GlassHouse Research

10/22/20

Columbia Sportwear Headed for Rocky Fall

(Under Armour Part Deux)

Who is GlassHouse Research? GlassHouse Research (GHR) purpose is to expose public companies that have been taking advantage of US GAAP as well as IFRS accounting for their benefit. We seek to find companies where GAAP (or even worse, non-GAAP) earnings are deviating from true economic earnings of the target firm.

Overall, we search for evidence of a "culture of fraud" within public companies.

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Initiation of Columbia Sportswear (COLM) with a Target Price of $45.29 (51% downside)

Our analysts find related accounting red flags between Columbia Sportswear and Under Armour (2017). In fact, GHR believes COLM is at risk of revenue recognition and channel stuffing concerns well beyond that of UAA in 2017.

- ***COLM currently has one of the worst inventory positions in all of retail*:** As such, we calculate that mgmt. has delayed writing down over $225 million of inventory (28% of total inventory).

- ***COLM's inventory channel is stuffed*:** Contrary to sell-side analysts who follow COLM, our research reveals that COLM's wholesale partners are currently stuffed with product and will be hesitant to purchase inventory going forward. These retailers account for 58.6% of COLM's total sales in fiscal 2019.

- ***COLM positioned for failure in COVID environment***: Management looks to be waiting for things to get back to normal instead of adapting to the new COVID environment. In terms of e-commerce sales (11% of sales in 2019), we see that the company has fallen far behind industry leaders such as Lululemon and Nike.

- ***Accounting irregularities are littered throughout COLM's financials***: Similar to the recent Under Armour debacle, GHR sees elevated red flags at COLM that point us to revenue recognition fears. Moreover, extending credit terms to failing partners and spiking prepaid expense lead us to believe management has been playing games with its financials.

- ***Valuation is irrational***: COLM's stock price remained fairly flat throughout a turbulent 2020. Based on the analysis laid out herein, we believe that fair value of COLM stands at $45.29, or 51% downside.

Key Similarities Between Columbia Sportswear and Under Armour

GlassHouse juxtaposes both Columbia Sportswear and the past indiscretions of their peer Under Armour. Based on our research, we believe COLM is in an ominous accounting position, akin to Under Armour in 2017. **The end result for UAA was charges of revenue recognition violations by the SEC and DOJ, but most importantly, the stock price dropped over 75% from all-time highs as a result of management's malfeasance.**

Key Characteristic	Under Armour (2017)	Columbia Sportswear
Company Led by Founders	Kevin Plank led Under Armour for over 20 years before being forced to retire in 2019. Based on our extensive research, we find that most founder-led companies that grow from start-ups tend to report poor internal controls and liberal uses of their accounting.	CEO Timothy Boyle took over then-Columbia Hat from his father in 1970 when he passed. Remarkably, he grew a business with $800,000 in annual sales into the $6.20 billion company it is today. However, our analysts remain wary of this founder-led company's internal controls and accounting.
Misstatement of Inventory Accounting	Under Armour was accused of pulling revenues from future periods by first stuffing the channel with products to wholesale customers. During the periods in question, UAA's 3M DSI values grew from 120 days in 2014 to 140 days in 2017. The increased amount of inventory on hand could have been caused by recent channel stuffing by management.	**We opine that COLM's inventory position is much worse than UAA's in 2017.** In fact, COLM's current inventory position is one of the worst we have ever seen at a public retailer. Whereas UAA's DSI balance grew by only 16% over the three years, COLM's DSI balance has spiked by 76.4% in this year alone (371 days). Our research points to a highly elevated stuffed retail channel that COLM faces in 2020 and beyond.
Violations of Revenue Recognition	Sales at UAA were pulled forward in order to meet sales estimates for a period of time between 2015-2017. Under Armour's DSO value, an indicator of pulled forward sales, grew by 56% during this timeframe.	Management discussed pulling forward sales in 2019 to the amount of $45 million in Q3 2019. Based on the firm's DSO metric, which has surged 41.8% in the last year (76 days), we believe this has taken place during other periods as well.
Motivation	While management and analysts were accustomed to double-digit sales gains at UAA, management needed to turn to financial engineering to keep the good times going. Once the sales growth stopped at UAA, the stock was decimated.	Management's continual poor inventory decision-making put the company into dire straits. A glut of inventory at the channel level as well as enticing retailers with credit terms have backed COLM in between a rock and a hard place.
End Result	**In 2019, CEO Plank "retired," as his firm was engulfed with revenue recognition violations presented by the SEC/DOJ. The firm's stock plummeted since then and has never recovered.**	**???????**

Columbia Incompetence Puts the Company in Dire Straits

GlassHouse Research first came across Columbia Sportswear (COLM) in our screens in 2019, when the company was riding high in a banner year. COLM grew the top line quarter after quarter and management painted a rosy picture, with new corporate plans such as CONNECT, C1, and X1. However, underneath all the revenue gains and promises of margin expansion, our analysts found reason to believe that most of the gains were artificial in nature, or in other words financially engineered. Outsized inventory metrics, unusually high gross margins, pull-forward of sales, extension of credit terms with wholesale customers, spikes in prepaid expenses, and new disclosures and risk factors detailed in the 10-K lead us to believe that 2019 gains were primarily a farce.

Then, COVID-19 began to rear its ugly head in early 2020, impacting China and much of Asia. While the virus spread in Asia, COLM management quickly weighed their options as their supply chain was disrupted. On 02/27/20, the company put out the following Press Release placating investors' fears that its business would be impacted:

February 27, 2020

Columbia Sportswear Company

Columbia Sportswear Company Provides Update on COVID-19 Impacts

PORTLAND, Ore.--(BUSINESS WIRE)-- Columbia Sportswear Company (Nasdaq: COLM), a global leader in designing, sourcing, marketing and distributing outdoor, active and everyday lifestyle apparel, footwear, accessories, and equipment products, today provided an update on the business impacts of the COVID-19 outbreak.

In 2019, China represented approximately 5 percent of total net sales and the Asia-direct business, which includes Japan, China and Korea, represented approximately 15 percent of total net sales. While stores have begun to reopen in China, approximately half of our owned and partner stores there remain temporarily closed. Stores that are open in China have experienced a material decline in traffic and corresponding sales. There has also been an impact of the COVID-19 outbreak in Japan and Korea. Until normality returns, we expect a continued unfavorable impact on sales in our Asia-direct business.

Like many other companies, the COVID-19 outbreak is also impacting our supply chain. While only a low-double-digit percent of our finished goods are manufactured in China, our contract manufacturers source a large portion of raw materials from China. Temporary factory closures and the pace of workers returning to work have impacted our contract manufacturers' ability to source certain raw materials and to produce and fulfill finished goods in a timely manner. The outbreak is also impacting distribution and logistics providers' ability to operate in the normal course of business. These supply chain impacts will likely affect our ability to timely fulfill orders and meet consumer demand. Given we have already received substantially all of our Spring 2020 product, potential order fulfillment delays would impact future seasons.

