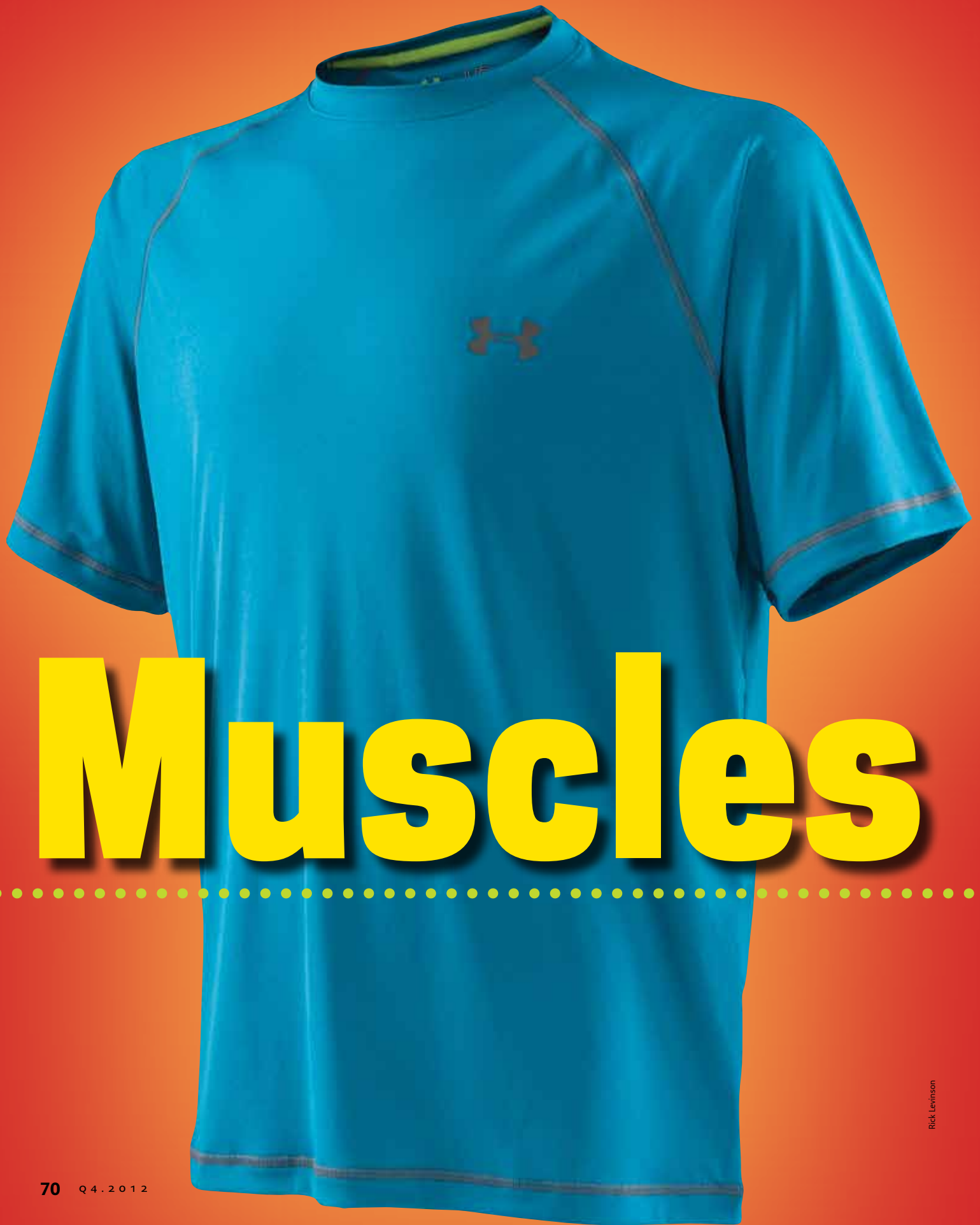




Under Armour

Rick Levinson



Muscles

Rick Levinson

Sometimes a corporate success story really does start with a single entrepreneur's inspired "aha!" moment. For Under Armour, it started with Kevin Plank's sweaty T-shirt.

