press that we're getting globally is putting us in a new light. We're now seen as a global fashion lifestyle brand, not just a boot brand. And I think the innovation that the teams have and how we're evolving the slipper category to not just work from home, but we're out from a fashion statement gives me real optimism in that as well.

So the brand has never been stronger. I truly believe that. We're seeing demand outpace supply in Q3. It's broad-based across all categories and genders, head to toe. And the momentum we're starting to see in Europe and Asia as well just gives us real confidence that this isn't just a one-time COVID situation. It's a real strength of the brand across – broad-based.

On the HOKA margin question, I'll let Steve answer that. But certainly, the HOKA margin is healthy for us. And as we drive more business online into our e-commerce and DTC channels, both for UGG and HOKA, that benefits us. You saw the margin in the quarter, 57%. I believe that's probably an all-time high for us in a quarter like this. And that's driven by a combination of full price sell-through at wholesale, and then obviously, DTC mix and the strength of HOKA that's laying into that as well.

So, again, just broad-based success and gives us real confidences, so we can continue down this path going forward. But, Steve, do you want to add a little more to that?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. Camilo, probably just a little bit more color. In terms of – as we think about normalizing on the gross margin, I think in the quarter, we saw about 100 basis points due to promotion. As we think about that going forward, that would normalize. We wouldn't necessarily see kind of really as much full price selling that we saw in the current quarter. And then, we did have a little bit of channel mix and then FX, which is probably about another 100 basis points. And that we would also begin to see normalize as we get into kind of a more normal quarter with more promotion in a normal environment and then not the FX lift that we saw in the current quarter either.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. So we're going to do everything we can to maintain these levels of channel mix and continue to drive upside in DTC. But longer term, it's hard to say at this point what the supply chain environment will look like overseas with tariffs and demand and logistics and other things that we'll have to consider. So there will be some headwinds in the future, but trust we're doing everything we can to maintain healthy levels of margin.

Camilo Lyon
Analyst, BTIG LLC

Q

Great. Thank you for that color. So, Steve, just to clarify, that was 200 basis points in the quarter for the overall, right?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. I would say 200 basis points that would – due to the exceptional quarter that we would attribute. And then we – and it always changes, right, as you think about promotion and how much. But I think the very clean quarter, as we talked about in the prepared remarks, definitely contributed at least 100 basis points. As I said, FX about 50 basis points and then channel mix, with the higher proportion of DTC, we would expect some of that to come back as there was a higher proportion of DTC selling in the current quarter.

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David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah.

Camilo Lyon
Analyst, BTIG LLC

Q

Got it. And if I could sneak one in, one last one in on HOKA. Dave, I think you said that over half the pairs are sold internationally, but that's not the mix from a dollars perspective.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah.

Camilo Lyon
Analyst, BTIG LLC

Q

So clearly, you're using distributors. What's the intention there to either bring those distributor sales to direct or more to a wholesale? How do you think about improving the profitability of those international direct sales?

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. Nothing to share on that front yet, but trust it's something we're taking a good look at longer term. We do believe that when we control markets that serves us better, obviously, from a margin and also consumer data perspective to have their DTC channels. So we're keeping a close eye on that. There's a lot of heavy lifting that's involved in that. And we'll share a little more color on investments going forward to be able to maintain this level of growth. But it's certainly something that we're keeping a close eye on. And longer term, it's a great opportunity.

Camilo Lyon
Analyst, BTIG LLC

Q

Excellent. Congrats again on a great quarter.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Thanks, Camilo.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Thanks, Camilo.

Operator: The next question comes from Jonathan Komp of Baird. Please go ahead.

Jonathan Robert Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Hi, great. Thank you. Maybe just a broader question on UGG to start. Dave, just given all the new customers you've brought into the brand domestically and then getting past the distribution cleanup in Europe,

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just any broader stroke thoughts on how large you think the opportunity here is for UGG as you look out into the future years?

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. I think certainly, the inventory levels, if you see how we've ended this quarter and how clean the channel is, that's going to serve us well going into next year and beyond. Like I said, the demand broad-based globally is very, very strong. And the strength of what we're seeing now with return to growth in FY 2022 for Europe and then some opportunities that we're seeing in China, we're very optimistic about it.

