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GOOS.TO - Q3 2020 Canada Goose Holdings Inc Earnings Call

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PRESENTATION

Operator

Good morning. My name is Kenzie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Canada Goose Third Quarter 2020 earnings Call. (Operator Instructions) I would now like to turn the call over to Patrick Burke, Senior Director, Investor Relations. You may begin your conference.

Patrick Bourke - *Canada Goose Holdings Inc. - Senior Director of IR*

Thank you, and good morning, everyone. With me are Danny Reese, President and CEO; and Jonathan Sinclair, EVP and CFO. After prepared remarks from Danny and Jonathan, we will take your questions. This call, including the Q&A portion, includes forward-looking statements. Each forward-looking statement, including discussion of our fiscal 2020 outlook, is subject to risks and uncertainties that could cause actual results to differ materially from those projected in such statements. Certain material factors and assumptions were considered and applied in making these forward-looking statements. Additional information regarding these forward-looking statements, factors and assumptions is available in our earnings press release issued this morning as well as in the Risk Factors section of our most recent annual report filed with the SEC and Canadian securities regulators. These documents are also available on the Investor Relations section of our website.

The forward-looking statements made on this call speak only as of today, and we undertake no obligation to update or revise any of these statements.

Our commentary today will include certain non-IFRS financial measures, which are reconciled in the table at the end of our earnings press release issued this morning and available on our Investor Relations website.

With that, I will turn the call over to Dani.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Thank you, Patrick, and good morning, everyone. There are two things that I want to accomplish with this call today. Number one, I'd like to share our third quarter results, which continue to reinforce our brand health and long-term growth trajectory; and secondly, I'd like to address the coronavirus health crisis and its material impact on our fourth quarter performance. So let me start with the good news.

Our brand is strong, and our third quarter performance results are a testament to that. I'm really encouraged about the health of our brand is as energized as ever about our long-term potential. To me, what matters most is that Canada Goose is driving traffic and sales at full price. We are delivering best-in-class product and experience, and we are building deeper relationships with our consumers. We're not only succeeding at all of this, but excelling.

This was recently reflected in the List Index, where Canada Goose was included as 1 of the top 20 hottest brands in the world in the last quarter of 2019. To compile this list, they analyzed the shopping behavior of more than 9 million shoppers across 12,000 designers and stores online. Considering search data and online sales as well as social media and engagement statistics, it is a great external validation of what we already know to be true. That brand strength led to strong performance.

Our third quarter revenue increased by 13.2% to $452.1 million, and adjusted EPS per diluted share grew by 12.5% to $1.08. This was achieved with wholesale revenue decreasing by 8.4% due to a planned and communicated timing shift.

As you'll recall, last quarter, we had a shift in the order book to the left, and we forecasted a mid-teen decrease in Q3. Nonetheless, we outperformed our expectation because of strong demand for reorders, further demonstrating the strength of our brand.

We also grew our direct-to-consumer business by 28.3%, even though our stores in Hong Kong, which, prior to the protest, were amongst our best in the world, were severely impacted by disruptions.

In what has been called a challenged retail environment and winter shopping season, the commercial energy in our stores was incredible. We continued to have frequent lineups across our store network, including our older locations such as Yorkdale and Soho, and our new experiential store at Sherway. That ability to drive profit and full price sales also applies to wholesale. Our carefully curated, best-in-class partners regularly call us out as a bright spot. Timely shifts aside, the fact that we have grown wholesale revenue by 11.2% year-to-date, while editing down our points of distribution, is a testament to how strong our brand is and to the quality of the partners that we have chosen.

While most other outerwear brands were discounting frequently throughout the season to drive business, we were not. We had a great Black Friday, one of our biggest sales days of the year, without any promotions in our entire DTC channel. And we saw the same strength for Cyber Monday and for Boxing Day. That tells me that we continue to offer consumers something unique, which they truly value and are willing to invest in. We are now prepared to participate in a race to the bottom with -- which other brands are. Many of you have done your own channel checks, and you know what I'm talking about.

This continued brand momentum all started with great products. We've been methodically adding depth and diversity to our offering for years. The results this season tell us that we are on the right path. 3 of the top 5 new styles across both genders were lightweight down, which is incredibly versatile product for a wide range of conditions and for climates. We also saw the Large Hoody, a core lightweight jacket that we've had in our collection for years, become one of our top sellers in DTC. There is no doubt that our strategy to move beyond just the Parka is working.

In knitwear, we also continue to see encouraging results. It is growing well above the business as a whole, with significant volume increases complemented by an additional uplift from pricing. For the first time, the category approached double digits in the percentage of sales and number of retail stores not surprisingly, I have seen in Hong Kong and Milan, given the climates as well as Mall of America.

As we all know, retail is undergoing transformation and success requires new thinking and bold moves. As I mentioned in our last call, we opened the journey, an innovative new retail concept that we launched in Toronto in December, which is a great example of that breakthrough innovation. We've seen an incredibly strong reception from consumers already. During a 3-week period in the heart of the holiday shopping in December, over

8,000 guests completed the journey. Designed to take 15 minutes, it is a guided and intimate tour to explore the brand through digital content, interactive displays and the next-generation of our award-winning hold room.

