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YETI Holdings, Inc. (YETI)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the YETI Holdings Second Quarter 2019 Earnings Conference Call. At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host Tom Shaw, Vice President of Investor Relations. Please go ahead.

Tom Shaw

Vice President-Investor Relations, YETI Holdings, Inc.

Good morning, everyone, and thanks for joining us to discuss YETI Holdings' second quarter 2019 results. Before we begin, we'd like to remind you that this conference call will include forward-looking statements, which are subject to various risk and uncertainties that could cause our actual results to differ materially from these statements. These statements are detailed in our risk factor discussions that can be found in this morning's press release as well as our filings with the SEC, all of which can be found on our website at investors.yeti.com. We undertake no obligation to revise or update any forward-looking statements or information.

During our call today, we will also reference certain non-GAAP financial information, including adjusted items. Reconciliations of GAAP to non-GAAP measures as well as a description, limitations and rationale for using each measure can be found in the supplemental financial tables included in this morning's press release and in our

filings. We use non-GAAP measures as a lead in some of our financial discussions as we believe they more accurately represent the true operational performance and underlying results of our business.

Today's call will be led by Matt Reintjes, President and CEO of YETI; and Paul Carbone, CFO. Following our prepared remarks, we'll open the call for your questions.

With that, I'll turn the call over to Matt.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thanks, Tom, and good morning. We're excited to report another strong quarter for YETI. As we reflect on what we have accomplished at the midpoint off the year, we feel great about the growth of our brand, the pipeline of new products and the progress on our strategic initiatives. Let me first give you a few details on the quarter.

Second quarter revenues grew 12%, resulting in first half revenues up 13%. These results were powered by our DTC channel which saw growth of 43% during the quarter and 36% for the first half of 2019. Our focus on building powerful brand and product stories continues to drive momentum. We saw this with the Tundra Haul and the Camino Carryall tote and with our new GoBox and Daytrip Lunch Bag, both of which have surpassed our early expectations.

The strategic use of color continues to resonate with customers, particularly the recent expansion of charcoal in soft coolers. Similarly, in Drinkware, we expanded the reach of our color inspired by true events series with Canyon Red, Reef Blue and Sand across tumblers and bottles. We also remained a go-to gift-able item during important moms, dads and grad period in Q2.

Gross margins expanded 140 basis points to 50.2% during the period as our focus on product cost improvements and increasing DTC mix more than offset the previously communicated impact of higher tariffs. All told, we delivered a strong adjusted earnings per share of \$0.33, giving us confidence to lift our full year guidance.

Now, let me transition to how we look at our four strategic growth drivers; expanding our customer base, introducing new products, accelerating direct-to-consumer and international. Starting with our efforts to expand our customer base, overall, unaided brand awareness from our 2019 brand study rose another 2 percentage points to 12%. This shows the meaningful potential ahead as we continue to broaden our brand awareness through product and messaging. Category aided brand awareness in both the Drinkware and Coolers showed strong 500 basis point and 400 basis point increases to 64% and 57%, respectively, indicating we're continuing to drive strong relevance in our heritage businesses.

We're incredibly excited by the continuation of our high 90% referral rate when owners are asked if they recommended YETI to someone else. This continues a very positive trend even as the brand has expanded geographically and product has extended. Powerful brand experiences continue to be a underpinning of what we believe makes a great sustainable brand and why we resonate with consumers in such a relevant way. Even as we evolve our strategies to reach and connect with new consumers, endemic, highly authentic brand opportunities remain at the center of what we do. This includes our recent activation of the Jackson Hole Food & Wine Summer Festival, an amazing two-day celebration of food, wine, spirits and craft brews alongside one of our chef ambassadors Adam Perry Lang.

Another example is the recent partnership with Skudin Surf in New York. Some of you on this call or your children may have tried a surf camp on Long Beach with Skudin. In addition to running great camps, Will and Cliff Skudin

are also doing meaningful work introducing surfing to a broad range of individuals, from wounded military veterans to those that are physically or visually impaired. This is inspiring work and we're incredibly proud to support them.

Finally, the story of single use elimination is front and center for us. We're playing an increasing role here that clearly starts with our product, which is naturally a durable and reusable answer, but we're also extending across many of the events we support. For instance at the GoPro Mountain Games in Vail, we provided three separate water refill stations that provided over 15,000 fill-ups for the 80,000 plus in attendance. All told, we estimate we have served nearly 140,012 ounce bottles worth of water to over 50,000 people throughout our events year-to-date. There's much more we can and will do here and we're creating a strong foundation around the impact we have with the YETI brand and products.

Switching to introducing new products. Complementing our wider brand reach, we remain disciplined in how we drive our product expansion and develop new product. As I mentioned in the opening, colorways continue to strongly resonate with our customers and we saw this again last quarter with the addition of charcoal in soft coolers, our three seasonal colors and existing colors expanding to new products. We also recently debuted three new colors for the second half of the year that are already starting to generate strong buzz; Peak Purple, River Green and Clay.

The first color to launch, Peak Purple, generated over 30,000 likes and 3,000 comments on Instagram in the first two days. We believe we have established a sustainable color cadence as an integral part of our innovation strategy. Beyond color, we have a compelling new product line up for the back half of the year much of which we debuted at the Outdoor Retailer Show in June. We were excited to introduce the next generation of our soft cooler with the Hopper M30. The M stands for magnet and an innovative magnetic closure system that creates an ultra-leak resistant shield. The M30 features a 50% wider opening than our legacy product, which simplifies packing and unpacking. Additionally, the enhancements drive roughly 20% greater ice retention over our Hopper Two second generation product.