Management was not concerned about the coronavirus' impact on sales outside of Asia, focusing on procuring new inventory for fall 2020 and beyond. Two weeks later, COLM had to reverse course, shuttering its stores in North America as the virus spread throughout North America.

March 15, 2020

Columbia Sportswear Company

Columbia Sportswear Company Provides Update on COVID-19 North America Store Impacts

PORTLAND, Ore.--(BUSINESS WIRE)-- Columbia Sportswear Company (Nasdaq: COLM, "Columbia"), a global leader in designing, sourcing, marketing and distributing outdoor, active and everyday lifestyle apparel, footwear, accessories, and equipment products, today announced that to protect the health and safety of its employees, consumers and the communities where it operates, it will close its North America brick and mortar retail stores on Monday, March 16. Columbia expects these stores to remain closed through Friday, March 27.

Based on management comments made in later analyst calls, we believe that during this short period, COLM doubled-down on their inventory procurement as management panicked at the thought of diminished 2020 sales due to insufficient finished goods. This backfired against the company in future periods; our research shows that many of COLM's retailers chose to cancel their orders, leaving COLM with bloated inventory and a stuffed channel. By the time management realized there would be substantially reduced foot traffic and sales throughout the world, it was too late.

Management downplayed its massive amount of inventory currently held on hand and has told a sensational tale of wholesalers chomping at the bit for refreshed inventory receipts in H2 2020. However, based on retailers' comments and current inventory positions, we believe management will need to impair/markdown over $225 million worth of inventory in upcoming periods.

Management's ineptitude and liberal use of accounting has set the company up for complete failure in the new COVID-19 retail environment. While retailers with a large online presence like Nike and Lululemon have thrived, it appears that COLM management has set itself up for failure.

Unlike accruals manipulation, inventory manipulation generates real cash costs. Relative to the optimal inventory level, producing excess inventory increases the carrying costs (storage, insurance, transportation, etc.) and the likelihood of inventory obsolescence, spoilage, and write-downs.

– Managing Earnings by Manipulating Inventory
Cook, Huston, Kinney 2007

COLM Inventory Diagnostics are Among the Worst in Retail

- Registering a bifurcation from its peers and channel retailers, Columbia's inventory *increased* by 6.7% YOY to $806.9 million as of 06/30/20, the highest absolute level ever reported by the company by far. This contrasts with 3M sales, which fell by an astonishing 39.8% YOY to $316.6 million.

- While many of COLM's peers either took appropriate provisioning or clamped down on inventory receipts in the last two periods, COLM was caught flat-footed. As a result of continued inventory purchases into H1 of this year, quarterly days-sales-of-inventory (DSI[1]) spiked by 73.4% YOY to 371 days, currently one of the highest in retail. Twelve-month DSI followed this trend, increasing by 19.5% YOY to 180 days, representing a new all-time high for the sportswear company.

- Analyzing inventory relative to quarterly sales, we find that the current inflated value of 254.9% (an all-time high), has risen from only 143.7% a year ago. Longer-term trends portray a similar trend, increasing by 324 bps YOY to 29.4% of 12M sales.

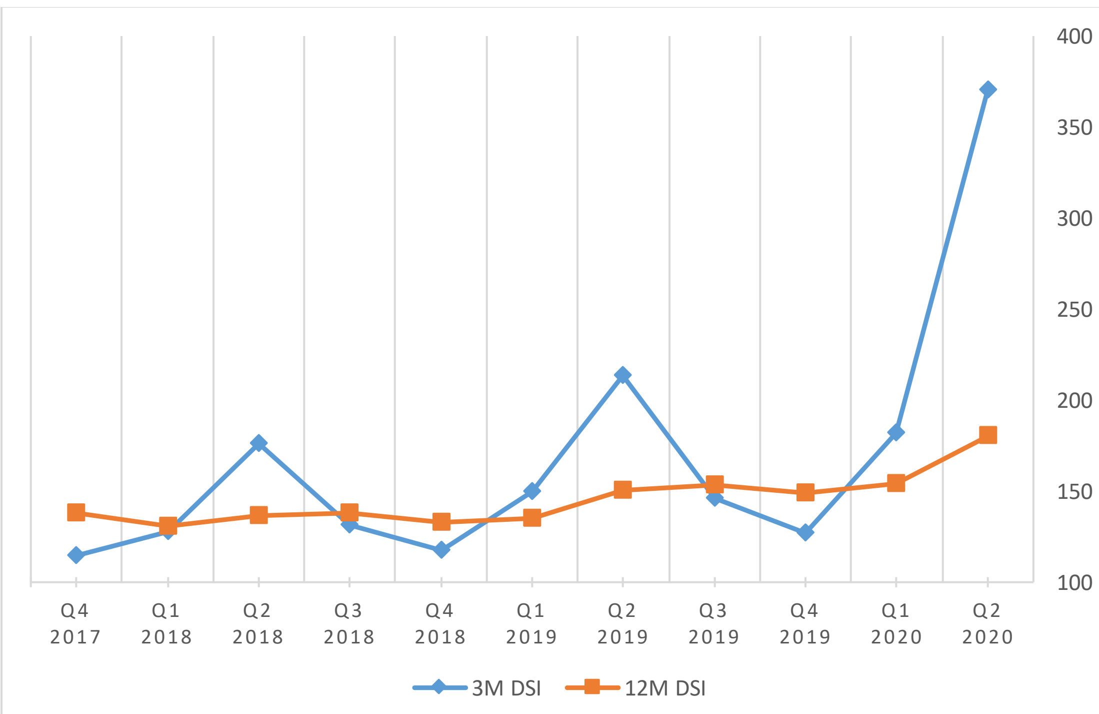
- Management has undoubtably blamed the glut of inventory and raised diagnostic metrics on the pandemic. However, we see a mismanagement of inventory and provisioning, notwithstanding COVID-19. Management's ineptitude regarding heightened inventory purchases going into 2020 remains the crux of our thesis.

[1] Three-month days-of-inventory (3M DSI) = Average inventory QOQ / 3M COGS * 91.25. Twelve-month DSI = Average inventory YOY / 12M COGS * 365.

- When we analyze inventory relative to normalized sales[2], the metrics, although improved, reveal a problem at Columbia Sportswear. For example, normalized 3M inventory-to-sales still increased by 960 bps YOY to 153.3%, representing the second-highest ratio recorded in the history of the company. Normalized DSI values reveal a similar trend, increasing by 18 days to 232 days, representing a five-year high.

- Chart 2 on Page 8 shows that while normalizing sales/COGS improved COLM's inventory metrics, excess inventory still remained within the company. DSI levels have increased in a stair-step fashion since 2017, revealing management's unwillingness to provision for inventory obsolescence, like many of its peers have.