As they finish their journey, guests have the ability to browse and purchase the full assortment of Canada Goose online with local same-day home delivery, and they do.

As an experimental omnichannel concept, there are a lot of valuable early learnings from the journey that we're reflecting on. It has proven that an inventory-free store environment can be commercially viable for us. With this format, it enables our brand ambassadors to focus exclusively on guest experience, education and service, and customers get access to the full depth of our online inventory at the snap of their fingers with same-day delivery.

We consider this experiment to be a big success in this concept of something that we are very excited to explore further.

I also want to provide an update on our supply chain, which we discussed last quarter. Now that we have sufficiently built our own manufacturing infrastructure, we are in the process of rationalizing our third-party manufacturing capacity by approximately 2/3. We expect that this will bring in-house production as a percentage of total output from the low 50s at present to approximately 70% in the next year.

As we have said before, in the short term, we plan to continue to ramp up our own facilities, building inventory ahead of near-term growth for next year to maximize efficiency and continuity.

Moving into fiscal 2021, our plan is to have inventory levels to be much more in line with sales as total output comes down in a planned way, and we expect to see inventory normalize relative to growth by the third quarter.

Now let me address the dynamics around the coronavirus outbreak, which has hit our biggest current growth market. First and foremost, our hearts go out to everyone who has been affected, and we stand together with everyone in China and the rest of the world in addressing this health crisis.

To that end, we have made a RMB 1 million contribution to the Wuhan Charity Federation, and we hope that our humble contribution to be of help to swiftly win this battle. The health and safety of our team in Greater China is our top priority, and we are closely watching the situation and adjusting our operations as needed in cooperation with the local authorities.

I'm proud of how our team has responded to the situation, they have demonstrated incredible calm and professionalism. On their behalf and on behalf of all of our 5,300 employees around the world, I want to express our gratitude to all of the health care workers who are working tirelessly on the frontlines.

Greater China is incredibly resilient, and we hope for a swift resolution to the situation. As it is to everyone in the luxury industry, this is, obviously, a major near term headwind. Understandably, people are staying home and avoiding shopping for their own health and safety in China and abroad. So we are seeing impact in our stores and on Tmall in China. And it also in stores located in major international shopping destinations in Europe and North America due to extensive flight cancellations and travel restrictions.

While we expect this to have a material near-term impact, this is a temporary disruption. Nothing about the situation impacts our fundamentals and our future growth potential remains intact.

We know we'll pass the time, and we believe we have the financial and brand strength to write it out with confidence.

From a supply chain perspective, we expect that any impact that may occur in the long-term will be offset by the buffer inventory that we have built over the last year. Unlike many other manufacturers, our current finished goods inventory gives us high confidence in our ability to fully satisfy demand for next year.

We've built an incredible business in Greater China in a short time, and we are ready to continue our rapid expansion there as soon as this is over.

In closing, I deeply believe in our long-term potential and our strategy to get there. We continue to work diligently on our product extension plans, our brand is strong, and we have a solid position in all of our key markets. We already commanded the things that we can control, and we have the strength to navigate the things that we can't. And with that, I'll turn it over to Jonathan to go over the details of our financial results and revised outlook.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

Good morning, everyone, and thank you for joining us. We delivered robust growth in revenue and earnings in the third quarter, in line with our expectations across key metrics as we contended with the external disruptions and a planned timing shift in our wholesale business.

As Dani mentioned, the continued strength of global affinity for our brand, and the growing international diversity of our business were pivotal for our performance. With that said, given the immediate and material negative impact that the coronavirus outbreak is having in the fourth quarter, with just 6 weeks of the year left, we have adjusted our annual outlook, and I'll return to this later.

So I'll now walk through the numbers in detail. Please note that all the figures are, as usual, quoted in Canadian dollars.

For Q3, compared to the same quarter last year. Revenue increased by 13.2% to $452.1 million or 13.7% on a constant currency basis. Starting with wholesale, revenue decreased by 8.4% to $150.3 million or 8.1% on a constant currency basis.

As we discussed on our last call, this is mainly a function of when we shipped. This year, we were able to deliver a higher proportion of total order shipments sooner than last year in response to customer requests and enabled by manufacturing flexibility. As a result of strong in-season reorders late in the period, we outperformed our communicated expectation of negative mid-teens growth.

DTC revenue increased by 28.3% to $301.8 million or 28.9% on a constant currency basis. Hong Kong was a very severe headwind in the third quarter, with the anniversary of IFC's exceptional opening and despite the opening of an additional store this year in Ocean Center.

Beyond the declines in tourism and traffic, we also had to contend with frequent reductions to regular operating hours. In the quarter, IFC had 21 days of early closures and 3 days of full day closures, while Ocean Center had 27 days of early closures and 2 days of full day closures.

Elsewhere, while we were pleased with this year's new store openings, they generally had lower revenue contributions in the quarter relative to last year. This is due to differences in the market characteristics and business patterns for these stores. With the exception of Short Hills, which is a great local store, the other 4 openings last year, Vancouver, Montreal, Beijing and until the disruptions, Hong Kong, are all among the most significant top line contributors in our retail network.