So we have a great product replacing what was already a category leader, demonstrating our ability to drive enhancement and continuous improvement. We also launched Daytrip are fresh-for-hours, fold-and-go, easy-to-carry lunch bag. This bag is loaded with premium insulating and performance features. Coming out of the Outdoor Retailer, Shape named the Daytrip to its Best Of list and the product registered over 20,000 likes in its Instagram debut.

In our new pet family, we're taking our popular Boomer 8 Bowl and providing a smaller four-cup version utilizing all the same great features of the original, including dishwasher stainless steel and our BearFoot Non-Slip bottom. We're also introducing our first dog bed, in YETI Fashion, the dog bed includes a rugged tear-resistant construction and a high density foam core. The bed also includes a two-in-one by offering a removable travel pad with a waterproof bottom. Gear Patrol recognized the YETI trailhead dog bed in its best gear list at the Outdoor Retailer. Naturally, the trailhead dog bed will be available for sale on Aug 26, also known as International Dog Day, exclusively on yeti.com and at YETI stores.

Yesterday, we announced two new products that are part of the expansion of our bag family, an everyday backpack and tote. As many of you heard me discuss, we believe there is a significant opportunity for the brand in bags given its large global nature and high level of fragmentation. It's also an area that we believe is a logical extension of our brand incorporating many of the design elements and attributes from other parts of our product portfolio. These two new products fit well with our current premium performance line of waterproof duffels and tote.

For instance, our new Crossroads backpack and tote take learnings from our Panga backpack and Camino Carryall tote but add enhanced features including improved overall accessibility, storage and ergonomics. The Crossroad bags add everyday functionality to manage the Monday through Friday you. These are great products that provide the durability and functionality you expect out of YETI for those times you might not be out in the water or venturing far afield.

On the Drinkware side, in addition to colorways we created an ultra-durable Rambler bottle for the little wild ones. The 12-ounce Straw Lid Rambler Jr. We're also introducing 10-ounce stackable YETI mugs. These new mugs were great keeping your morning coffee hot or your evening wine down cold and conveniently stacked for storage.

Accelerating our direct-to-consumer growth. As we have emphasized, an omnichannel strategy is important to our customers and consequently to us. We remain very pleased with the evolution in our DTC business allowing us to complement the work of our wholesale partners while also providing a pinnacle brand experience that our customers expect. Highlighted by the 43% growth generated in the second quarter, our DTC sales mix reached 36% for the period versus 28% last year, while also continuing to serve as a key margin driver for the overall business.

With our efforts to leverage our growing database of owners and recent investments across our marketing and data analytics teams, we are becoming more prescriptive in how we engage both new and existing customers, whether it's via social, digital, e-commerce, event or in store. During the quarter, we focused on investment in our yeti.com platform and technology including the April integration of yeticustomshop.com and numerous other improvements.

As we have mentioned, this updated customer experience removes the friction that existed in the past when we had two separate sites and ultimately drives greater customization awareness through the customers' purchase path. In addition, we have two initiatives that will drive improved capacity and customization and improve 3PL coverage in the second half of 2019. We're adding customization capability that we believe will allow us to deliver deeper [indiscernible] (11:10) during the holidays.

As some of you may have noticed, our order cut-off periods for customized work have historically come quite early in the holiday season, so we're excited to support demand later into the holidays for both consumers and corporate customers. We're also opening our second domestic 3PL located in Salt Lake City this quarter, improving our speed to customers in our West Coast markets. As it relates to YETI retail stores, we celebrated a milestone this quarter with the opening of our first store outside of Austin in Charleston, South Carolina. The store is off to a great start and we're energized as we move towards our next door later this quarter in Chicago, followed by the planned late 2019 store opening in Denver.

With our omnichannel approach remaining focused on the customer experience, this increasingly means we are partnering with retailers who are investing in merchandising a holistic brand experience. Our criteria for future distribution remains focused on the intersection with a new customer, creating a new buying occasion or as an augment to our existing wholesale portfolio. We believe combining these dynamics balances the needs of an expanding product portfolio with the ability to tell and show a proper brand and product story for the customer.

Finally, our international business remains largely in its early stages even as sales ramp in Canada, Australia and Japan. With the international mix approximately 5% of our total in the second quarter, we have now generated more sales internationally in the first half of 2019 than we did during the entirety of 2018. Further, on the

international front, we're also pleased to announce our expanded entry into Europe and the UK. We launched our dedicated EU and UK e-commerce sites in late July, added a 3PL in the Netherlands and will now focus on extending to select wholesale partners.

On Canada, we're seeing great momentum and we're excited to have taken our next step in the country through the launch of yeti.ca in late June. This is a significant move for the brand in this market as it creates a better localized experience. Last month, we also continued our support in Canada with the Calgary Stampede. This 10-day celebration bills itself as the greatest outdoor show on earth, featuring one of the world's largest rodeos as well as other events, concerts and exhibits.

In addition to YETI product sales at the event, our Tundras were used in the presentation for the winners of the daily bronzes and we're thrilled that one of our ambassadors walked away as the overall champion in saddle bronc riding. With total attendance of nearly 1.3 million throughout the event, it was a wonderful opportunity to continue to introduce the YETI brand to new consumers.