At the University of Maryland, Plank was a walk-on player and self-proclaimed "sweatiest guy on the football field." Weighing a cotton T-shirt before and after play, he found it had gained 2½ pounds in sweat, turning into a soggy mass that slowed him down. He searched for a shirt that would wick the perspiration from his body to make him lighter and faster.

"I had an idea when I started Under Armour in 1996, but I had to learn how to make it real, I needed to know about fabric and tailoring, so I went to the garment district — we still had one here back then — and started walking around," Plank said in an interview at the company's Baltimore headquarters. "I did it in three days — I learned how to make my first shirt — then found manufacturing in Baltimore."

Plank didn't invent moisture-wicking fabric, nor was he the first to put it in a T-shirt. DuPont introduced Coolmax in 1986, and it became the "Intel-inside" for sweat-evaporating shirts from a myriad of brands and manufacturers. Many other proprietary fabrics followed. Plank's innovation came from marrying a wicking material with a stretchy one to make a "compression shirt" that clung to an athlete's musculature and felt great under football pads and jerseys.

"They really pioneered compression apparel and defined a niche that was nonexistent before that," said Andrew Burns, a securities analyst with D.A. Davidson & Company in Portland, Ore. "They brought something new and differentiated to the market, and it took several years for Nike and Adidas to react. That success continues today. They are still the top in compression apparel, and really no end in sight."

But it was hardly an overnight success. After graduating with a bachelor's degree in business administration, Plank ran through seven prototype shirts before settling on a blend of materials that worked. He then asked his former teammates to try the compression shirts, explaining they would enhance performance on the football field.

As Plank's friends moved on to professional teams, he would send them shirts, asking that they pass them out to other players. While Plank was still operating out of his grandmother's Georgetown row house, Under Armour reached a milestone in late 1999, when a \$25,000 advertisement in *ESPN* magazine spurred \$1 million in direct sales in 2000, as athletes and teams began buying the product. Galyan's, a large retail chain eventually bought out by Dick's Sporting Goods, took on the brand and other chains followed. Today almost 30 percent of Under Armour's sales come from Dick's and Sports Authority.

In 2003, Under Armour's first television advertisement showed a football squad huddled around Plank's former University of Maryland teammate Eric Ogbogu, shouting, "We must protect this house." The phrase "Protect this house" became emblematic of the Under Armour brand and is still featured prominently in its marketing materials, as are the pro football players who wear the shirts on the playing field.

The professionals' endorsement gave Under Armour an almost iconic identity that resonates with aspiring players as well. That identity has helped keep Under Armour the market leader in performance apparel in the face of competing products like Nike Dri-Fit, Adidas ClimaLite and Reebok Hydromove.

"Kevin had a strong sense of what it was going to take from a brand perspective, even if he



IN

BY LAWRENCE M. FISHER

was creating a new category, to capture the hearts and minds of a new generation that could grow up with the product,” said Paul Swangard, managing director of the James H. Warsaw Sports Marketing Center at the University of Oregon in Eugene. “Go to any school or playground: There is a generation of kids who have grown up with the Under Armour brand, and that has helped stave off the competition and marketing muscle of companies far larger.”

Had Under Armour stuck to undershirts for football players, it could have had a small though profitable niche, as if REI, the outdoor-sports company, had stuck to ice axes for mountain climbers or Nike to running shoes. Plank always had ambitions to extend the brand, but he said the extensions had to make sense, had to be in alignment with the company’s mission to help athletes perform better.

“The baseball players wanted them, too, and the girls on the lacrosse team wanted them, and I realized this was a concept, not just a football T-shirt, but a category and an industry around this idea of performance,” said Plank. “I was always smart enough to be naïve enough to not know what we could not accomplish. We love stats and market research and want to be as smart as we can before we enter any category, but most important, we have to believe that it can happen — heart and head.”

Under Armour now makes clothing and footwear for at

son, for everything in between, are differentiated by a precise fit and a silky feel. Plank said he wants customers to be able to pick them out with their eyes closed.

“He was selling the sizzle, but the product actually performed as promised,” said Swangard. “For the companies in the athletic space, the ‘f word’ is ‘fashion.’ They really don’t want to be seen as being driven by a fashion consumer behavior because that would be leaving their heritage behind; these items are supposed to function as part of the active lifestyle.”