Looking at our fiscal '20 openings show ways experimental and experiential, Banff is our first ever store in a resort town, and Edmonton is a strong but smaller market in relative terms. With Milan and Paris as well as Banff, we also expect a proportion of sales to occur outside of our typical peak season in Q3. Intuitively, this is due to high levels of international retail traffic in these markets in the summer months.

With a network of only 20 stores globally, we are still incredibly underrepresented in some of the world's most important luxury retail markets. A great example of this is our new store opening in Shanghai. This was a standout performer in Q3 from our openings this year. Shanghai is China's wealthiest and largest city by open core with over 20 million people. It's also the nation's fashion capital, with a highly sophisticated global shop.

We knew going in that local demand was exceptional, thanks to the Tmall information. At our location at the Pudong IFC mall is world-class.

More broadly, the pulse of our DTC business was great during the holiday shopping season. We believe our brand continues to define the performance luxury space, driving exceptional traffic and consumer engagement, with our stores and e-commerce sites as the destination for those who want the best product and experience. It's great to see our older stores in our most developed markets, Yorkland and Soho, perform so strongly. It's well documented that, as our first 2 locations globally, they opened to a great fanfare. 3 years later and during the peak season, they're going from strength to strength, with frequent lines and exceptional results throughout the quarter.

Online, both Mainland China through Tmall and the U.S., led the way, growing significantly relative to last year. That momentum speaks to the incredible digital runway we have in those 2 major markets.

Moving on to revenue by geography, we're making great progress in our evolution as a global luxury brand. While Canada is our most developed market in terms of distribution relative to size, it is and will continue to be important, with further growth potential. Informed by how the sector looks globally, we believe that we have larger longer-term opportunities in other parts of the world, and we're moving the needle on them, starting with Asia.

Here, our top line doubled to $94.7 million from $46.4 million. This was driven by incremental revenue from expanding DTC operations in Greater China compared to last year. As a wholesale distributor market, you'll also recall from previous quarters that Japan had a particularly large timing shift. Japan was not a positive contributor in this quarter, though its trajectory in the year-to-date remains very strong.

In Europe and Rest of the World, revenue increased by 11.9% on a constant currency basis. DTC performed well across the region and drove growth.

In the United States, revenue increased by 10% on a constant currency basis. Strength online and in-store offset the impact of negative growth in wholesale. Through a year-to-date lens, and adjusting for timing shifts, our U.S. wholesale business has outperformed the wholesale channel as a whole significantly. We continue to be an incredible driver of full-price business for our carefully-curated network of best-in-class U.S. partners.

Lastly, at home in Canada, revenue decreased by 11.6%. Wholesale revenue declined more than other regions due to both timing and a more challenged retail landscape relative to other markets. We have reached a stage where our wholesale presence is at maturity, and so we are looking to adjust the balance of that going forward.

And although both stores continued to produce at exceptional levels, we also had tough comparisons from very strong opening periods in both Montreal and Vancouver as I mentioned before.

Moving on from revenue, consolidated gross margin was 66% compared to 64.4% last year, and that increase was driven by the change in channel mix. As expected, wholesale gross margin was flat year-over-year at 47.7%. This is a 20 bps improvement from Q2. As our comparisons have normalized versus the first half, this level is right in the mid- to high 40s area that we wanted to be in.

Increases to realized prices were a meaningful and positive tailwind. We used the benefit of that to fund cost inflation and the strategic investments in product mix, with lighter weight jacket styles growing significantly, even in our most significant heavyweight parker quarter. From an elevated comparison of 76.1%, DTC gross margin came in at 75.1%. Again, pricing was a tailwind. In this case, the combined impact of higher input costs as well as higher freight costs and duties from international sales more than offset the benefit.

While this quarterly result came in under our expectations as it is right on the mid-70s level that we think is appropriate over the long term. To sustain direct gross margins at these levels, while growing significantly in newer categories, speaks to the power of our pricing model.

Wholesale operating income was $56.5 million, and operating margin of 37.6% compared to 40% last year. This decline was driven by the operating deleverage on SG&A, given the timing shift in channel revenue to the first half of the fiscal year.

Excluding pre-store opening costs in both periods, DTC operating margin was 56.6% compared to 58.8% in the third quarter last year. This reflects the decline in channel gross margin already described as well as lower contribution margins from current year store openings.

Unallocated corporate expenses were $61.4 million compared to $61.3 million last year. While our unallocated depreciation also rose $0.1 million from $2.5 million to $2.6 million.

While we concentrated more of our marketing investment in this quarter and grew it ahead of revenues, this was offset by cost efficiencies as well as higher nonrecurring costs in the comparative period, relating to the Baffin acquisition and the secondary offering last year. Combined, this resulted in a total operating income of $161.4 million compared to $139.9 million.

On a non-IFRS basis, adjusted EBIT was $163.8 million compared to $144.7 million, with a flat adjusted margin of 36.2% this year and last.

Net income was $118 million or $1.07 per diluted share compared to $103.4 million or $0.93 per diluted share last year. Adjusted net income was $119.7 million or $1.08 per diluted share compared to $107.2 million or $0.96 per diluted share last year.

Turning to the balance sheet, we ended the quarter with net debt of $296.5 million. This now includes $219.7 million in lease liabilities under IFRS 16. On a spot basis at the quarter-end, net debt-to-EBITDA on a trailing 12-month period remains very strong at 1.1x. This reflects a seasonal peak in cash generation and full repayment of our short term facilities.