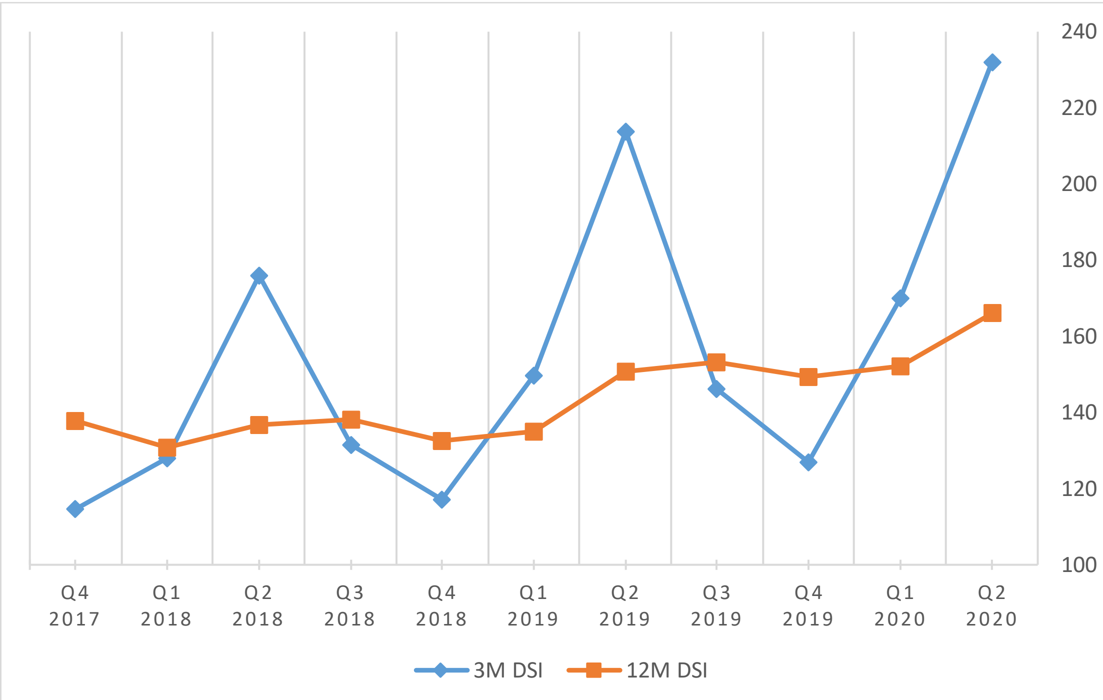
Chart 1: COLM DSI Trends[3]



[2] GlassHouse normalized Columbia's DSI values in Q1 and Q2 2020 by using the prior year's COGS value in our DSI calculations.

[3] Columbia adopted ASC 606 which reduced total inventories by $24.0 million in Q4 2017.

Chart 2: COLM Normalized DSI Trends



COLM Needs to Impair $227.1 Million Worth of Excess Inventory

While the entire retail industry faced inventory headwinds in H1 2020, many of Columbia's competitors chose a different route than our target company. COLM's competitors were busy in Q1 and Q2 because they cancelled supplier purchase obligations immediately, marked down their inventory to fair market value with significant losses, and/or sold through a material amount of inventory through e-commerce and digital channels. Chart 3 (Page 10) demonstrates how much of an outlier Columbia Sportswear is regarding its outsized inventory position.

Management tried to assuage sell-side analysts and investors' fears about its over-procurement in early March by stating that their wholesale partners had cleaned their inventory and would be ready to purchase in great numbers come fall.

The problem with this theory is twofold. First, even if inventory is viewed relative to future sales (using analyst estimates), inventory still spikes to five-year highs of 48.3% and 29.5% of 6M and 12M forward sales, respectively (see Chart 4, Page 10). Moreover, retailers seem to be stuffed with COLM inventory from a product perspective, as discussed later in the report.

With COVID-19 on the rise again in Europe and certain parts of the United States, we believe that retailers will continue to be stringent with their inventory procurement in H2 2020. Delaying product purchases will crush COLM in two ways: 1) highly diminished sales from retailers as they take a wait-and-see approach to the pandemic, and 2) a need to impair millions worth of inventory that no one will take off its balance sheet.

Finally, it is obvious to our analysts that after COLM management realized the massive error of its bloated inventory purchases, it decided to pump the breaks in late Q1 and Q2. For example, the firm reported purchase obligations from suppliers of $505.0 million at the end of Q1 2020. This amount was in line with historical norms for COLM. However, just one period later, this amount plummeted to only $232.9 million in purchase orders, as COLM scrambled to cancel their orders from suppliers.

But the damage appears to have been done — even with the decline in supplier orders, inventory still ballooned to $806.9 million, the highest balance on record for COLM. Pressured by retailers earlier in 2019 to obtain inventory for seasons over 18 months out, the same retailers have now cancelled most of their orders with COLM, leaving them high and dry.

Calculating the Impact:

Basing our calculations on a normalized 12M DSI ratio of 151 days (previous year's value), we reverse-engineered what we believe is the correct amount of inventory Columbia should currently carry. We estimate that COLM's normalized inventory balance should stand at $579.8 million (versus $806.9 million currently). Consequently, GlassHouse analysts believe that $227.1 million of excess inventory needs to be impaired, marked-down, or written-off in future periods, putting all the recent TTM operating profits at risk ($224.9 million). With expected inventory of $579.8 million in the period, this represents a 23.3% YOY decline, more in line with COLM's 39.8% YOY revenue decline and COLM's retailers (as discussed later).

So far, management has been obstinate to impair a meaningful amount of inventory as it believes the inventory can be salvaged in future seasons at full price. In fact, we learned that management only charged approximately $6 million for inventory obsolescence in the latest period (only 2.6% of our estimate), which deviates materially from peers. We believe this is a form of earnings management to cosmetically maintain gross margins in current periods.