I think one of the things that we're learning and we learned over the last six months is the power of localized marketing efforts. And that's what you're seeing in both Europe and China to be driving adoption of new categories such as Fluff, resetting the brand from a consumer perspective. And we're going to continue to invest to drive that growth.

So we still think there's definitely growth in the UGG brand globally. And when you start looking at these new categories and the strength of men's, which was a driver this past quarter as well as kids and apparel, it's a very exciting proposition going forward.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. I think just to add on to that, Jon, the diversity that we saw of product in Q3 was really impressive. So UGG had its most diverse selling quarter probably ever.

Jonathan Robert Komp
Analyst, Robert W. Baird & Co., Inc.

Q

And more, just near-term on UGG then, how do you think about in a marketplace that supply is obviously less than demand for multiple styles. How should we expect that to play out from a wholesale order book perspective? And just thinking into next fall, what the replenishment factor might look like?

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yes. We're obviously not going to share any details of that on this call. We'll have a little more color on the next call. But just, as you said, there is great demand out there. And what's impressive about it is, it's diversified across consumer and category by our account segmentation. And the teams have done an amazing job of cementing our distribution and then supplying them with relevant products.

So in the past where everybody was clamoring to get their hands on the Classic, each account now has a different assortment that works for them, and we're servicing them more specifically than we ever have before. So that bodes well for the order book. They're seeing new opportunities with younger consumers, and as I said, men's. When you start looking at folks like Genesco and Foot Locker Group, there's great opportunity to expand into new consumers and styles. So at this point, that's the best way to look at it, but the demand is certainly very, very strong.

Jonathan Robert Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Understood. Appreciate the color. Thank you.

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David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. Thank you.

Operator: The next question comes from Paul Lejuez of Citi. Please go ahead.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Hey, guys, thanks. I just wanted to ask about inventory down a ton. Curious how much of that was planned versus whether you might be seeing some supply chain disruption? Is it a function of just stronger sell throughs? Maybe if you could talk about how you're planning inventory over the next couple of quarters?

And then also curious about the HOKA business, if you could give us an update on the apparel initiative, where are you in terms of building the design talent? When should we expect to see a greater emphasis on a push into the apparel category? Thanks.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah, you bet, Paul. So on the inventory side, the intentional side of this was in the international regions. As we talked about with the transformation of the European market, cleaning up inventory, creating more of a pull model, particularly in Classics.

So our inventory levels were expected to come down in there. The strength of the brand and the demand helped us get there faster than we anticipated, but that was by design. And then also in Asia, specifically China, cleaning up the channel there as well.

So those were work that the teams in those regions were focused on and anticipating, but the demand helped us accelerate that even further. Steve, I'll let you comment on the total company.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah. So, Paul, kind of as we saw total company down, it was really all brands except for HOKA. HOKA's inventory was up. But as you would expect, with the brand growing kind of over 50% trying to just keep pace with that growth is a challenge. I think from an inventory perspective, as Dave said, lower than what we thought but helped us kind of chase incremental sales.

Going forward, there are still disruptions in the supply chain. So we'll be working to bring inventory kind of as quickly as we can as we continue to see demand. So that'll be an area that we're working very closely with our suppliers, really to make sure that we're getting inventory in.

So as we've depleted it, as we've seen inventory levels in the channel significantly lower, it's a big focus of our supply chain to manage that inventory and manage that incoming inventory. So pleased with the position, but also know it's lower than what we expected and so how do we replenish it really going forward.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

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Yeah. And I think it gives us a great opportunity to kind of reset in the channel. And I know the teams are working on that. It also allows us to get orders in earlier, which will help with our supply chain and our production going into this year, which we know will be challenging, but we're getting ahead of that because of the current situation. But it allows us to really set the channel the way we want it to be and to maintain the strength and the positioning of the brand and control it better by distribution type, whether it's DTC or wholesale or depending on the account in wholesale. So it's an enviable position for us to be in and we're going to take advantage of it as best we can.

On the HOKA side, what we said before still holds true. We see this as $1 billion brand with footwear doing the majority of that business, and we're still focused on that. Wendy, the President of the HOKA brand, myself and the rest of [ph] the LT (00:45:43) are evaluating the apparel opportunity. We do believe longer-term that this is a significant opportunity for us. But you're looking 2 to 3 years out before it has a real meaningful impact. But we want to do it right. We want to make sure that we do hire the right design talent, to your point, and that we have the operational and distribution tactics in place to be able to do it in a quality way.