Net working capital was $284.7 million compared to $170.7 million in the same quarter last year. This reflects the continued build of inventory as we move more production in-house, partially offset by increases in accounts payable and accrued liabilities.

Looking at the composition of our $348.1 million inventory position in detail, the vast majority is being staged for the next financial year. That captures essentially all of the raw materials and work in progress in manufacturing as well as over 80% of our finished goods, given our current year guidance.

I also want to provide an update on the third-party manufacturing rationalization we discussed last quarter. We are in the process of reducing Canadian third-party capacity by over 2/3. In the near term, our intention is to confidently build and stage inventory again ahead of near-term growth as we further accelerate in-house output for efficiency and continuity.

Moving into fiscal '21, as the rationalization takes effect, there will be an offset to the growth you're seeing now.

By Q3 of next year, we expect to reach an inflection point with investment levels in inventory normalizing relative to growth.

Now turning to our revised guidance for fiscal '20. As I mentioned at the start of my remarks, our fourth quarter performance to date is being materially impacted by disruptions from the outbreak of the coronavirus in Greater China. The period going into the Lunar New Year is one of the peak shopping times for our brand. Inevitably, it performed well under our expectations, and our experience last year.

It is also, the last major window of opportunity in the fall/winter selling season. As you're well aware, throughout Mainland China, retail traffic has fallen sharply, with consumers staying home and avoiding all nonessential shopping as a health precaution. This includes our most significant [Tmall] markets such as Beijing and Shanghai. In Hong Kong, this is another blow to a market, which was already heavily interrupted. Travel restrictions have essentially come -- all traffic from Mainland China and local activity is almost at a stand still. SARS, unfortunately, it's still fresh in many memories.

Irrespective of closures and reduced operating hours, revenue is now at negligible levels across the entire store network and Tmall in Greater China. Abroad, the impact is spreading globally to major shopping destinations in North America and Europe. For us, as with others in the sector, traveling shoppers from the region account for a significant share of global luxury demand. That is being largely and suddenly cut off with flight cancellations and travel restrictions, both contributing.

While our brands -- while our brand continues to be in great health globally, and is a standout performer in each of our markets, this development has caused us to revise our guidance as follows: annual revenue growth of 13.8% to 15%, implying revenue of $945 million to $955 million. This assumes wholesale growth between 9% and 11%. Adjusted EBIT margin contraction of between 280 to 330 basis points, implying an adjusted EBIT margin of 21.6% to 22.1%.

Annual growth in adjusted net income per diluted share of negative 2.2% to positive 0.7%, implying EPS per diluted share between $1.33 and $1.37.

There are a couple of factors to consider in assessing this short-term revision. It starts with the success we have had in rapidly scaling our business in Greater China, with a revenue base that is almost entirely DTC. This makes the impact more immediate and more material.

We believe that this sudden change in consumer behavior is temporary and unrelated to underlying demand for our brand. We believe that we're poised to resume our strong growth trajectory in Greater China when this is over.

With regard to margin and earnings, the timing is also relevant. You'll recall that we concentrated our SG&A growth investments early in the year to secure strong momentum throughout the peak season. We had expected Q4 to drive our annual operating margin inflection as there was an offset from that spend tapered. With this sudden development, we lose that leverage, and we don't have enough time left in the year to make significant adjustments beyond those reflected in this guidance.

In summary, our brand and our underlying business model are as strong as ever. We continue to have deep conviction in our strategy, and we're really encouraged by the progress we've made this year. Whilst we will make surgical adjustments to our forward plans, as you'd expect, we won't lose sight of the long game. The phenomenal long-term potential of this brand will be -- will always be at the forefront of every decision we make. And with that, I will hand back to Dani for his final remarks.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Thanks, Jonathan. I would be remised if I didn't take this opportunity to encourage you all to check out our new Project Atigi collection. This year's expanded collection features 90 bespoke pieces created by 18 Inuit designers from 12 communities in Canada's north, who retain all the rights to their designs. All proceeds from the sales will benefit the Inuit communities across Canada through ITK, which is a national Inuit organization, which supports self-directed Inuit education, employment and cultural preservation programs. Arctic stewardship has always been a part of our business and is something that I'm very passionate about. We're leveraging our global platform to share Inuit craftsmanship with the world and to create significant economic development in the areas that need it most. Watch this space closely as we have a big long-term vision for Project Atigi and we are just getting started.

While we activated this important initiative, we also just launched our global spring campaign with New Goose person Kate Upton. A renowned supermodel, entrepreneur and actress, Kate is a passionate advocate for polar bears and protecting their habitat. This year's collection includes 5 new spring styles for our polar bears international capsule, including rainwear, windwear and lightweight down options. $50 from each jacket goes to funding for critical research and advocacy. I have always believed that what is good for business must also be good for the world. So I'm really excited about how closely our commercial efforts are married to our long-standing corporate citizenship initiatives. We are doing it in our own authentic way, true to where we come from, and we're doing it at a greater scale than we have ever before. We look forward to releasing our first sustainability report in the near future.

And with that, I will now turn it over to the operator to begin Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Erwan Rambourg from HSBC.