Footwear is unquestionably Under Armour’s boldest brand extension to date, and the company approached it from a characteristic point of strength: the needs of the professional football player. Thus Under Armour’s first shoe was a football boot, colloquially known as a cleat, for the stubs on the outer sole that add grip in turf. They used innovative materials that kept the shoe light despite a higher top, and added a built-in compression sleeve that eliminates the need for the taped-on reinforcement that many athletes attach for support. At \$140, the shoe is premium priced but has sold well.

“I think we’re the only company that went from apparel to footwear,” said Mirchin. “Instead of going into a big-volume category like running shoes, we knew we had a very captive audience in football. You buy a football cleat for one purpose, to play on the football field, whereas 90 percent of basketball

“He was selling the sizzle, but the product actually performed as promised.”

least 16 men’s and women’s sports, everything from golf to hunting to something called Tough Mudder, but all share that common attribute: performance. In an era where Banana Republic is playing up its “Heritage” in safari clothing, and Levi’s “Made and Crafted” is meant to recall the Jewish tailor who turned up in Gold Rush-era San Francisco with a bolt of denim, Under Armour’s focused marketing of Performance, with the capital P, has an invaluable ring of authenticity.

“One of the things this company did right was to have a maniacal focus on performance,” said Matt Mirchin, Under Armour’s senior vice president for global sports and brand marketing. “We set out to build the best football T-shirt, but that became the best performance T-shirt. That gives us the right and permission to get into outerwear and footwear because the promise to the customer is still performance.”

But there is much more to performance than moving moisture efficiently. There were perspiration-wicking shirts before Under Armour, but most felt itchy, fit badly and stank after a single wearing. Under Armour’s Heat Gear, for temperatures above 75 degrees, Cold Gear, for below 55, and All Sea-

shoes never see a basketball court. We wanted to authenticate ourselves on the field of play. Then we added the baseball cleats, lacrosse cleats, and only then did we go into running shoes. We wanted to build authenticity.”

But outside of cleats, Under Armour’s foray into shoes has seen limited success. The company has seen double-digit growth in the category, but off a very small base, and UA shoes remain a tiny percentage of Under Armour’s total sales and claim a minuscule share of the total market. Analysts say the company name, which naturally brings to mind underwear, may be part of the problem, and indeed Under Armour has de-emphasized it on its Web site and in most marketing materials, going by the unpunctuated initials UA that form its logo.

“UA’s challenge is there’s only so much you can do when you’re 25 or 30 times smaller than your other domestic competition,” said Swangard. “UA is limited by its brand. It’s synonymous with this category and harder for them with a name like Under Armour. I could see them doing a sock with moisture wicking, better cushion, but wearing their shoe on the outside seems counterintuitive to the brand.”



Under Armour founder, Kevin Plank

Women's clothing is another category where Under Armour has struggled to rise above its heritage. Thanks to Title IX, an extension of the Civil Rights Act of 1964 that guaranteed women equal access to elementary, high school and college sports, and partly due to the feminist movement and a growing awareness of fitness and health, women athletes represent nearly as big a market as men — but you would never know that from Under Armour's Web site. There are links for women's and girls' clothing, but the art and graphics are overwhelmingly masculine. Women say it's a turnoff, even if they like the clothes.

"The Web site is a bit intimidating if you're not a jock," says Wendy Feltham, a retired school principal from Seattle. "But I went bicycle touring in Vietnam in February, and my HeatGear shirt was perfect. I wore it over and over. It looked fine for nice restaurants under a sweater in Hanoi, and it was my base layer for bicycling in the chilly north. It was also ideal when I rode down the tropical coast of southern Vietnam where the breeze from riding filtered through the shirt and cooled me off."

Under Armour executives say they are painfully aware of the Web site's shortcomings, not the least from their wives' remarks, and that it is a work in progress. And they know they are playing catch-up ball in the women's market, where brands like Nike Women, Title Nine and Lululemon have gained the loyalty of female athletes. But they add that their women's business is much bigger than it is perceived to be.

"Our women's business is \$400 million at wholesale, which is \$800 million at retail," said Byron K. "Chip" Adams Jr., a longtime board member and private equity investor who joined the company in 2011 as chief performance officer. "Our roots were in male team sport. When we first entered women's, there was a very heavy, maybe overly heavy male emphasis. We didn't have the expertise in the building to tap into women the way we did into guys."