We're known for the innovation and the bold approach to footwear. We need to have the right design talent and supply chain to be able to do that also in apparel. And it's something that we're very excited about. And as we talk about investments going forward, apparel, not just in HOKA, but also in UGG, is going to be a key area of investment for us over the next couple of years.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Got you. Thanks. Just a follow-up, can you talk a little bit about the UGG business within China? Sort of what you're seeing there in terms of what's working, what's not? How you feel about the marketing and how you plan to invest in that region over the next couple of quarters?

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah, it's a great question. A year ago – two years ago now, actually, the year has gone by so fast. Stefano, our leader of omnichannel, Andrea, the President of the UGG brand and the leadership team involved with China and in the brand here put a plan in place to transform that business. It was traditionally a Classics-driven approach, our business there. It still is in large part, but with the focus on localized marketing, on utilizing local influencers, creating excitement around the Fluff franchise and other fashionable styles, such as the UGG Classic Clear, which blew out in no time in China, we're starting to see a turnaround in that business.

And again, it's beyond the Classic. It's new, fresh, exciting styles from a fashion perspective. The impression of the brand is improving based on the localized marketing efforts and the influencers that we're using there. And this quarter was successful from an inventory cleanup, both for ourselves and partners over there, which, again, allows us to set the channel going into FY 2022, the way we want to see it, and make sure that we're still driving healthy full price sales at a diversified offering. And we're confident that we continue on that path, but it is going to take investment.

And as Steve mentioned in the script, we're starting to reinvest in this quarter, Q4. We were shy in investment last year for obvious reasons. But now in Q4 and going in FY 2022, China is going to be a pretty significant focus for us in investments, not just in UGG and marketing, but also to get HOKA off the ground in a real meaningful way.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

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Got it. Thank you, guys. Good luck.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Thank you.

Operator: The next question comes from Sam Power (sic) [Sam Poser] (00:48:31) of Williams Trading. Please go ahead.

Sam Poser
Analyst, Williams Trading LLC
Q

Yeah. I changed my name to yours, Dave.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

I like that.

Sam Poser
Analyst, Williams Trading LLC
Q

Happy New Year. A couple of questions. Number one, how should we think – I mean, given the clean inventory and everything else and the way the momentum of these brands, should we consider the gross margin in the fourth quarter to have a similar year-over-year increase in basis points? And then the same question with SG&A, you said the S&A was going to be elevated. Is that going to be in line sort of with the percent change we saw in Q3 or is that going to be higher than that?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Yeah. So I'll take that, Sam, first. So on the SG&A, it's going to be more, right, because we've been holding back really kind of through the pandemic, as Dave just said. And even as we've looked at marketing, now I think with the success that we're seeing with the brands, the need to invest more.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

And to drive spring business as well. Yeah.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Yeah. So we're looking at how you can drive an increased kind of spring/summer business year-over-year. And that is contributing to a disproportionate increase in the SG&A spend in Q4. So, again, haven't given full guidance, but expect that to be seen in Q4.

Then on the gross margins, I would not extrapolate what we saw in Q3 from a gross margin perspective year-over-year into Q4. I think some of the tailwinds that we saw in Q3 were much bigger than what we would anticipate in Q4. So I wouldn't necessarily increase Q4 gross margins like you saw in Q3. We won't be getting – we'll get some, but not the extent that you saw in Q3.

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David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Yeah. And I would say from an investment standpoint and SG&A, we do have – we believe we have a significant opportunity in spring and summer business, particularly for the UGG brand, that's obvious, and HOKA. But we want to take advantage of this time right now with the momentum of that brand to really drive success in spring and summer this quarter. Obviously, we're looking at the full year results, which will be exceptional based off Q3. But we want to make sure that we're continuing to invest to drive opportunities for the long-term.

Sam Poser
Analyst, Williams Trading LLC
Q

Thanks. And then lastly, just some housekeeping stuff. Could you give us either the wholesale or the direct-to-consumer by brand, either the absolute dollars for Teva, UGG, Sanuk, HOKA and so on, please.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Yeah, okay. So wholesale sales in Q3 for UGG, call it, $408.9 million; HOKA was, call it, $101 million, wholesale. Teva was $12.1 million. Sanuk was $3.8 million, and this is in millions, and then other brands was $32.2 million. And then you can back into [ph] the DTC. (00:51:36)

Sam Poser
Analyst, Williams Trading LLC
Q

Okay. Thanks so much. Appreciate it.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Okay. Sure.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Thanks, Sam.