Erwan Rambourg - *HSBC, Research Division - Global Co-Head of Consumer & Retail Equity Research and MD*

I'm quite surprised by the magnitude of the revision of the guidance given that North America is still 60% plus of your sales. So I was just wondering if you could give us details in terms of how much Chinese consumers account for in terms of your sales? I mean, we can have a look at Asia and take a view of what Greater China accounts for. But I guess, more importantly, it would be interesting to understand how much Chinese travelers accounts for in terms of sales in Canada and the U.S.? So I don't know if you can give us an assessment of sales by nationality, which would be quite useful in understanding this revisions.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

Right. So I think our guidance revision has been -- it's important to understand, is driven by the impact of the outbreak on our overall business in the fourth quarter, having had a third quarter in line with expectations across our key metrics.

In China, what we're talking about here is that we have negligible revenue across our entire store network, including Tmall. And while local demand in North America and China continues to be strong, international traffic from Chinese consumers is essentially shut off due to travel cancellations and restrictions. And for us, and for the sector generally, these -- they are the largest buyers of luxury goods.

Now while the impact is, of course, less severe on a unit-by-unit basis, the size of our business outside of Greater China is much larger in terms of distribution revenues, as you say. And for those reasons, and this is reflected in our guidance, we also expect material revenue declines in North America and Europe. Historically, we've always said that we have a mix of clientele, which always varies by store, but on -- in aggregate, it's a 50-50 mix between domestic demand and international demand, and I think that's what you're seeing play out here.

Erwan Rambourg - *HSBC, Research Division - Global Co-Head of Consumer & Retail Equity Research and MD*

And just maybe a follow-up on wholesale. I think you mentioned that Canada was close to maturity. I'm just wondering if you could give us a -- an update in terms of where you stand in terms of the number of doors? I think you went gradually down from 2,500 to close to 2,000 or maybe a bit below. Where do you stand today in terms of the doors at wholesale?

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

So in fiscal '18, we were at 22 -- fiscal '19, sorry, we were at 2,200. And we're on a gradual journey of editing towards about the 2000 mark.

Operator

Our next question comes from the line of Omar Saad with Evercore ISI.

Omar Regis Saad - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

I just kind of wanted to follow-up on the commentary around China and the coronavirus impact. Just a kind of couple of questions embedded within that. Did you see a sharp drop off, both in Mainland China and with the tourist business outside of Mainland -- Greater China? Could you see that really start to drop off post that kind of January 23 time line that everyone's pointing to? And then, I guess, if I look at your revised guidance, it seems like the implied fourth quarter growth, that was implied in the guidance previously, is probably around plus 20% and now it looks like you're talking about minus 10% to minus 20% for the fourth quarter. Does that mean that the Chinese consumer, does that imply that the Chinese consumer is roughly 30%, 40% of your overall base? Is that the right way to think about it, including the traveling Chinese consumer? And then are you -- last piece on -- last question on the China piece. Are you seeing any -- what's happening with your e-commerce business in China? We've heard from a couple of other players that the e-commerce business is holding up better because people don't have to leave their homes and they can still shop online and have stuff delivered.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes. I mean, in terms of the big picture, I think that the fourth quarter was -- the impact on the guidance in the fourth quarter were directly related to China and also to Chinese tourists traveling and the overall travel brands that have taken effect and airline cancellations that has caused a decline in traffic overall. And also, understandably, people staying home and not shopping to take care of their health, both -- not shopping in stores or online as much they were before. And that's a macro reason why our guidance changed this quarter.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

And I think it's fair to say that the the drop-off in traffic in malls and in shopping destinations in China was sudden, dramatic and happened -- and affected the entire sector around the time we suggest. And that guides us to Tmall just as much as it does physically to the stores.

Operator

Our next question comes from the line of Kate Fitzsimons with RBC Capital Markets.

Kate Bridget Fitzsimons - *RBC Capital Markets, Research Division - Assistant VP*

I know it's too early, obviously, to give guidance for fiscal '21, just given the business is facing some headwinds right now between Hong Kong and China. Dani, you've been pretty clear that Asia is a big part of the growth story go forward. And you have seen tremendous growth in recent quarters, despite what you're seeing right now. I guess, when we're thinking about fiscal '21 growth plan, how is what you're seeing in the business right now, adjusting how you were thinking about the growth levers into fiscal '21? And then longer term, can you just speak to your confidence that this headwind doesn't impair growth below that 20%-plus, 3-year top-line outlook you guys put out about a year ago?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes, thanks for your question. I mean, we're very confident in our long-term prospects for the business. There is to it -- there's a near-term business impact, and there is a long-term business impact. And obviously, it's a major headwind near-term and long term. We're very confident in the financial strength of our business, and we're poised to continue our expansion. And we're very comfortable that we're going to continue to do so.

On the same trajectory, similar trajectory as we have been growing our business, especially in China, where we just started just over a year ago, building that business unit, and it's grown very rapidly, and it continues to grow rapidly and there's so much runway there. We're excited to continue that growth. Once this crisis passes, and once we get -- we, as a world, get through it.