Before turning the call over to Paul, I wanted to provide a few updates on our ongoing efforts to build out a world-class leadership team here at YETI. Last month, we realigned our leadership team to fit with the global opportunities in front of us. With this move, we consolidated all direct customer engagement including e-commerce, retail, international and our customer experience group under the new role of SVP, a direct to consumer and managing director of international.

Given the growing importance and alignment of global DTC, we're excited that Rob Murdock, who has led our innovation efforts the past two years, has taken on this new role. We've built a very strong innovation team and I'm excited to provide the interim leadership in this important area while we look to bring in our next leader. Additionally, at the end of July, Matt King joined YETI in the newly created role of Chief Information Officer. We look forward to leveraging Matt's 20-plus years of deep IT and applications experience, including his previous five years driving the omnichannel technology roadmap at TOMS Shoes and 15 years working through large scale business applications at Nestlé USA.

With that, I'll turn it over to Paul to review our financial results in more detail.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

Thanks, Matt, and good morning everyone. I'll begin with an overview of our second quarter results followed by updates to our fiscal 2019 outlook. For the second quarter, net sales increased 12% to \$231.7 million compared to \$206.3 million in the year-ago period. As Matt indicated, these were very strong results, notably, in a quarter where several gift-giving occasions are important drivers of the business and overall volumes are nearly 50% higher than what we typically generate in the first quarter. Net sales growth benefited by approximately 160 basis points driven by two factors.

First, an approximate 400 basis point favorable impact from the revenue recognition change related to the Amazon Marketplace. We have now fully lapped the recognition change from a comparison standpoint. Partially offsetting this benefit, growth during the quarter was adversely impacted by approximately 240 basis points from the earlier timing of wholesale shipments into the first quarter.

Looking at net sales by channel, direct-to-consumer net sales for the second quarter increased 43% to \$82.5 million compared to \$57.5 million in the same period last year. Performance was strong across all our direct channels, yeti.com, Amazon Marketplace and corporate sales, as well as balanced across product categories.

Wholesale net sales for the quarter were unchanged year-over-year at \$149.2 million inclusive of the shift in shipments into the first quarter. By category, second quarter Drinkware net sales increased 16% to \$117 million compared to \$100.9 million in the prior year quarter, primarily driven by the continued expansion of our product offerings, including new colors and sizes and expanded lineup of Drinkware accessories including a new HotShot, [indiscernible] (17:18) and Cup Cap and strong overall demand for customized product.

Coolers & Equipment net sales increased 9% to \$109.1 million compared to \$99.6 million during the same period last year, primarily driven by strong performance in bags and hard coolers including more broadly distributed Camino Carryall and Tundra Haul products, outdoor living products and cargo with the successful launch of the GoBox.

Gross profit increased 16% to \$116.3 million or 50.2% of net sales, compared to \$100.6 million or 48.8% of net sales during the same period last year. The 140-basis-point increase in gross margin was primarily driven by cost improvements, especially in our Drinkware category, and the favorable shift in our channel mix led by an increase in DTC channel net sales. These gains were partially offset by higher tariff rates and the unfavorable impact of inventory reserve reductions in the prior year period.

Adjusted SG&A expenses for the second quarter were \$72.8 million or 31.4% of net sales, as compared to \$61.7 million or 29.9% of net sales in the same period last year. Approximately 80 basis points of the 150-basis-point increase was attributable to higher G&A expenses primarily driven by increased head count to support our growth as well as higher contract labor to support our IT infrastructure and the development of our omnichannel capabilities. The remaining 70-basis-point impact was from higher selling expenses, reflecting higher variable expenses led by online marketplace fees.

Adjusted operating income increased 12% to \$43.4 million or 18.8% of net sales compared to \$38.9 million or 18.9% of net sales during the same period last year. Our effective tax rate was 24.3% during the quarter compared to 23.2% in last year's second quarter and approximating our full-year outlook. Adjusted net income grew 23% to \$28.6 million or \$0.33 per diluted share compared to adjusted net income of \$23.2 million or \$0.28 per diluted share last year. Adjusted EBITDA increased 13% to \$50.8 million to 21.9% of net sales compared to \$45 million or 21.8% of net sales in the same quarter last year. Capital expenditures for the quarter were \$8.4 million compared with \$4.9 million in the second quarter of last year.

Now, turning to our balance sheet. As of June 29, 2019 we had cash and cash equivalents of \$38 million compared to \$71.3 million in the year-ago period. We ended the quarter with \$181.4 million in inventory compared to \$149.4 million last year. The 21% increase in inventory represents a strategic buildup in advance of potential additional tariffs, primarily in Drinkware, as well as investments to support anticipated sales growth including new product introductions planned for the second half of 2019. Excluding this high quality buildup of Drinkware inventory, growth was in line with our expectations and below our reported sales growth for the quarter.

We ended the quarter with total debt, excluding unamortized deferred financing fees, of \$309.1 million compared to \$435.4 million in last year's second quarter. During the quarter, we made mandatory payments of \$12.6 million using cash on hand. Including our cash balance, the ratio of total net debt to adjusted EBITDA for the trailing 12 months improved to 1.7 times compared to 3.0 times in the prior year quarter.

Now, switching to our 2019 outlook. Following the completion of a strong first half of the year, we are raising our overall top and bottom line outlook. Let me provide some additional color on these updates along with quarterly timing. We now expect full-year 2019 net sales to increase between 13.5% and 14%. This continues to assume

both product categories growing within our long-term growth rates of 10% to 15%, with higher growth expected in Drinkware as experienced year-to-date. As we have discussed on past calls, we continue to expect double-digit sales growth in the second half. We remain bullish on our new product launches as well as the expanded capacity of our Drinkware customization capabilities, principally in the fourth quarter holiday period.