Chart 3: COLM DSI vs. Peer Group

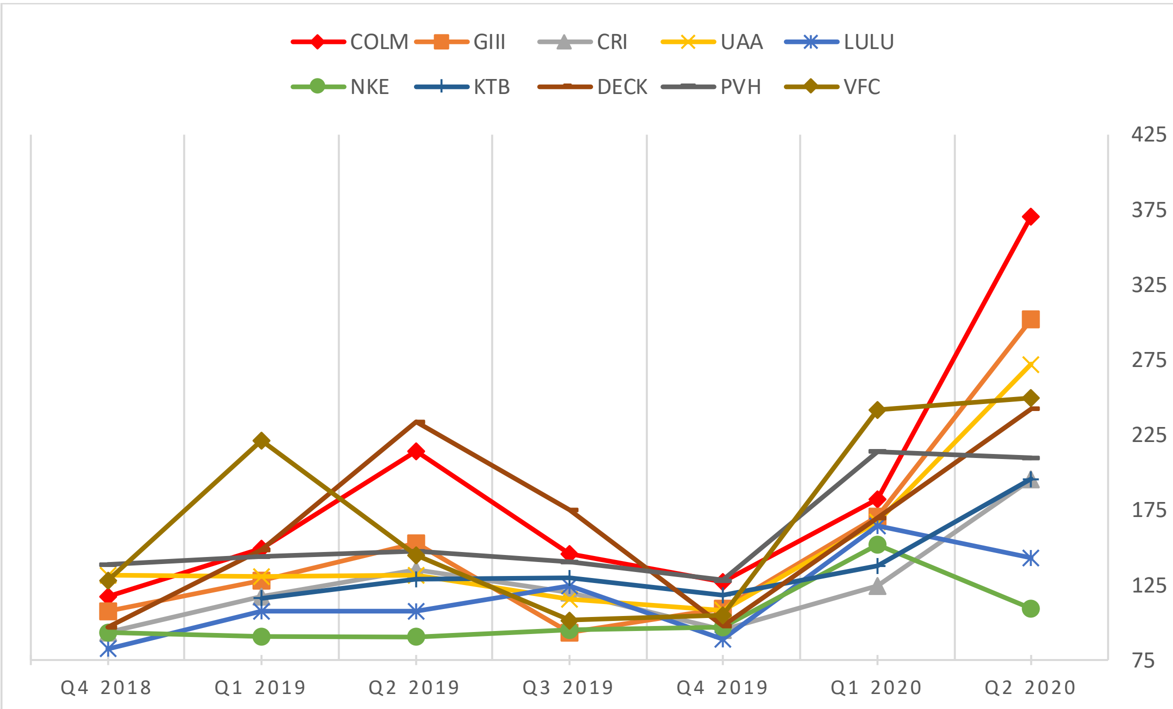
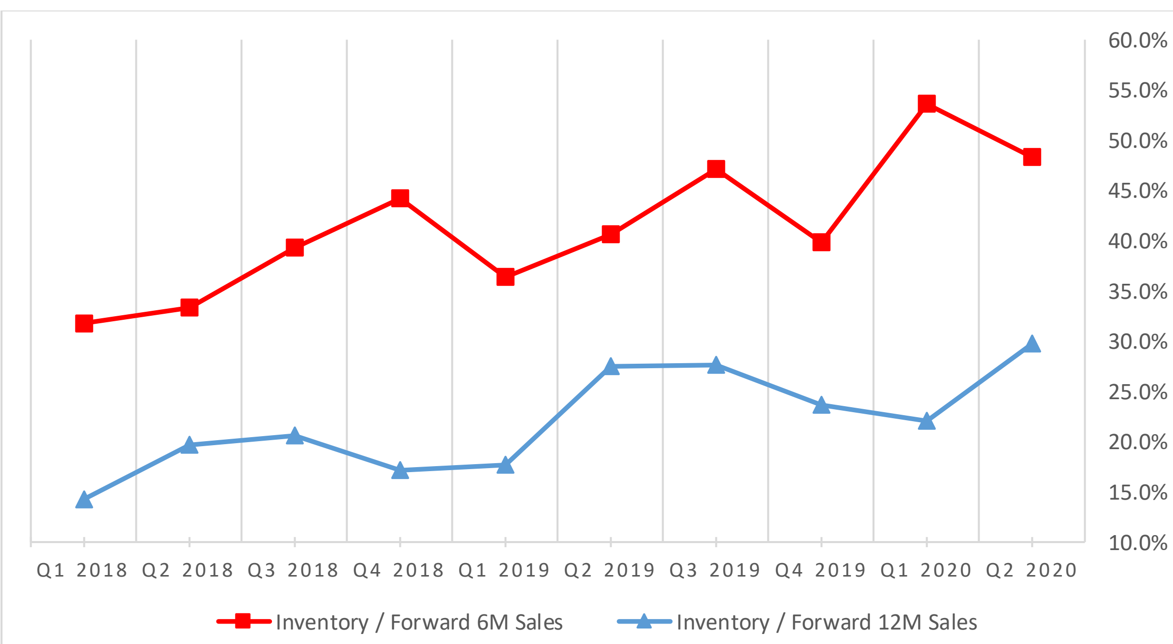


Chart 4: Inventory to Future Sales



Gross Margins Remain Unsustainably High Versus Retail Channel

Analyzing gross margin trends at the retail channel, we find that most retailers took material inventory obsolescence write-downs in Q1 and Q2. As a result, gross margins fell dramatically within the industry (see Chart 5, Page 12). While COLM's gross margins only fell by 362 bps and 201 bps YOY to 47.8% and 46.2% in Q1 and Q2 2020, respectively, the decline in retailers was much more pronounced. We calculate that retailer gross margins fell on average by 1,179 bps and 437 bps YOY. Contrary to the litany of sell-side analysts who follow COLM, we believe these retailers' demise is a harbinger of things to come for COLM at the wholesale level.

Additionally, most retailers took substantial hits to their stock price when the degradation of gross margins was disclosed. This is where we believe most the sell-side analysts get it wrong when it comes to COLM. As discussed, most believe that COLM's retailers' inventory books are lean and will be eager to buy more in H2 2020; we disagree wholeheartedly. Furthermore, analysts believe that gross margins will remain fairly flat in H2 2020, then report expansion in H1 2021. Due to compressed sales and increased provisioning over the next year, we believe reaching these gross margin estimates will be near impossible.

When asked about gross margins during the back half of 2020 in the Q2 2020 earnings call, CFO Jim Swanson appears to be highly sanguine about the situation, stating:

> I think it's going to be largely dependent upon the consumer and consumer demand and the promotional environment from an overall retail standpoint. As you look at our first half gross margin, most of the drivers that are in there are COVID related. Among them were some fairly significant inventory provisions that we've made, given our excess inventory position. <u>Assuming the environment doesn't get worse, I wouldn't anticipate that, that continues to be a headwind in the latter part of the year</u>.

While Mr. Swanson appears to ease analysts' fears about a degradation of gross margins, we find it highly unlikely that the firm will be able to *increase* margins. It also of note that Mr. Swanson gave these comments on July 30th when COVID-19 cases appeared to pass their apex in the United States and were miniscule in Europe. However, in the last month, cases have increased as the world appears to be bracing for a second wave (see Exhibit 1).