And I think we can point to things like the fact that we were included as 1 of the 20 hottest brands on the Lift Index in the last quarter of 2019. That's, I think, a very important external validation of our brand and of what we know to be true. This is -- on top of Asia growth, we've -- we see a great strength in U.S. DTC as that continues to grow. So we see a lot of really positive signs. We see really -- I think, our concept store and the fact that we're taking a leadership position at redefining and finding out the new generation of experiential retail, that's really important to us to and is -- to not be complacent to continue to figure out what that is. I think that's all really important. So once we get past this temporary and specific matter, I think, I'm very confident in our continued ability to grow.

Operator

Your next question comes from the line of Jonathan Komp from Baird.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes. Maybe just a follow a little bit with the questions around China on corovirus?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Sorry, we can't hear the speaker.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And more specifically, when you look forward beyond the March quarter. Any thoughts to both that's kind of the seasonality of the business changes? And then also maybe your utility.

Allison C. Malkin - *ICR, LLC - Senior MD*

Kenzie, we can't hear the speaker.

Operator

Jonathan Komp, we are unable to hear you. If you could remove yourself from speaker phone?

Allison C. Malkin - *ICR, LLC - Senior MD*

Do you want to move on to the next one, and we can take Jonathan after he reaches you.

Operator

Our next question comes from the line of Michael Binetti from Crédit Suisse.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

So I want to follow-up on the coronavirus impact. It looks like you're implying margins in that business. And that was lost sales, fairly similar to what we've seen from some of the other global businesses recently. But in the -- I'm trying to figure out, is that -- is the $50 million, $55 million reduction, is that concentrated in global DTC? Or was there any -- did you lower the plan at all for wholesale that you had in the fourth quarter? It would seem like most of that would be -- it seems like you're putting -- you're assuming most of that impact will happen in direct-to-consumer. It would be helpful to understand kind of what you're seeing or a few -- I don't know if you're seeing any wholesale partners cut orders in the near term, just quickly, considering Corona really just hit the newswires 3 weeks ago.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

Yes, Mike, it's Jonathan here. You're absolutely right. This is the DTC story. Wholesale is relatively low in this quarter anyway. It's all in support of our spring business. It's proceeding as planned. This is all about DTC.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. I guess, I just -- I would love a little bit of help understanding some of the metrics within D2C because as the business has grown, it's become a lot more complex and a lot harder for us to understand. We're trying to reconcile between dynamics like 29% D2C growth in the quarter. The store count was up 70%, even depending on the footage, if we have it right. It looks like it might be 50%. Both numbers are significantly higher than the 28% total D2C growth. I know you'll reference a difference in productivity as you move out of the real power centers in Soho and things like that. But it's hard for us to understand the componentry of how the legacy stores are growing on a year-over-year basis? Is e-commerce growing globally within that D2C number just because of the number of lines that are feeding in there? Is there anything you can help us understand so we get a better understanding of the economics of the new stores as they're coming in, and you really move out of the shopping centers that are

-- there's not going to be many shopping centers, right? like outside of Soho with the kind of economics like that as you go forward, and I think it's becoming more important for us to understand as the store count grows bigger for you.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

Okay. So 2 or 3 things. Number one, we've got 20 locations in a world where there are way more than that in terms of prime, highly-productive retail luxury locations. So it's not a question that we're sort of going down the list as it were and so only having the best stores in the first year and everything else is worse than that. So second point, inevitably, therefore, different cohorts of stores have different characteristics. And this year's cohort of stores happens to have a set of characteristics, which is somewhat different when it comes to the sales densities that we experienced for a variety of reasons, and I enumerated those on the call -- sorry, in my prepared remarks. In the sense that we've got stores, which are in tourist locations or we've got stores that are in resort locations or experiential stores, and therefore, extrapolating the sales density of the existing fleet into those and expecting that to be how the numbers manifest themselves is probably oversimplifying it as a result.

And -- but that said, when we look at the future runway and the ability to grow the stores and the sales from those stores into the future, we have huge amounts of white space to grow the brand.

When it comes to online, we've seen strong risk in our online pretty much around the world. I think we've certainly seen -- we've called out the strength and performance in America, we've called out the strength performance in China, both of which are huge e-commerce markets, and both of which saw sort of significant growth. As we get further into omni-channel, I see that as a point of leverage across the entire DTC operation.

Michael Charles Binetti - *Crédit Suisse AG, Research Division - Research Analyst*

Can I just -- if corona comes and goes within the March quarter, I don't know about the timing, is this a 20% multiyear revenue growth algorithm business as we get into 2021?

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

For a variety of reasons, we've made the case as to why this business is a fraction of its eventual size. The impact of this terrible and sudden health crisis is temporary in our view. And it doesn't affect our view of our strategy and of the potential of this brand, and of our ability to continue to grow.

Operator

Our next question comes from the line of Jonathan Komp from Baird.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes, apologies for the last time. Maybe just to reask my question. Really want to understand, as you're planning the business, how you're thinking about the ongoing impact from the coronavirus crisis? And as you think to the months and quarters ahead, just any more color on how to think about the seasonality as it changes? And the relative mix of the business being impacted? And then also your ability to react more from a cost or margin perspective?