On the margin side, we now expect reported GAAP operating income margins of between 13.9% and 14.1% of net sales, driving margin expansion of 80 basis points to 100 basis points. While operating margin is expanding versus last year, this expected range is lower relative to our prior outlook, mainly driven by cost related to our May secondary offering, our investments in international growth, and higher public company cost.

Adjusted operating margins are now expected to be between 16.3% to 16.6%, increasing versus our prior outlook and reflecting margin expansion of 40 basis points to 70 basis points versus the prior year period. The primary driver of higher adjusted operating margin remains gross margin expansion as we continue to benefit from lower product cost and a favorable shift in channel mix to our direct-to-consumer business. We continue to expect gross margin expansion in the back half of the year, despite a greater impact for List 3 tariffs of soft coolers and bags, as it flows through the average cost of goods. Our plan to move the majority of our soft cooler and bag production out of China by the end of the year remains on track. We have also proactively worked on other elements of our supply chain in the event of further tariff actions.

Partially offsetting these gross margin gains, we continue to expect full-year adjusted SG&A deleverage led by higher marketing investments and costs associated with our faster growing direct-to-consumer channel. This deleverage eases in the back half of the year relative to first half results, especially in the fourth quarter as we begin to lap our increased marketing investments.

GAAP earnings per diluted share are now expected to be between \$0.88 and \$0.90, reflecting 27% to 31% growth. Assuming a normalized tax rate of 24.5% in 2018, expected earnings growth would be between 40% and 43%. We expect adjusted earnings per diluted share of between \$1.07 and \$1.09, reflecting 18% to 21% growth. Again, if we are assuming a normalized tax rate of 24.5% in 2018, expected adjusted earnings growth would be between 27% and 30%. We continue to expect diluted weighted shares outstanding of 86 million.

Adjusted EBITDA is now expected to be between \$174.8 million and \$177.7 million, reflecting growth of 17% to 19% and margin expansion of 70 basis points to 90 basis points. We continue to expect capital expenditures in the range of \$35 million to \$40 million versus \$21 million in fiscal 2018. As a reminder, the year-over-year increase is driven by investments in molds and tooling to support both our anticipated sales growth and new product launches, as well as the strategic expansion of our retail stores. We continue to expect debt repayments of approximately \$80 million and the ratio of net debt to adjusted EBITDA is expected to be approximately 1.0 times at the end of 2019.

In closing, we are seeing momentum across our business and we are excited about the progress we are making across our strategic initiatives. As always, I'd like to thank our strong and growing team as we continue to support these efforts and drive the long-term opportunity of the brand.

And with that, we will now open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Jim Duffy of Stifel.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you. Good morning, guys. Things are tracking nicely, a lot of good evidence of progress. Matt, I wanted to ask a question about the customer funnel and customer lifetime value. Do you have any new data to support evidence of expanded geographic uptake? And do you have any new data to talk about repeat purchase behavior from consumers?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yes, Jim. Good morning. Thanks for the question. As we talked about on prior calls, that's a big area of focus for us and one as we continue to build out with the significant growth in our DTC business that we're getting more and more data and being able to track that. If I break it down into two things, from a geographic expansion, as we've mentioned in the prepared remarks, we've completed our 2019 first half brand study and have our 2019 owner study, which is giving us a lot of confidence that the geographic expansion has continued to progress and grow in the way we talked about in the past and continue to increase relevance in some of the under – what historically had been underpenetrated market. So, we've seen very good growth in unaided brand awareness and in aided brand awareness around our categories in geographic ownership. The other thing we've seen in our direct-to-consumer business is a really nice balance geographically both in the markets we've been operating and the longest – in the markets that we're moving into.

As far as the tied calculation of a lifetime value, that's one of the things that as we brought in this year additional analytics capability as we've enhanced our marketing intelligence, it's one of the things the team is working on in forming what that repeat purchase rate looks like, what the basket from the first purchase, second purchase is, and so those are things that we're getting more and more insights. But it's a journey that we continue to focus on and one that we think is very important for a business that is quickly shifting and quickly evolving to heavy or direct-to-consumer.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And then, with respect to the wholesale channel, I'm curious what you're seeing from sell-through velocity of new products as you migrate some of those newer products from direct-to-consumer distribution into the wholesale channel. Are you seeing a good uptake and similar patterns to what you'd seen in your own direct-to-consumer business?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yeah. We, as you know, depending on which product we launched, sometimes we go broad across our omnichannel and sometimes we test into it and give our supply chain a chance to ramp up through our own primarily yeti.com site. What we've seen is as products have transitioned from yeti.com to omnichannel, they've performed to our expectations and in some cases exceeded our expectations. So, we're excited about what we're

seeing from an uptake of innovation and as we've talked about in the past, we don't launch products into the channel to be with the expectation that they're a seasonal home run. We expect them to build over time and we're thoughtful about how we roll those out, how we build up the supply chain but very, very pleased with both the innovation we put into the market broadly and the innovation that we have coming.

James Vincent Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Thank you.

Q

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thanks, Jim.

A

Operator: Our next question comes from Sharon Zackfia of William Blair.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Hi, good morning. So a couple of questions, I guess, first on the customization capability. Matt, I think you mentioned that, that shift into the later in the holiday season, could you provide like any dates for us on what that cut-off will be now versus what it used to be just so we can get kind of order of magnitude? And then, Paul, I think you were trying to kind of provide some thoughts on cadence for the back half revenue, but you're probably too subtle for me this early in the morning and I didn't really get what you were trying to suggest there, if you're trying to suggest it was more fourth quarter weighted or what the thought process was there.