Operator: The next question comes from Tom Nikic of Wells Fargo. Please go ahead.

Tom Nikic
Analyst, Wells Fargo Securities LLC
Q

Hey, everybody. Thanks for taking my question. So when I look at UGG for the fourth quarter and then, I guess, beyond, I know you said UGG growing, but I was wondering if you could contextualize that a little bit. It would seem between the easy compare, the brand momentum, the channel inventories being extremely low, like you talked about on the call, which would give an opportunity for some restocking, the strength in the Fluff in the spring style. It would seem like this could end up being like a really, really strong UGG quarter. So I was just kind of wondering if you could contextualize a little bit and how you're thinking about it for Q4 and maybe into early FY 2022.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

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Yeah. I think, Tom, it's a little bit hard. It's again why we're not giving guidance. We see opportunity. We're also dealing, as this kind of mentioned on the previous question, some supply constraints with bringing inventory in and so forth. So that's affecting Q4.

So we're really not in a position to give a lot. We see – clearly, it's something like we've said when we were approaching the fall/winter season, the demand is there. The opportunity is there. We still have to manage through kind of inventory, bringing inventory in, expediting inventory. And that's really what – why we're not giving kind of more specifics.

The opportunity is there for UGG, but there are some constraints in the system as we continue to kind of navigate the current environment. So I would just say, the opportunity to do more is there, but there are other constraints that will provide headwinds against the ability to meet the demand that's out there right now.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. And still a very uncertain environment. We still have store closures in the UK and sporadically across the world. And we're going to be coming into Q1 up against last year's pandemic, and that's mixed results based off category and region and channels. So there's a lot to navigate still, but you can't deny the demand and the strength of the brand at the current time. But we just have to balance that out. We're still -the fact that we're still in an uncertain environment.

Tom Nikic
Analyst, Wells Fargo Securities LLC

Q

Got it. And just a quick follow-up. Steve, when I look at the balance sheet, I see almost $1.2 billion of cash. And obviously, some good cash generation for the business overall. And I know you said you're looking to restart the buyback program. Would there be a scenario where M&A would start to become more appetizing to you to have a sort of third leg of the stool, so to speak, or is that not in the cards right now?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yeah, Tom, I think it's a good question. And clearly, it's – we're having a lot of conversation around capital allocation. With the cash that we have on hand, now having our strongest quarter of the year behind us and having an exceptional result for the quarter gives us opportunity to look at a number of things. And so that is what we're doing right now, more conversations, management and the board in terms of capital allocation. I would say just more to come, but recommencing our share repurchase is a good start to that.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. And I think, listen, we have incredible opportunities with organic growth with our brands. And we need to make sure that, first and foremost, we're executing on that opportunity. And that includes global expansion, continued expansion of HOKA, particularly in China, which we're really just getting started still, apparel opportunities and then also the necessary infrastructure to support the kind of growth, both for our DTC channels globally and to logistics to wholesale.

So as we continue to look at where to invest our money, we feel like the first place is organic growth opportunities in talent and resources in our digital transformation. M&A is something we're certainly always keeping an eye on.

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But honestly, I think smaller with high-growth potential is more in our wheelhouse than a big transformative acquisition.

Tom Nikic
Analyst, Wells Fargo Securities LLC

Q

Understood. Well, congratulations on a great quarter and a great year and talk to you soon.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Thanks, Tom.

Operator: The next question comes from Dana Telsey of Telsey Advisory Group. Please go ahead.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Good afternoon, everyone, and congratulations on the quarter and the success. As you think about the marketing spend, which is increasing, where is the marketing spend going? What have you seen in terms of marketing expend, in particular, through any channels where you may see higher returns? And then on unit average costs, any change in average costs in terms of what you're seeing on product? And then lastly, on the shipments and shipping surcharges, how much is that impacting next quarter as compared to this quarter in terms of what you're seeing? Thank you.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. Thanks, Dana. On the marketing side, I believe this is a real strength of Deckers. And the way we set up our marketing spend is in a centralized team that manages all of our spend for our brands globally by region, by channel and consumer type, and we manage that very closely. As a leadership team, we review that – those numbers on an ongoing basis and are continually fine-tuning the dials to optimize spend.