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

So I think we're being responsible in the way that we plan the business, obviously. None of us know exactly how this plays out and over what period of time. But what we are doing is, if you like, looking at the business through 2 lenses; one is our long-term growth, our long potential and ensuring that we are taking the right decisions to continue to grow this brand; and on the other hand, we're being responsible in the short term, so that we are good financial stewards of the business.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes, I agree.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. Understood. And then if you -- No, I'm sorry, go ahead, Dani.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

No, just to add to that, I was asked maybe (inaudible) rather than say that to add to it -- I think that it's near-term and long-term. In the near term, we're being cautious. In the long term. I'm an optimistic person. I have a tremendous amount of optimism about the future of this business.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, great. And then just 1 follow-up. Both related to some of the comments around Canada and the tough retail environment? And then, obviously, the dynamics in China, just when you think of the inventory you have today is -- how different is it on hand versus what you would have expected 90 days ago? And just any thoughts about the risk to the balance of current goods that you have on hand?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes. We're really happy with where we stand with regards to our inventory. I mean, as we've explained and as we've planned, we've really been building out our in-house capacity, which is a core strategy of ours from beginning, and we've successfully reached a point where we're very happy with the -- our in-house facilities to a point where we're now rationalizing third-party Canadian contractors. And so as a result of this build, we've built a lot of inventory. And through this rationalization. We're going to see the ratio of that inventory to sales come down, and that'll become noticeable in the third quarter of next year. And also, as a result, we have a good amount of inventories. All of this inventories is -- stays for next year. As Jonathan mentioned in his prepared remarks, over 80% of it is made for next year, and it's all good inventory. So we feel like we're in a really good position, especially given the unfortunate events that the coronavirus presented to be able to deliver all the orders for next year as well with this inventory.

Operator

Your next question comes from the line of Oliver Chen from Cowen & Company.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

As we model the gross margin on a on a longer-term basis, should we expect continued pressure from freight cost inflation? And as you enter newer categories, the negative mix impact? Would love your thoughts.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

Thanks, Oliver. I think, from our point of view, we -- nothing has changed in the sense that we talk about tailwinds and we talk about headwinds, and our algorithm doesn't change. In other words, we don't see margin over time going massively up or down. What we see is ourselves managing a balance in channel between the tailwinds of bringing more production in-house, pricing efficiency and reinvesting that in the -- in addressing the cost inflation of the inputs that we have as well as in the development of our product. So we don't see anything that's really changing on that front.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay. And in the newer categories, it looks like consumer reception has been really good. What are your thoughts on the inventory planning around newer categories and a different kind of risk profile as you assort to year-round product versus some of your core, high-margin staples?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes, we're really excited about how -- with the reception to our new products. And I think that the reason why that we've been able to deliver great new products in the market is because of our strategy and taking our time around new products and making use of the rights of the marketplace. And we're very conservative in how we build inventory through our new products -- new product offerings, which is why they build slowly, and we're and over time. And we believe that's the right way of doing it, and we have a long runway ahead of us.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

And lastly, are you thinking about M&A in terms of your strategy and what you're considering for growth opportunities in synergizing your talents?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

We are not.

Operator

Our next question comes from the line of Sam Poser from Susquehanna.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

A couple of things. Prior to the slowdown of the traffic due to the coronavirus, was there a change in the manner -- the fill-in orders that were planned -- from retailers that was planned for fourth quarter? I mean, was there any impact on any other thing in the fourth quarter maybe due to weather and so on that impacted your fourth quarter reduction in guidance as well?

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

No. I mean, if anything, what we saw was that we took more in season orders than we thought because we guided, as you'll recall, to mid-teens decline in Q3 in wholesale. And we actually came in at an 8% or so decline and the delta there was the in-season reorders. So no, absolutely not.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

But nothing impacting the expectations of -- so some of those reorders may have been pulled from what you're expecting in the fourth quarter, but nothing else changed?

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

No. And the reality was that people wanted the inventory in Q3 when they can sell it. They were keen for it.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes. But on the contrary, our wholesale orders in Q3 were higher than expected. We shifted a lot into Q2, and we expected a year-over-year decline, but it was far less than we thought it would be.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

And then secondly, are you doing anything with your logo? Adding more black label, maybe developing other new logos going forward? I noticed that within the Soho store that there's just -- relative to others, there is a very large swath of black label there. But -- and I was just wondering if you had anything in the works in that regard?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Thanks for your question. We are strong advocates and believers in consumer choice. And we recognize that different consumers have different taste preferences and that's reflected in the colors of the logos that are available in market.

Operator

Our next question comes from the line of Mark Petrie from CIBC.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

I just wanted to ask about the relative sort of pricing levels and price increases that you've taken across the portfolio this season. I'm not sure if you can quantify what the overall sort of price increase would have been for this year. And sort of interested, I guess, specifically with regards to parkas but also then in lightweight down, and you called out the success there. And then you have been introducing many new products at the higher end of the range. I'm not talking about BRANTA, but just in terms of the core portfolio. Wonder if you could talk about the performance of those newer products at the higher end? And your perspectives on pushing prices further in fiscal 2021?