Q

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Perfect. Good morning, Sharon.

A

Sharon Zackfia

Analyst, William Blair & Co. LLC

Good morning.

Q

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

The way I would talk about customization is, historically, early – particularly as we get into the fourth quarter, we've been having cut-offs that were in late October or early November as we've hit capacity constraints. One of the things our operations team has been focused on for the last year is both driving optimization within our current footprint, but also building out incremental capacity that will allow us to move later into that season. We haven't communicated an exact date, but we mention it because we believe we'll be bringing meaningful [ph] half the (32:59) online and we think the demand that we've left on the table the last number of years due to capacity constraints and early cut-offs has been significant.

A

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

And Sharon, good morning. So a couple things...

A

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Good morning.

Paul C. Carbone
Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

...I would say is, one, we expect double-digit growth in the back half of the year as our updated outlook of 13.5% to 14% would imply. To Matt's point on, or your question that Matt answer on the customization capacity, there's one thing I did mention that will drive growth in the fourth quarter. So that's something that's different year-over-year, so we do see the fourth quarter being very important to us from a growth year-over-year. So it is a little bit heavier weighted in the fourth quarter versus the third, but again we expect double digit growth in the back half of the year and in both quarters.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

And then one follow-up, I'm assuming this will be the case, will there be some sort of marketing dynamic around the customization ability being further into the holiday season so that now folks like me who might have thought we missed it can still have that opportunity?.

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yes. And I would put that, Sharon, on two different groups. One would be consumers who are interested in buying for the holidays or buying for holiday events or for individuals. And then the other side is our corporate sales in gifting business, which traditionally, because of the size of those orders we've had to cut off a lot earlier. So we will put marketing effort and awareness behind both of those channels. Some you would see on the consumer side and some that will be directed at those corporate channels.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Okay. Great. Thank you.

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Thank you.

Operator: Our next question comes from Robby Ohmes of Bank of America Merrill Lynch.

Robert F. Ohmes
Analyst, Bank of America Merrill Lynch

Q

Hey, guys. Thanks for taking my question. Actually, I just have a few. Paul, maybe two things, just can you give us some color on how we should think roughly about DTC growth for the back half versus wholesale growth? And then also, any color on as we think about the back half and 3Q versus 4Q on gross margin? Maybe weave in for us what the tariff impact is expected to be in 3Q and 4Q or at least some thoughts on that and how we should – maybe remind us how we should think about DTC mix impact as well. And then the second question is, Matt for you, could you kind of paint us maybe the long-term picture for international and remind us how you're thinking

about it? 5% of sales today, but where could that go? And also, how does profitability in areas like Europe look relative to the U.S. in sort of long-term? How do you think about international profitability? A lot there so I apologize ahead of time. Thanks.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Great. Thanks, Robby.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

No worries. Good morning. On the channel, so as you know we don't give specific outlooks by channel, but if you go back to our long-term algorithm of DTC in the mid-20s and wholesale in the mid-single digits, and then you can use those as kind of a road map on the back half of the year. That would be number one. Number two, I think you asked us in just similar to Sharon's question on quarterly cadence. We are excited about the back half of the year and believe that we will drive double-digit top line growth in both quarters.

And then lastly on tariffs, tariffs obviously continue into the back half of the year, the impact in dollars in Q2 is about \$2.6 million. I mean you'll see that as we publish the Q as it flows through those about 110 basis points. In the back half of the year, we'll continue to see tariffs, it will step down on a quarterly basis. In total, the back half of the year will be greater than what we saw in Q2 as I talked about in my prepared remarks. But as we move the supply chain out of China, some of those non-China goods come in and with average costing now starts to bring down the tariff impact. So, and again, that is fully contemplated in the outlook that – the updated outlook that we provided this morning.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

And, Robby, on the long-term international, maybe I'll start with a short term, we're very pleased with what we're seeing out of the teams that we have internationally today in the business they're driving. Albeit 5% is not an endpoint, it's been really nice progress since we really started into international in 2017. As you think about the long term opportunity, we continue to believe in our experience collectively in prior businesses that the 5% where we are today is a short way towards [ph] or right (38:04) a long way from where the business potential really is.

If you think just about Canada alone and where Canada indexes traditionally to the U.S. market, we're still under indexing, albeit our performance in Canada we're very excited about, it's been very strong. The approach to international has remained the same and we're being thoughtful about how we go and expand internationally, it gets to your gross margin, your profitability question.

In Canada, we run a direct subsidiary with YETI employees. We do the same thing in Australia. Both of those businesses have balanced direct-to-consumer and wholesale businesses, which is what we like. We like to build, just like we did in the U.S., referential wholesale while coming over the top with a strong e-commerce presence to intersect with where consumers want to shop.

The UK and Europe, our most recent market entries, we follow the same thing. We've set up our subsidiaries for that and we have hired our first two employees, a sales leader and a marketing leader based out of the UK to get that market up and running and those e-commerce sites went live in late July. We'll follow a similar playbook there. We've seen relatively consistent gross margins internationally. Obviously, as the businesses ramp, the [ph] fall through (39:22) profitability builds over time but the gross margins we're very focused on trying to keep

consistent global gross margin. And in Japan, as we talked about, we entered Japan in late 2018 through a select wholesale partner. That's a market that we're focused on the next steps and following comparable playbooks to Canada, Australia, the UK and Europe.