Digital spend is obviously what's driving a great deal of our business, but I also have to give credit to the PR teams across our brands that are just doing an amazing job of creating brand heat at the top of the funnel. And then, we're driving that down to our DTC channels through effective marketing tactics.

Obviously, we have all the traditional marketing channels that we've been using over the years, everything from Facebook and e-mail and Instagram, but we did some great tests over the last six months with Snapchat and Pinterest and using influencers and consumer-generated contact – content, and those are all paying off extremely well also.

So just getting more targeted, more specific with our spend by channel and consumer type. And then as I said, putting more into the regions, but more localized content, leveraging local user-generated content in those regions and then amplifying the strength of our reach through localized channels, particularly in China where they have different channels than we do in the U.S.

But the philosophy, the approach, the financial guardrails around our marketing spend and expected return on investment is managed essentially across the globe. And then we have fantastic teams on ground in regions who are localizing it for the best return.

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So we're going to continue to invest in marketing. If you think about it, even at the rates we're spending now, we still haven't really invested to the extent we should in men's, particularly outside of the US, or apparel. And particularly in China, there's still a lot of opportunity for us to invest in UGG, but certainly in HOKA to drive awareness of that brand. So it's working. It's very productive. And there's a lot more opportunity for us to drive growth through increased marketing spend.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

And then, Dana, just to answer, I think the other two questions were on average selling price. So average selling price for the company is actually going up. And that's being driven by HOKA and a higher proportion of DTC business. So as that proportion has increased and a higher proportion of HOKA, it is driving our ASP up.

Now, within UGG, where you have – kind of in corresponding channels, you will have a slight decrease as diversity has increased and we're selling more product and lower-priced products. So interesting dynamics, overall, again, driving higher ASPs, but some dynamics within the brand in a healthy way driving kind of diversity of product.

And then your question on shipping costs. This relates a little bit to a previous question about gross margin for quarter four. On a proportional basis, we're seeing higher expedited shipping costs as we're trying to bring in inventory due to the depleted inventory that we currently have.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Chasing it.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

So that's going to be a headwind on the gross margin as you look at Q4 because, again, on a proportional basis, we'll be looking to increase that.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC
Q

Thank you.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Thanks, Dana.

Operator: And the last questioner today will be Jim Duffy with Stifel. Please go ahead.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Thank you, guys. And great execution through it all.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

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Thanks, Jim.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

To start, I wanted to talk about international markets. Dave, really encouraging to hear you're expecting growth for EMEA in fiscal 2022. I know a big part of the success in North America has been through diversifying the consumer base. Are you seeing similar success with the customer base in EMEA and Asia? Are you seeing the same kind of uptake with men and same kind of age group diversification?

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. It's a good question, Jim. And we are starting to see signs of that. We've traditionally in Europe, particularly, and really driven by the UK, have had just kind of a core consumer, a little bit older consumer. And that's why you saw the business stagnate over the last few years. But with the focus on a more diverse consumer and speaking to them in a really authentic way, making sure that we are showing up in the right points of distribution, such as JD Sports and Foot Locker and ASOS in the UK and also Zalando across Europe. And then just showing more exciting, fresh, relevant product on influencers, it's having a positive impact.

And what's encouraging to me is we're starting to see younger consumers come into the brand for the first time through fashion product. It's not the traditional Classic that they're buying for the first time. They're buying Fluff. They're buying Classic Clear. They're buying Ultra Mini. So it's a new way to enter the brand. It's a much more fun and fashionable consumer that's coming into the brand, and they're seeing more wearing opportunities versus just when the cold weather hits and putting on their Classic Boot.

So we're starting to see early days of that. The slipper and the fluff phenomenon was slower to take hold in Europe and Asia, but we did start to see that over the last three to six months in those markets. And it's certainly an increased opportunity as we go into FY 2022 in those international markets.

The other area is, as I said, the Ultra Mini and the Classic Clear, but also rain is a great category for us, and we're starting to see a lot of traction there. We've had some production issues with our rain boots in the past, but now that we're bringing those to market, we're seeing great success there as well.