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

So I'll -- we'll answer your question in 2 parts. I'll talk a bit about the pricing. We've always talked about taking price in the mid-single digits, and that's something that we continue to do. That applies surgically across the product collections. And then we deploy that around the world, in line with the global pricing index, followed by other brands. So nothing's changed. We continue to do that.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

And to follow on to Jonathan's comments. With regards to us putting new products into the marketplace at higher price points, that has definitely been a strategy of ours, and I'm happy to say it's working extremely well for us, and we intend to continue to do so.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Okay. And then I just wanted to follow-up on the previous comment just about the trends in Q4 that there is -- there seem to be a pretty healthy inventory levels throughout the retail channel, the wholesale channel. I know you haven't seen sort of evidence of discounting, but could you just talk about your conversations with your wholesale partners to this point? Their level of sort of comfort with inventory levels today? And how you see that playing out?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes. We have a very strong and strategic relationships with all of our wholesale partners. We've always aligned ourselves with the partners who share the same values that we do. And we -- the conversations are really easy because we -- first of all, we are a brand that helps drive traffic to stores as many of our wholesale partners have called out themselves. And so the nature of the conversations are very easy. I guess, we're an outlier in that -- we don't believe in being promotional and our partners share that vision.

Operator

Our next question comes from the line of Ike Borco from Wells Fargo.

Irwin Bernard Boruchow - *Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst*

I think, Jonathan, there's 2 questions for you. One, just a clarification -- is very simplistically. I'm curious, prior to the coronavirus outbreak, given what you had in your pocket for Q3, would you guys have planned to reiterate or raise your fiscal year outlook? Or is there something else on top of that? I just want to clarify that. And then when I'm digging in more on Q4 and maybe even beyond, can you just talk about the gross margin implications? Because when you think about the revenue issues you're having at DTC, it sounds like gross margin should be under pressure because of the mix of the business shifting in the -- more towards wholesale. But then within that, I'm assuming that there's even more margin -- gross margin decline because of the higher -- what I assume is a higher margin DTC revenue within those stores in China that are going away. So I guess, just any color on the Q4 gross margins and beyond as well.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

Okay. So I think, two things. First of all, we're being very clear that we were on track in Q3, and what's changed, and the fundamental thing that's changed is this terrible situation with the coronavirus. That is the sum total of the change in the business. That's what we're talking about here and its impact on shopping -- consumer shopping trends around the world. So I think that's the first question you asked.

As far as gross margins are concerned, we're on record of saying that we see high single -- high 40s as it -- for wholesale gross margin to mid-70s for DTC gross margins as the right place for this business. What you see here is exactly that, and that's something that I expect to play out over time. I don't see any change to that. You'll see some seasonality when spring is stronger, margins for the time being a little bit weaker, when spring is weaker because we're on seasonal margins are a bit stronger. But fundamentally, you're looking at sort of wholesale gross margin more or less where it is. DTC margin more or less where it is going forward. And then the optics of the business will change as wholesale assumes a smaller proportion of our business, and DTC assumes a bigger proportion of the business. No, nothing changes.

Irwin Bernard Boruchow - *Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst*

But can you comment on Q4 specifically given what's going on with DTC under pressure and China within DTC under pressure? I'm just trying to understand how much gross margin pressure we should expect for Q4.

Jonathan Sinclair - *Canada Goose Holdings Inc. - CFO & Executive VP*

I don't think you should be reading things into Q4, that there should be any real difference in pattern to what we saw a year ago in Q4 because, ultimately, to the extent people are buying, they're buying the same mix of products that they had been buying a year ago.

Operator

Our next question comes from the line of Alex Walvis from Goldman Sachs.

Alexandra E. Walvis - *Goldman Sachs Group Inc., Research Division - Research Analyst*

My first question is on the the Canadian market. You made some comments about new challenges there. I wonder if you could elaborate? And did that region fall short your expectations coming into the quarter? Or was that embedded in expectations before?

And then my second question is on the European market, a couple of openings there this quarter. Any color on performance there? And how that's changing your thinking on the opportunity in the European market?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

Yes. Thanks, Alex. I think our wholesale business in Canada is reaching a point of maturity. The retail environment here is softer than other markets, including the U.S. and, frankly, some of our partners did not have great fall/winter season. And we are in the process of rebalancing our presence and ending it down and this is a natural occurrence. It's not concerning to us. Canada is the most developed market in terms of distribution relative to size. In the immediate term, we also have to contain the impact of the coronavirus, of course, outbreak and just to travel and the effect it has on travel and tourist traffic and that, that's going to be a headwind. And none of this at all concerns me when it comes to our brand health or continued D2C growth and potential in our expansion in Canada. The commercial energy in our stores and the consumers sentiment behind it is and remains extremely strong.

Alexandra E. Walvis - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Great. And then maybe a comment on the European market?

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

European market remains very strong. Yes, we opened 2 new stores there this year, and we're very excited about that. First Milan and then Paris. And we see -- I mean, Europe is in relation to all of our markets has the lowest percentage of DTC. So we see a large amount of runway there going forward.

Operator

This concludes our Q&A session for today. I will now turn the call back to Dani Reiss for closing remarks.

Dani Reiss - *Canada Goose Holdings Inc. - Chairman, President & CEO*

All right. Well, thank you all very much for taking the time to be here with us today. These are fatal times. We appreciate your interest in and your support of Canada Goose, and I very much look forward to speaking to you again at the end of the year.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.