Robert F. Ohmes

Analyst, Bank of America Merrill Lynch

Terrific. Thanks so much.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thanks, Robby.

Operator: Our next question comes from Alex Walvis of Goldman Sachs.

Alexandra Walvis

Analyst, Goldman Sachs & Co. LLC

Good morning. Thanks, guys, for the taking the question. First question, you talked about a few hundred basis points increase in awareness with the latest survey. I wonder if you could help us to break down where that – those awareness [indiscernible] (40:08) with the greatest – how much of that was in some of the lower penetration areas like New England and the Mountain Region? I mean, you're also seeing gains in some of your more heavily penetrated regions like South Central and Atlantic region?

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Yeah. Alex, this is Matt. That's great question. We're really pleased with the broad-based growth we saw across the regions. Obviously, from the baseline being smaller in some of the growth regions where we've historically been less penetrated, we saw significant – more significant growth. We – in 9 of the 11 regions that we track, we saw at least a 3 percentage point growth when consumers reps when they think of a top of the line outdoor company or brand, which one comes to mind. So in a relatively short period of time, we think that's meaningful growth and follows along that the product is resonating, the brand marketing is resonating, the product marketing is resonating in those markets. And so we're going to continue to play into that from a product and a brand perspective.

Alexandra Walvis

Analyst, Goldman Sachs & Co. LLC

Great. And then a similar question on the brand study. I think last time you did this you noticed an increase in the number of your customers that were non-hunters, that were female, that were under 45. Are those trends still ongoing as you expand the reach and the product range?

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Yeah. What I would say, as far as the expansion of sort of activities and pursuits, we're absolutely seeing that the percent that hunt and fish are primarily that is continuing to decrease as our population grows. Again, we continue to invest heavily in those endemic communities because they're important to us and they're important to the brand, important to product portfolio. But as the aperture opens up and as the pie grows, we see – we're seeing a really nice natural progression of the diversity in our group.

We've seen pretty good consistency and we saw a big step up, as we've talked about in the past, of female ownership. [ph] Once they study the study (42:13), we haven't seen a significant movement there. It's been pretty consistent with where it was. And then I would say as far as the under-45 age group, it's similar to the female. It stayed relatively consistent to where it was and we feel very good about both the age and the demographics, the opportunity, particularly demographic side, but we feel very good about where the age – the age side and where we continue to resonate and expand the brand.

Alexandra Walvis

Analyst, Goldman Sachs & Co. LLC

Q

Great. And then maybe just one more in here. Product cost improvements have been very impressive for a long period of time now. How much more runway is there? And can you talk about what the biggest drivers of the improvements in the current period and sort of for the balance of the year are likely to be?

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

Yes. So for the quarter product cost improvements were about 200 basis points benefit to gross margin. And as we talked about in the press release that was primarily in our Drinkware category. We see a nice product cost improvements there. We continue to expect and model out product cost improvements from a few different areas. So, just our natural volume across both Coolers & Equipment and Drinkware. And then, as we've talked about our should cost modeling, certainly drives the negotiation. So we continue to expect our supply chain and our operations team with good balanced negotiating to continue to drive cost improvements and that is in addition to our mix shift to direct-to-consumer, one of our two sustainable levers, I mean not a timing or a rollover [ph] that look (44:05) at gross margin expansion into the future. So we do expect that to continue.

Alexandra Walvis

Analyst, Goldman Sachs & Co. LLC

Q

Thanks so much, guys.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

Thanks, Alex.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Thanks, Alex.

Operator: Our next question comes from John Kernan of Cowen.

John Kernan

Analyst, Cowen & Co. LLC

Q

Hey, good morning, everybody. Thanks for taking my question. I wanted to ask a quick one on the wholesale channel, up low singles in the first-half of the year. Just wondering how we should think about it in the back-half. And then within wholesale, can you talk to growth with the new doors and partners? I know DICK's last year finished around a quarter of that wholesale business. So if you can elaborate on a strategy with them as well that would be great. Thank you.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

Sure. So let me start within the first-half, wholesale growth was – been modestly above our original target for the first-half of the year. So we feel really good about as we're coming into the back-half of the year, the wholesale business. As you think about the back-half, I would say the growth similar to the front-half and we've talked about – I think it was Robby's question where I said, think about wholesale for the – in that mid-single digits. So, I'd continue modeling it that way. So, we were really happy with the wholesale growth in the first half. To your question or your comment on DICK'S. DICK'S continues to be an important partner of ours. They do one of the best jobs of really displaying the entire YETI portfolio of products and really giving that brand image and look for a strong back half with them as well, and they had a strong first half with us.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yeah, John. This is Matt. I'll add a couple things to what Paul said. One, our door count or account number has stayed relatively flat. So, this is the wholesale performance to-date has been relatively kind of door total comping. As Paul said, we are – and DICK's is a good example as we continue to partner with people who are investing in the assortment, in the brand, in the merchandising rather than items, and that's something we'll continue to look for. And as we've talked about in the past, we are in – we are always in conversation with additional wholesale opportunities. But we're looking for people who either reach a new consumer, create a new buying occasion, or augment our existing portfolio. And so as we grow this omnichannel business, as we drive our 43% plus growth DTC business, we'll continue to look at the wholesale as an important strategic part of that but in a way that we constantly revisit the right partners doing the right things.