Chart 5: COLM Gross Margin vs. Retailers

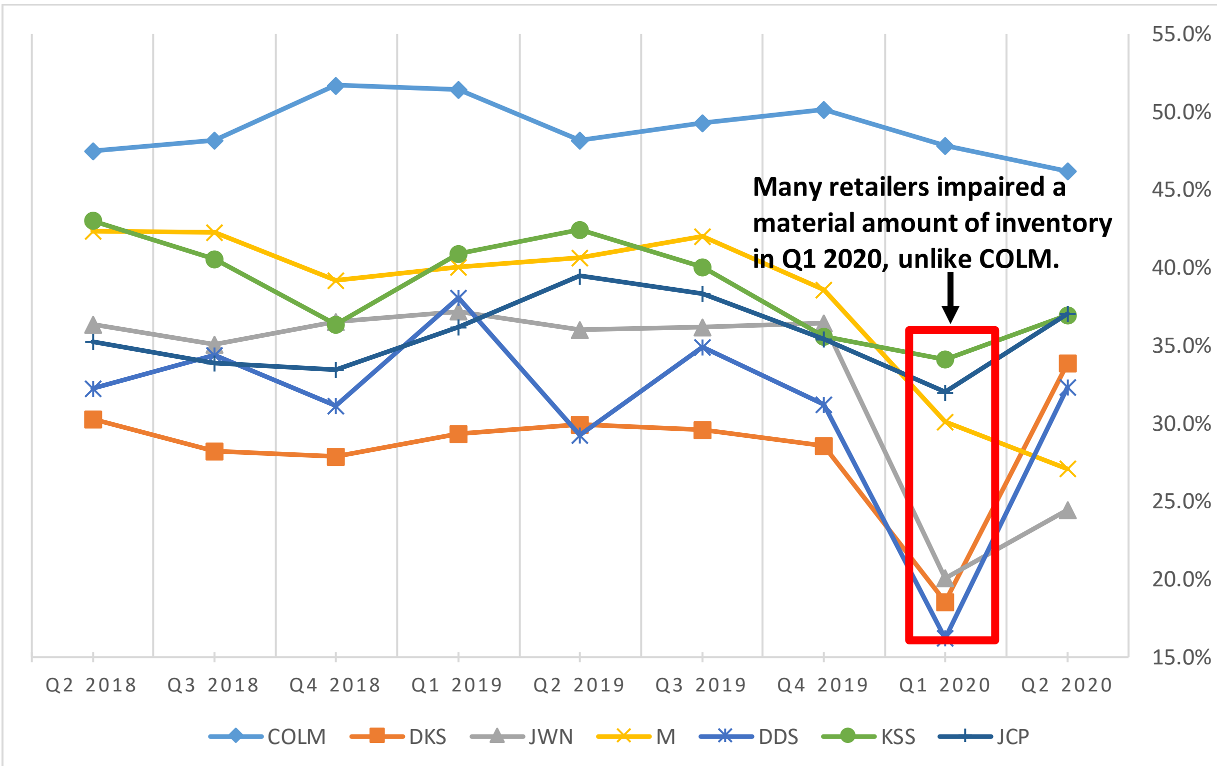
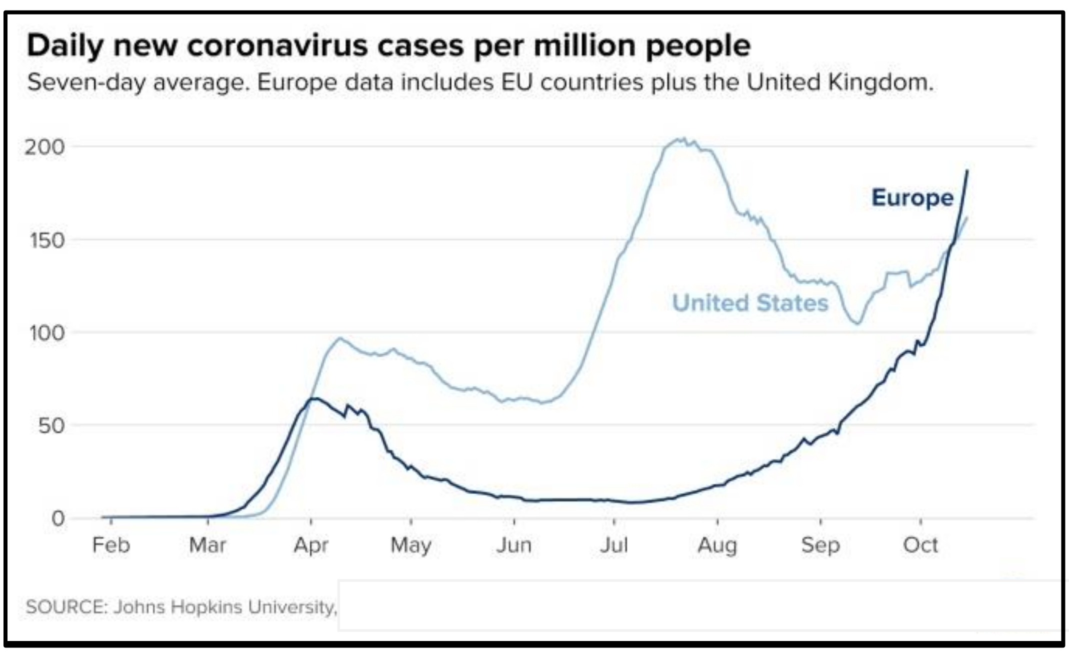


Exhibit 1: COVID Trends in U.S. and Europe



Columbia's Current Retail Channel is Stuffed

Columbia Sportswear has one of the worst inventory positions in retail. Not only has COLM management figured out a way to stuff its own retailer channel with products pre-COVID-19, it also figured out a way to purchase an exorbitant amount of finished goods, only to have wholesale customers cancel orders. Management has been way off on inventory positioning in terms of its customer demand, dating back to 2018. It was almost comical for our analysts to go through each earnings call and see how far off-base Mr. Swanson and Mr. Boyle were in their assessment of future demand environments.

But let us start at the beginning.

In 2017, management came up with "Project CONNECT" to "drive sales, capture cost of sales efficiencies, generate SG&A expense savings, and improve marketing effectiveness." However, this project impacted inventories as well. In response to an analyst who questioned the company's inventory growth in 2018, CEO Tim Boyle stated the following:

> But one of the things that the company has in its favor is an enormously strong balance sheet frankly. <u>We can have a higher return on the balance sheet by investing in inventory where it's appropriate. So we've done a lot of work around Project CONNECT to level load our factories, which is going to increase the – a percentage – a certain percentage of the inventories that we carry at certain times of the year</u> when comparing. And to answer your question about cancellations, actually, it's been quite the opposite. So we're very comfortable with the inventories where they are, and we believe we're in great shape to keep the business growing (Q2 2018 Earnings Call).

While management kept inventory turns in check throughout 2017, they have now changed their strategy through Project CONNECT to hold a larger amount of inventory on hand to satisfy suppliers, which is where COLM's inventory demise began. The firm spouted off double-digit percentage gains in inventory over the next seven consecutive periods.

Based on comments made by Mr. Boyle, Columbia seemed dead-set on keeping an outsized amount of inventory on hand throughout 2019, as the firm was ill prepared for the 2018 winter season:

> Based on the exquisite year that we had in 2018 and beginning of 2019, <u>where inventory levels were compressed. We ran out of inventory in certain categories.</u>

> And so we probably got a little ahead of ourselves. But as our business is a high percentage of repeat products, where we have a significant business and so those – that merchandise has been, as I said, on orders that we have for our wholesale customers as well as inventory that we'll be placing in our outlet stores. (Q4 2019 Earnings Call)

On top of the outsized inventory on hand, management felt pressure from wholesale partners to procure inventory earlier in the supply chain. From the firm's 2018 10K filing, COLM states the following:

> Demand Planning and Inventory Management
> As a branded consumer products company, inventory represents one of the largest and highest risk capital commitments in our business model. We begin designing and developing our seasonal product lines approximately 12 months prior to soliciting advance orders from our wholesale customers and approximately 18 months prior to the products' availability to consumers in retail stores. As a result, our ability to forecast and produce an assortment of product styles that matches ultimate seasonal wholesale customer and end-consumer demand and to deliver products to our customers in a timely and cost-effective manner can significantly affect our sales, gross margins and profitability.