Adams readily concedes that the Web site needs work, but said Under Armour's approach to women has already changed dramatically. "What we've done in five years is transition from a recognition that the women's market is important, to a team of women who own that business. Women

How Wicking Shirts Work

While it seems like the cotton T-shirt has been with us forever, it actually dates to about 1898 and the Spanish-American War. Breaking with the tradition of the union suit for underwear, the United States Navy issued cotton T's to sailors as a base layer to be worn under a uniform. Civilians picked them up after the war, and a casual apparel institution was born.

Problem was, cotton is hydrophilic, meaning it absorbs water, so that soft, dry T-shirt turns into a wet rag when the wearer perspires. Early synthetic materials did not absorb water, but also did not conduct heat well, trapping the body in a wet steam room of its own making. The petrochemicals industry and textile manufacturers searched for a solu-

tion, and wicking fabric was born.

Just how, or even if, wicking works has been the subject of much debate and quite a few dissertations. As Craig Burton Simile explained in his 2004 thesis for the Georgia Institute of Technology, "In general, wicking takes place when a liquid travels along the surface of the fiber but is not absorbed into the fiber. Physically, wicking is the spontaneous flow of a liquid in a porous substrate, driven by capillary forces. The wicked moisture spreads throughout the fabric, allowing the moisture to easily evaporate."

Branded fabrics, like DuPont's Coolmax, Under Armour's Heat Guard or Patagonia's Capilene, em-

ploy differing weaves and mixes of fibers to achieve the desired microclimate between the body and the shirt. A weave that traps more air keeps a body warmer, while a more porous weave keeps a body cooler.

But some people don't like encasing themselves in plastic, and synthetic fabrics still have the problem of retaining body odor. That's one reason for the growing popularity of soft Merino wool, grown on a special breed of sheep in New Zealand, as a "technical" fabric. Not to be left behind, Under Armour has a new technical material of its own, which mixes hydrophobic and hydrophilic fibers to wick moisture, plus 5 percent elastane to add stretch. They call it Charged Cotton.

designers, women sales. If you walk around the building, you'll see almost 50/50. People who, all they think about is how to make women athletes better or safer. Living the customer is critical; if we're not doing that we're dead."

International sales is another potential growth area that presents a challenge to Under Armour. According to UA's 2011 annual report, net revenues from international sales increased 35 percent last year to \$89 million, but that sum represents just 6 percent of the company's total \$1.47 billion in net revenues. The company has approximately 4,000 points of retail throughout Europe, the Middle East and Africa, compared with 18,000 retail sites in North America. "We believe the future success of our brand depends on developing our business outside of North America," the report said.

Toward that end, in April the company announced it was hiring former Adidas executive Karl-Heinz "Charlie" Maurath to run its international business. The announcement came six days after Under Armour launched its first major television and digital marketing campaign in the United Kingdom, France, Germany, Austria and Switzerland. But Europe could be a tough market to crack, even without the current euro zone crisis.

"They talked about that for a long time, that international was underdeveloped because they didn't have the management to do it," said Burns, the equities analyst. "To a certain

extent that was true. International strategy sat idle. But it's also important to call out the heritage of the brand and how that resonates overseas. UA is a football brand and secondarily a baseball brand — two overwhelmingly popular sports in the U.S. that no one else cares about. Nike is a running brand, which is an international sport."

Taking a page from Plank's original playbook, Under Armour is wasting no time getting its shirts on the backs of professional rugby and soccer players. This fall, Under Armour will begin a five-year deal as the uniform sponsor of the English Premier League club Tottenham Hotspur. And the company has full uniform sponsorship deals with the Welsh Rugby Union, Israel's Maccabi Tel Aviv soccer team and Greece's Aris FC soccer team, as well as individual endorsement deals with Tottenham defender Michael Dawson, Queens Park Rangers striker Bobby Zamora and Welsh rugby player Jamie Roberts.

"Being known as a football company is a positive that could also be a challenge," said Mirchin. "So we are always looking at what sports are relevant to customers. Through the sports of rugby and soccer, we'll tell the UA story in ways that will resonate around the world."