John Kernan

Analyst, Cowen & Co. LLC

Q

Got it. Thanks. That's helpful. And then maybe one quick follow up. Just on the corporate business, any comments on scaling of this? We obviously got an idea as to where it finished last year [indiscernible] (47:09) just wondering what the growth in corporate is, and what the long term potential of this market is.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

So we're really happy with our corporate business overall with the 43% DTC and it's inside of there, the DTC performance, which is very strong this quarter. We continue to see that growing both from – as we've talked about in the past of turning that model from just in inbound, getting receiving request to actually having outbound in driving sales. And then secondly, to what Matt talked about earlier about the capacity in the fourth quarter, right? So similar to the consumer, the fourth quarter is a big quarter for us in corporate sales and having that capacity deeper into the fourth quarter is really going to help us drive both corporate sales and that fourth quarter business as we talked about.

John Kernan

Analyst, Cowen & Co. LLC

Q

Excellent. Thank you.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

Thanks.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thanks, John.

A

Operator: Our next question comes from Joe Altobello of Raymond James.

Joseph Nicholas Altobello

Analyst, Raymond James & Associates, Inc.

Thanks. Hey, guys. Good morning. So first question is on the sales outlook, the range is pretty narrow, I think it's about \$4 million from top to bottom. What gives you guys increased visibility on the second-half? Is it the selling on new products or just the fact you've got another quarter in the books at this point?

Q

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

Good morning. I would say it's a combination of both. So we feel confident coming out of the second quarter and the momentum coming into the back-half of the year, our new products, as you talked about, we're really excited about those as we go into the back-half of the year, certainly talking to our wholesale partners. We see their plans, but we feel really confident going into the back-half of the year and understand it's a – it is a tight range, but we're halfway through, although we have two big quarters to go. So while the second quarter is a certainly a big quarter at moms, dads and grads, we have two big quarters to go, but we feel confident in our top line visibility and giving that range of 13.5% to 14%.

A

Joseph Nicholas Altobello

Analyst, Raymond James & Associates, Inc.

Got it, that's helpful. And secondly, in terms of increased investment in new markets and retail stores, is that because you're seeing more opportunities, maybe accelerating some of those investments that were planned for next year or are the cost trending above what you had planned coming into this year?

Q

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

It's really a timing. So on international, launching in the EU, in the UK, once we develop to that business model and got it up as Matt talked about. We launched it just last week, about 10 days ago. So that was one piece of it is just kind of as we finalize that model and then put it in. And then on retail stores, it's a little bit as we go out and we [ph] look in open to (50:14) the two stores – and that one is really understanding the cost of to open the stores. But those are the two big pieces of the add-back, if you think about it, outside of the expenses for the May secondary.

A

Joseph Nicholas Altobello

Analyst, Raymond James & Associates, Inc.

Got it. Okay. Thank you, guys.

Q

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thanks, Joe.

A

Operator: Our next question comes from Kimberly Greenberger of Morgan Stanley.

Kimberly Conroy Greenberger

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much. Good morning. Paul, I was hoping you might be able to unpack the gross margin puts and takes a little bit for us just so we can try to figure out on a go-forward basis how to model what should be sustainable and what might reverse a little bit, specifically in terms of channel mix. If you could just tell us of the 140 basis points of improvement, how much is channel mix? How much was improved costing? It sounds like the improved costing is expected to continue on a go-forward basis, but I'm guessing just because of the distortion between DTC and wholesale this quarter not all of the channel mix benefit is sustainable. If you could just help us understand just some of the pieces within there, within gross margin and what do you think continues and what doesn't.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

Sure. Good morning. So I think about gross margin expansion similar to the way you laid it out of what's contingent and what doesn't and I think about it as what's sustainable and then what's just a comparison, right, so [ph] effecting (51:51) this year or last year. So in the sustainable bucket for this quarter, cost improvements, which were about 200 basis points, and then the channel mix shift of 110 basis points.

On the comparison side, I get about 70 basis points from lower inbound freight and that was really because last year I still had some air freight flowing through the cost of goods and that's really a comparison. And then, some inventory reserve reductions last year, lower inventory insurance recoveries, all of that was about 150 basis points. And again, I think of those as just comparisons, and there's 150 basis points negative this quarter. I think about those as just comparisons. And then the one I'm not sure how should I think about it, is it a comparison or is it sustainable as tariffs? And that was about 110 basis points.

We expect those sustainable ones obviously to continue. If you think back this time last year and as we launched our IPO that's when the cost improvements really started to ramp, so I would expect cost improvements to continue although it may be around that 200 basis points, maybe a little bit lower, as we go into the back-half of the year, but that is the range that as we model out the back-half of the year and that couple of hundred basis points is what we're expecting.

Kimberly Conroy Greenberger

Analyst, Morgan Stanley & Co. LLC

Q

That's super helpful, Paul. In terms of the channel mix, I would imagine you would expect wholesale to grow in future quarters and the growth here was sort of depressed because of that revenue mix shift into Q1. So do you think the full 110 basis points of the channel mix shift is sustainable or would you expect a lesser benefit in future quarters from channel mix shift as wholesale begins to grow again?

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

Yeah. That's a hard one because there are pieces inside of even the DTC business of mix of corporate sales versus yeti.com versus Amazon. I think that's a good range or a ballpark in that 100 basis points range, but that will, to your point, that will increase, decrease relative to what wholesale is and even inside of wholesale what the makeup of that is. So that was a harder one even than the cost improvements, but I think in that 100-basis-point range is a reasonable way to look at it going forward.