After this excerpt, Columbia's accountants and lawyers added the following, which was new to the current 10K report:

> The demand planning process has become more complex as an increased proportion of the forecast is for in-season replenishment that is not confirmed until later in the selling period. Failure to achieve our demand planning goals could reduce our revenues or increase our costs, or both, which would negatively affect our gross margins and profitability and could affect our brand strength…
>
> We use those advance orders, together with forecasted demand from our DTC businesses, forecasted wholesale order cancellations, reorders and replenishment orders, market trends, historical data, customer and sales feedback, and other important factors to estimate the volumes of each product to purchase from our suppliers around the world. The competitive landscape with our suppliers has resulted in our efforts to extend our buying periods and to procure products earlier in the seasonal period.

We believe the extended procurement period has presented a significant risk to a legacy outerwear company such as COLM. The strategy of buying inventory earlier in the supply chain process is what would ultimately become a disaster in 2020. COLM found itself in a conundrum. The company faced greater pressure to replenish inventory on demand from its retailers, while simultaneously attempting to appease manufacturers by placing orders well before demand was confirmed.

On top of the absurd inventory strategy employed by management in 2019, the company continued to execute more blunders as they: 1) doubled-down on inventory purchases in March before the pandemic hit the U.S., and 2) heightened the use of extending credit terms to retailers to entice purchases, which stuffed their retailers with bloated product.[4] Both strategies blew up in their faces in 2020. Now, for the first time, Columbia is discussing inventory that will be sold over several *years*, not months. (Q1 2020 Earnings Call):

> **Timothy P. Boyle**
>
> As it relates to carryover inventory, as you know, the bulk of our sales are through fairly long historical products and we have good visibility on that merchandise, and <u>we have some carryovers that we'll be selling over the next several years.</u> We're going to be focusing on inventory turns and liquidity, an area where we really never had to manage with the kind of precision we're going to be working with in the future.

Our main thesis speaks to management incompetence relating to inventory procurement time and time again. While other competitors and retailers over-provisioned excess inventory, cancelled orders and cleaned their books, COLM appears to be happy with the status quo.

Management also believes that its wholesale customers will purchase products at historical levels in H2 2020, greatly deviating from peers' strategies. Here again is CEO Boyle in the latest earnings call:

> **Timothy P. Boyle**
>
> Certainly. Well, our order book was essentially complete in January of 2020 for fall, prior to the pandemic real – hit in Europe and North America. And since then, that order book has compressed slightly, not a tremendous amount. <u>But what we've seen is, frankly, an opportunity where we have inventory present where we believe that, frankly, later in the season, there will be a likely shortage of inventory in winter</u>

[4] GlassHouse will discuss this in our Accounting Irregularities section on Page 22.

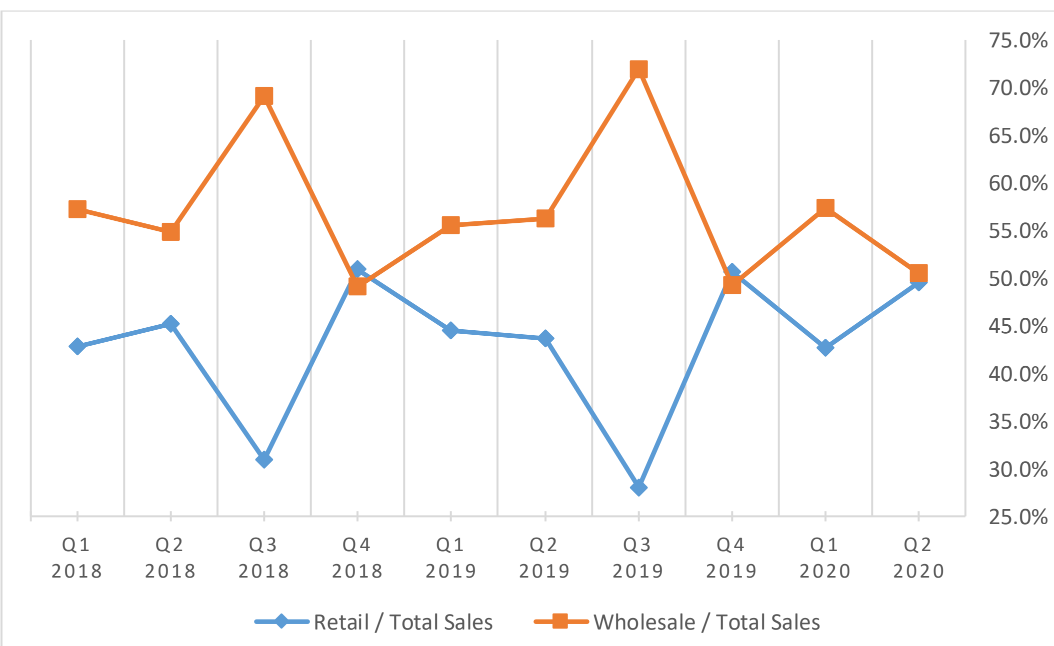
> products. Many of our competitors canceled all orders for merchandise coming in from Asia in winter. And we were very selective in terms of how we work that effort. And so my feeling is we're in the right position with inventories today matching our order book.

Our analysts scoured every public retailers' comments regarding inventory purchases in H2 2020. We have no idea where Mr. Boyle is getting the notion that there will be an inventory shortage. We believe H2 2020 will be a rude awakening for a company that continues to make all the wrong decisions.

Retailers Hesitant to Purchase Finished Goods in H2 2020

Our research points to Columbia's heavy reliance on their retail channel to move product and increase sales. We find COLM's wholesale revenues grew by 10.6% to $1.78 billion in 2019. Furthermore, the company reports that 58.6% of sales originated from their wholesale customers in fiscal 2019. While this percentage split stayed steady at 57.4% in Q1 2020, the ratio fell to 50.5% in the latest period as retailers cut back and cancelled purchase orders from Columbia.

Chart 6: COLM Retail vs. Wholesale Revenue %



As detailed in our above analysis, management believes that they will be able to sell through the current glut of inventory on hand onto its retailers in H2 2020. Much of this theory is based on comments made by retailers discussing their clean/lean inventory levels going into the fall season. While most retailers have admitted to clean inventory levels heading into the fall, we believe this is due to write-downs from an accounting perspective and not a physical one. Retailers seem reluctant to purchase inventory for the fall season in a weak demand environment.

Below are major retailers' inventory positions, as well as recent comments made by management. They illustrate COLM's abysmal approach to the fall and winter retail seasons. Although we cannot ascertain specific metrics regarding COLM's inventory at each retailer, we show an overall perspective about what each management team faced going into H2 2020.

Dick's Sporting Goods (DKS)

In the midst of the pandemic, DKS worked to reduce and cancel their inventory receipts from wholesalers almost immediately. Here is Dick's CFO Lee Belitksy discussing inventories on the Q1 2021 call:

> Our quarter end inventory levels decreased 2% compared to the end of the same period last year. And working alongside our brands, we acted decisively to reduce, defer and cancel planned receipts to align with our new sales forecast. For the rest of 2020, we are conservatively planning our inventory receipts.

Corroborating our "channel is stuffed" hypothesis, DKS disclosed a material $28 million in inventory write-downs on their book in Q1, a major factor in inventory levels' fall of 2% in the period.