For the quarter ended March 31, UA reported revenues of more than \$384 million, up 23 percent year over year, beating Wall Street estimates by about \$4 million. Earnings per share rose from \$0.23 to \$0.28, beating estimates by four cents. The

company also announced that it expects 2012 revenues of \$1.78 to \$1.8 billion, up 21 to 22 percent.

But while analysts have cheered UA's top-line growth, there are lingering concerns about the bottom line. In a May 14 review, the Web site Seeking Alpha reported: "The company's cost of goods sold for Q1 rose nearly 24.8 percent from the prior year period, which was faster than the 22.93 percent rise in revenues. That caused gross margins to decline from 46.39 percent to 45.58 percent. Operating margins declined from 6.76 percent to 6.35 percent, quite a bit of a decline. The company did see a decline in their effective tax rate, which helped to offset some other expenses. However, net profit margins still declined year over year, from 3.88 percent to 3.81 percent. All three primary margins declined, which is not a good sign."

UA's gross margin of 46.16 percent is slightly higher than Nike's 43.79 percent, and considerably lower than Lululemon's at 56.88 percent. But profit margins show a much greater disparity, with UA at 6.44 percent, Nike at 9.68 percent and Lululemon at 18.39 percent, nearly three times higher.

Although the very presence of a private equity guy in the C-suite indicates that leadership is thinking about the numbers, Chip Adams downplays the significance of UA's net margins. He also questions the direct comparison to Nike, which is more than 15 times UA's size, or to Lululemon, which sells only through its own stores, a very different business model.

"It's not part of the gritty Baltimore culture to overinvest in stuff," Adams says. "People who need stuff are not attracted here. We're not wasting money on things. We're not wasting money on needless acquisitions, needless campaigns."

Laura Lippman, a former *Baltimore Sun* reporter turned bestselling mystery writer, once described her hometown as "the city one leaves," although she never did. Nevertheless, Baltimore's population has declined by about a third since its peak in 1950, and many areas are distinctly depressed and crime-riddled. On the other hand, much of downtown has benefited from urban renewal, the Inner Harbor is beautiful, and the city boasts one of the world's largest aquariums.

For Adams, who left a home in Woodside, Calif., and an office among the lions of venture capital on Menlo Park's Sand Hill Road, the blue-collar sensibilities and vibrant small neighborhoods of Baltimore help define the company culture. With its origins in team sports, UA naturally has a team culture that is quite different from the individually driven nerd mindset that permeates high-tech companies, he said.

"I can't believe the authenticity of this place," Adams said. "Certain categories of people love Baltimore, and as fast as we're growing, this isn't a corporate culture; it's a team culture," he said. "It's real. It's Darwin's law of the best coaching principles put into practice. It's about dedication to each other rather than ourselves. If you come in for a job interview and

Being part of the club, part of the hometown team, is the core of the Under Armour ethos.

"When growth companies are investing in the things that are critical to growth — technology, quality, developing people — almost 100 percent of the time, their margins are and should be lower than larger companies that aren't trying to scale as rapidly, and who may have efficiencies greater than we have," Adams said. "We're investing. We have lots of places we spend money. If our margins weren't lower, you should question it."

While Under Armour's SG&A expenses look high, Adams insists the company is not spending money frivolously, and indeed, the company's spartan headquarters, in an old brick Procter & Gamble factory, would never be mistaken for a Silicon Valley campus. Even as companies like Google brag about the gourmet cuisine provided to employees, the cafeteria at UA is titled "Humble and Hungry," which is also Plank's email signature. The one conspicuous perk is the state-of-the-art exercise equipment available to UA's preternaturally fit employees — most of them about 30 — and no one at UA would consider that an unnecessary expense.

ask, 'What is my career going to be?' you're not going to get it. Team before self. I'm here because of that. This company could not exist in Silicon Valley. The people who grew up there would not thrive in this culture."

Being part of the club, part of the hometown team, is the core of the Under Armour ethos that extends beyond corporate headquarters and sponsored teams. That's why customers will pay more for a hoodie with the vertical UA logo.

Category leadership comes "when you touch the core of people, when you stay authentic to them," Adams said. "We only serve a couple of people. We serve that athlete that likes premium stuff, but who also wants to be part of a team, part of a club. When you put it on, it feels better. Athlete is a state of mind, and that creates a bond that is really powerful for those people who love the association with this club, and with having the best product."

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