Kimberly Conroy Greenberger

Analyst, Morgan Stanley & Co. LLC

Q

That's really helpful. And then my last question, Matt, it sounded like you were considering a variety of options for Drinkware just given what's going on with trade. Could you just maybe share with us some of your preliminary thoughts on that and maybe the range of consideration in terms of country of origin for the Drinkware? Thank you so much.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yeah, thanks, Kimberly. As we look at, and as we talked about in the past, when the List 3 tariffs came into play back in September, we were already on a strategic path to move our bags and coolers out of China. It was part of a broader landscape study of where the best place to manufacture the products were and frankly they were being manufactured in China because at that time where the business was, it was an easy place to go make it.

The other thing we started in September was an investigation of Drinkware, broadly, though it was not and is not part of a current tariffs list. We wanted to make sure we were working kind of well ahead of it. And so one of the things we've established is a playbook of options as these things come into play. Obviously, price negotiation is one that we did with our bags and with our soft coolers that we've been in conversations for almost the past year with our suppliers around that.

The other one is looking at the total cost of goods and the manufacturing location, the one piece that we didn't do with soft coolers and bags was use price as a lever. It's one of the ones – if Drinkware were to come into play, it's one of the levers we would look at, partly because of the established supply chain of Drinkware today in China. And so we'll continue to look at attacking the opportunity and the problem, both strategically for the right long term positioning where the products should be manufactured and where the business should be positioned, but also the near-term mitigation if tariffs were to come into play.

Kimberly Conroy Greenberger

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thanks so much.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Thanks, Kimberly.

Operator: Our next question comes from Peter Keith of Piper Jaffray.

Robert A. Friedner

Analyst, Piper Jaffray & Co.

Q

Hey. Good morning, guys. It's actually Bobby Friedner on for Peter. Nice results. I'll start with a question on retail and promotion, so in Q2 there were a few YETI promotions offered by major retail partners, including REI and DICK'S, it seems like these promotions were run last year and likely continue. Could you explain the thinking behind allowing retailers to promote YETI product and do you have any concerns about this kind of prices, limiting full price selling in the future? Thanks.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yeah. Thanks, Bobby. Let me kind of hit that on a couple of different fronts. You are correct in that it's consistent with past practices. It's consistent with both member-only events and also consistent with what I would consider kind of high gifting seasons when the market broadly is in a promotional way. The one thing I would step back and say is, we're incredibly pleased with our omnichannel execution really led by our direct-to-consumer business and it's plus 43% growth, and the continued brand strength. And that growth in the direct-to-consumer channel is in a very limited promotional activity way. So we continue to be emboldened by the strength of the brand, the resonance of the product, but we have had kind of consistent and promotional activity around those specific events. And what – when we talk about our MAP policy, we still have a strict MAP policy, our retail and wholesale partners adhere to that MAP policy. They make us aware when they are – when they would like to run these – when they would like to run and support these programs. And it's just part of what's become the rhythm of I think the wholesale channel.

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

And then, Bobby, I would just add that from a – from our perspective, the retailer funds the promotion, but as our wholesale, as part of our wholesale relationship, we do provide some standard demand creation support. So we're – think about it as marketing co-op because we generally get this question, are we funding these promotions? We don't fund the promotions that you see at these retailers. But there are some marketing co-op support to drive the demand creation in those retailers either for a promotion or just during the holidays. We do that throughout the year.

Robert A. Friedner

Analyst, Piper Jaffray & Co.

Q

All right. Got it. Thanks, guys.

Operator: Our final question comes from Alex Maroccia of Berenberg.

Alex Maroccia

Analyst, Berenberg Capital Markets LLC

Q

Hey. Good morning, guys. Thanks for taking my questions. Can you just expand a bit more on the new 3PL that you have in the Netherlands? I guess, how much capacity can they handle and will you be looking to further expand this in the future through another partner or by bringing it in-house?

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yeah, Alex. This is Matt. Thanks for the question. I would say we feel good about the 3PL partner that we have in the Netherlands. It's obviously early days. We're in day nine of available for sale through this new e-commerce site. What I would say is we're confident in both the location in Netherlands and also the flexibility. We also have a number of 3PL relationships in the U.S. When we say bring in-house, as a reminder we're at that light and so we – even in the U.S. we use 3PL partners and so we have a number of global relationships that as capacity was needed, we have confidence we can leverage.

Alex Maroccia

Analyst, Berenberg Capital Markets LLC

Q

Okay. Great. And then the second one, I know it's kind of tough because there's limited historical data but it looks like the DSO has ticked up slightly in the quarter. I guess the way I was thinking about this number is it should decline in tandem with the shift towards DTC sales. Can you just explain the increase and what we should expect here in the future?

Paul C. Carbone

Senior Vice President & Chief Financial Officer, YETI Holdings, Inc.

A

Yes. So DSO will decrease and has decreased significantly over time and it will with the shift to DTC. We'll continue – as we look at it, as we calculate it internally, we have been flat throughout the second quarter and we ended June roughly flat with the prior June. So all in all, it does – DSO does decrease as we continue to shift and we've seen that over time as well.

Alex Maroccia

Analyst, Berenberg Capital Markets LLC

Q

Okay. Great. Thank you.

Operator: This concludes time for question and answers on today's call. I would like to turn the floor back over to Matt Reintjes for closing comments.

Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thank you. And thanks everybody for joining today. We feel great about the direction of business, the brand and the product, and look forward to talking to everyone on our Q3 call.

Operator: This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.

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