Dick's CEO discusses the excess of physical inventory on the same call:

> Oh, yes. I don't know yet. None of us do. We think it will probably be a tad more promotional because people have inventory to get rid of.

Looking at Q2 2021 for DKS, the company decreased inventories further by 12% to $1.88 billion. Because of this, it kept inventory turns within historical values for the company. Management seems to be content with keeping levels here during the reduced traffic environment.

Furthermore, when asked about future inventory receipts in the fall, DKS management focused more on home grown brands such as CALIA and Alpine Design Brands, which outperformed the company average in the period. A key account for Columbia, it is interesting to note that Alpine Designs product lines are in direct competition with Columbia Sportswear (as well as DKS' CALIA being in direct competition with Columbia's SOREL). According to comments made by Dick's management, DKS continues to give floorspace and web presence to their private label brands such as CALIA and Alpine, leaving Columbia out in the cold.

Nordstrom, Inc (JWN)

In the latest period, Nordstrom brought inventories down significantly by 24.1% YOY to $1.47 billion. Though inventories decreased from a dollar perspective, we believe most of the physical inventory was marked down and moved to Nordstrom Rack outlets, as discussed on the 08/25/20 Earnings Call:

> The roots of our Rack business is in more efficiently clearing out inventory from our Full-Price business, allowing us to flow in new merchandise. So this is certainly a time for us to leverage that capability, that asset, to look at our inventory health overall across our company, <u>and our Rack team played a huge part in getting us into the clean inventory position that we enjoy being in right now</u>.

Moreover, it appears that management remains cautious about purchasing new inventory in the fall:

> And then we're very prudent on the inventory choices that we've made for Q2, partially because we really want to make sure we were set up in the transition period for fall in the second half of the year…
>
> <u>From an inventory perspective, again, we were very prudent in how we thought about this. Our plan was, quite frankly, to just focus on preserving cash and liquidity and really looking at how to best manage the biggest investment and risk that we have, which is in inventory</u>, primarily seasonal inventory, and we were really pleased with how we executed against that.

Macy's, Inc (M)

Like Nordstrom, Macy's reduced inventories by making appropriate markdowns in the period. Unfortunately, it appears that with their newfound clean positions, they will lean into categories that Columbia is not a part of:

> In the quarter, Backstage performed better than our main boxes but still saw sales erosion of nearly 45% due to closures. We took appropriate markdowns during the quarter to clear through seasonal merchandise in Backstage and enter the third quarter in a clean inventory position. <u>The sales recovery is expected to improve in the third quarter as we lean into stronger trends in home, casual and basics</u>…
>
> So what we've seen is that now that we've got our inventory in parity with the demand that we're expecting in the back half of the year, seeing some really good regular-priced sell-throughs in categories from off-price all the way to luxury, our freight is moving very well right now.

Columbia appears to be at a disadvantage again, with Macy's happy with its inventory position and reluctant to make significant inventory purchases in the fall. This is also corroborated by Macy's 10Q filing:

> <u>Company is approaching the back half of the fiscal year conservatively</u> given an anticipation of continued turbulence associated with the COVID-19 pandemic and a moderation of its stores' recovery…
>
> The Company has been and may continue to be required to change its plan for inventory receipts, <u>which could place financial pressure on its brand partners</u>.

Finally, Macy's, a major Columbia customer, has a real chance of going bankrupt in 2020 (Altman Z-Score of only 0.96x as of 08/01/20). If Macy's goes under, it will be unable to pay what is due under the extended payment terms that COLM has offered. None of these Macy's retailer level issues bode well for COLM in the upcoming periods.

Kohl's Corporation (KSS)

As of 08/01/20, Kohl's was able to bring down inventories by 26.2% YOY to $2.70 billion. Reducing inventory by this significant amount, the firm was able to reel DSI values within historical averages at 133 days. Like the other retailers, Kohl's may be hesitant to purchase material amounts of inventory going forward, based on the CFO Jill Timm's and CEO Michelle Gass' recent comments:

Our inventory dollars at the end of the quarter were down 26% as compared to last year driven by lower inventory receipts during the quarter and our ability to work through existing inventory as stores reopened. As we look to the balance of the year, we will continue to manage inventories tightly with the opportunity to chase into demand…

Further, we will continue to manage our inventory and expense with great discipline and ensure we are prepared to react to the ever-changing environment…

We positioned our inventory very conservatively. Jill shared inventory down 26%. You asked how we're planning the back half of the year. We are continuing to plan the back half of the year conservative from an inventory position, but we are working very closely with our vendors to go after any upside and chase demand. And you've seen us do that in the past.

JC Penney Company (JCP.Q)

The now defunct JC Penney reduced inventories by 23.5% YOY to $1.89 billion as of 08/01/20. We believe that a large portion of COLM's recent spike in bad debt expenses may be due to JC Penney's bankruptcy. In either case, this will hit Columbia on multiple fronts: decreased sales from a lost retailer and lost receivables/bad debts from a dying company.

Here is what the company discussed in their latest 10Q filing (JCP no longer releases earnings calls):

> Merchandise inventory decreased $580 million, or 23.5%, to $ 1,891 million as of the end of the second quarter of 2020 compared to $ 2,471 million as of the end of the second quarter of 2019 and decreased $275 million from year-end 2019, as a result of the deferral of supplier shipments due to the closing of stores and resulting decline in sales. Merchandise payables decreased $642 million as of the end of the second quarter of 2020 compared to the corresponding prior year period and decreased $550 million from year end 2019.

Dillard's, Inc (DDS)

Dillard's inventories declined by 20.0% YOY to $1.28 billion as of 08/01/20. While the company does not publish earnings calls, we found information regarding inventory procurement from the company's 10Q filings:

> The Company took a number of actions to enhance liquidity during the six months ended August 1, 2020 as the COVID-19 pandemic progressed, including the following:
>
> - Extended vendor payment terms during the first quarter but restored most vendors to standard payment terms by August 1, 2020
> - Canceled, suspended and significantly delayed merchandise shipments
> - Reduced merchandise purchases during the first and second quarters by 33% and 62%, respectively
> - Reviewed and reduced discretionary operating and capital expenditures
> - Reduced payroll expense
> - Executed aggressive promotional markdowns to clear inventory

Now that we ran through the gauntlet of Columbia retailers and their recent demand environment, can we say with a straight face that we are excited about inventory purchases going into the back half of the year? With COVID-19 resurging in the fall in many parts of Europe and the United States, we cannot for the life of us understand why Columbia management would be so optimistic going into the fall season.

Revenue Recognition Concerns Headline Accounting Red Flags

As aforementioned, earnings quality issues sprouted up at COLM even before the pandemic hit. We now believe that the pandemic exacerbated these issues to cataclysmic levels at the firm. For example, while 2019 was a banner year for the sportswear company in terms of revenue and profits, we believe much of these gains were artificially enhanced by accounting gimmicks. One of these gimmicks relates to the firm's receivables balance and the extending of credit to retail customers. Our following analysis presents how the firm was able to pull forward sales into current periods, which runs parallel to Under Armour's strategies in 2017.