So we do believe that the playbook, so to speak, that has enabled the growth in North America, 20% growth in North America for the quarter is a playbook that will serve us well international. We're starting to see early signs of success.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And then, I was pleased and frankly, surprised to hear that Neumel was the number one style globally. Are you seeing balanced penetration of that across regions? Or is that more of a North American phenomenon with some catch-up to be done in other international markets?

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Yeah. Similar to what we're seeing with a lot of our new revenue drivers as it takes hold in the US first and then we see it trickling into the European and Asia Pacific market. So we've been driving the Neumel business pretty

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hard in North America. It hadn't really taken hold in the international markets until the last three to six months. So it's an emerging opportunity for us in those markets, which is great.

And again, the strength of the men's Neumel and also we have a women's Neumel, so the combination of those two styles gives us great opportunity going forward. And it's also a style that is really exciting when you start thinking about iterations on that and creating seasonal styles with materials and collabs and things of that sort. I think that it's going to be the style that's got a tremendous runway for us going forward.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you. Then, Steve, I know there's been a lot of questions around the inventory, but I'm just curious on the mechanics. Specific to the December quarter, were you able to pull forward receipts to deliver some of that upside in the third quarter? Or was that not how we should think about it? It was really just consuming inventory that was already on the books. And I'm curious, in that December quarter, did you indeed consume any of the airfreight expense? And then is there a way that you can put some shape around the airfreight impact to the margins in the fourth quarter?

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.

A

Yes. Good question. I think you had a multiple, so I'll try to unpack some of that. In terms of what happened in Q3, I would say we consumed mostly inventory that we had or inbound inventory that came in and went out in the quarter. And that's why you're seeing inventory down kind of nearly 17%. So it was more about selling out the inventory that we had. We also, as I mentioned, kind of shifted some of the orders to in-stock inventory, so that helped lower inventory, too. So where we didn't have inventory and an inability to bring it in or have it come in, in Q3, shift some of that into product that we did have. That was a successful move.

And then, in talking about kind of Q4, we're still working through components of that. As I said, as a proportion, again, the expedited amount that will be coming in, in Q4 will be higher. Remember, but Q3 is a much bigger quarter.

So not necessarily giving direction on a specific gross margin, but kind of, I think, where your question was in relationship to one of the previous questions was can we proportionately flow the same level of lift in Q3 that – or similar into Q4. And I'm saying, no, don't do that because of our depleted inventory as we're shifting to more spring/summer, trying to get that inventory in, we are having to expedite it. We're still working through some disruptions in the supply chain. So we haven't necessarily quantified that, but I would say, as you're thinking to build out Q4, I would not extrapolate Q3.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.

A

Those headwinds exist.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

No doubt. I was hoping you could quantify the air freight impact in Q4. And then maybe related to that, are you expecting the air freight to continue to have consequences even into the first half of fiscal 2022?

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Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

Yeah. I think potentially, I think there is a disruption. I can tell you, in Q3, the headwind of FX on the gross margin was probably 20 to 50 basis points. And so on a gross margin basis, I would think that will be bigger in kind of Q4, again, on a comparable basis. I don't see things getting better in the next six months. So I think for the foreseeable future, we're going to continue to have kind of disruptions in the supply chain. I think there's pressure on factories to get product out. There's pressure on shipping companies to get ships across the ocean.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Cost of containers are going up.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

There's issues within logistics within the ports of moving containers and then just getting it to your warehouse and then trying to turn it around. So at multiple steps, we're still seeing headwinds. Now, we, I think, did a very good job in Q3, but it took a lot. Things aren't getting better, like we have not seen things get better at this point.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Yeah. The silver lining is that brands are strong. So our customers, although they are disappointed, they're willing to wait to get the product because the demand for it is so strong. But the costs are still there.

Steven J. Fasching
Chief Financial Officer, Deckers Outdoor Corp.
A

And sorry, Jim, just to clarify, I misspoke. I think I said FX, it's freight. Freight was a 20 to 50 basis point hit. Sorry.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Yeah. That makes more sense. Well, great guys. Thank you so much. And congratulations on the great quarter.

David Powers
President, Chief Executive Officer & Director, Deckers Outdoor Corp.
A

Thanks, Jim. Take care.

Operator: This concludes our question-and-answer session and the Deckers Brands third quarter fiscal 2021 earnings conference call. Thank you for attending today's presentation. You may now disconnect.

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