In Q3 2019, consensus estimates for revenues in the period stood at $883.3 million. But COLM reported revenue of $906.8 million, or a 13.9% YOY gain. Digging into the earnings call, we found that a material amount of $45 million in sales was pulled from Q4 into Q3.

> Analyst
> Congrats on a strong quarter. Just first, maybe for Jim, can you help us frame the impact of the timing shifts given the earlier shipment of the fall 2019 orders? So if you normalize that out, can you help us quantify maybe the dollar value or EPS impact of that pull-forward?
>
> Jim A. Swanson – CFO
> Yes. Absolutely. So in our second quarter earnings call, I'd indicated that the shift was going to be about $20 million out of the fourth quarter and into the third quarter relative to the experience that we've had last year. And as we sit here today, and obviously we had the earlier receipt of our inventory that we've been reflecting in our inventory balance, that shift became about $45 million from – again from Q4 and into Q3 and, call it, 2/3 of that was in the U.S. There's a portion of that was international as well. And that's, by and large, what drove the upside to our outlook for the quarter. So it's more of a timing shift than anything.

As a result of the timing shift, management beat estimates by 2.7% in the period. However, sans this artificial gain, revenues would have been $861.8, resulting in *missing* earnings by 2.4%. Timing shifts like these are eerily similar to the SEC's charges of revenue recognition violations against Under Armour. This quote from UAA details the accusations presented against them:

> The Wells Notices, which the SEC uses to inform investigation subjects that it intends to bring enforcement actions against them, relate to sales that were allegedly pulled forward during a period from the third quarter of 2015 through the end of

> 2016, Under Armour said. The SEC is "focused on the company's disclosures regarding the use of pull-forward sales in order to meet sales objectives."[5]

Since then, an increase in COLM's receivables diagnostics give us great cause for concern. The continued rise indicates two nefarious signals: 1) the company is using relaxed credit terms to entice retailers into shifting future sales into current periods, and 2) the company is now at risk of heightened bad debt expenses from failing retailers during COVID-19.

We present our accounts receivable (AR) analysis below:

- Dating back to Q4 2017, our research points to 11 consecutive quarters where receivable growth outpaced sales. As a result, an AR-to-3M sales value of 49.6% (42.4% under ASC 605) in Q2 2018 spiked up to a current value of 68.7% just two years later (see Chart 7 on Page 24).

- This increase represents a 1,915 bps (2,627 bps ASC 605) gain in just a two-year period and a new five-year seasonal high for the company (under either ASC 606 or 605).

- Days-sales-outstanding (DSO) metrics have also exploded over the last two years, when we believe most of the channel stuffing and timing shifts have occurred. While AR decreased by 22.5% YOY to $217.5 million at the end of Q2, sales declines outpaced this, plummeting by 39.8% during Q2 2020. As a result, 3M DSO surged by 41.8% YOY to 76 days; the highest DSO value recorded by COLM in the last five-years (under ASC 606 or 605).

- Based on our analysis, we believe that management pulled forward $70.9 million of sales in fiscal year 2019, normalizing the firm's DSO balance, then reverse-engineering a normalized AR balance. This amounts to 18.0% of 2019 operating profits and will be a major headwind in future periods.

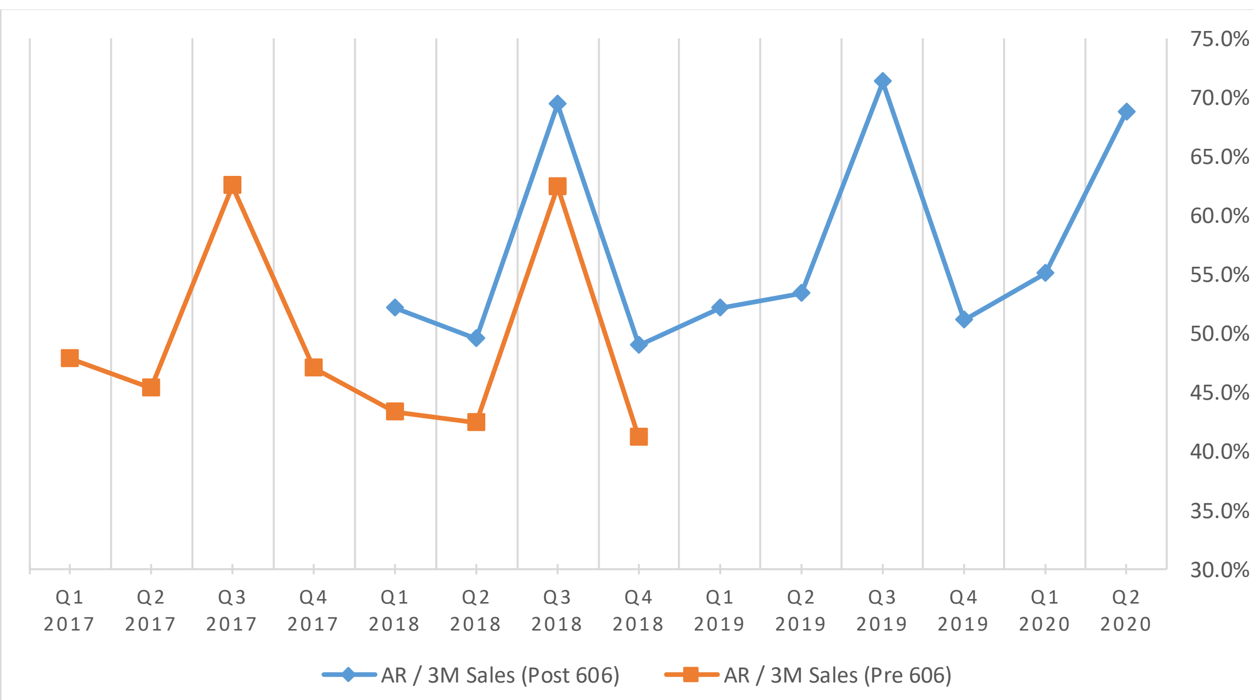
- Exacerbating COLM's receivable woes, the firm's bad debt expense spiked in 2020 as several of the company's retail partners face possible bankruptcy. Astonishingly, Columbia's allowance for doubtful account (AFDA) increased by 256.6% YOY to $28.8 million. We believe this could just be the start, in terms of sufficient provisioning. COLM cites bad debts as a material reason for the increase in SG&A costs in the Q2 period stating, "increased bad debt expense, reflecting heightened AR risk resulting from the ongoing COVID-19 pandemic."

[5] https://www.accountingtoday.com/articles/under-armour-falls-after-founder-cfo-are-named-in-sec-probe

Table 1: Accounts Receivable Metrics
($ in millions)

Period Ended:	Q2 2020	Q1 2020	Q4 2019	Q3 2019	Q2 2019
Accounts Receivable (AR)	$217.5	$313.0	$488.2	$646.4	$280.6
AR to 3M Sales (%)	68.7%	55.1%	51.1%	71.3%	53.3%
AR to 12M Sales (%)	7.9%	10.6%	16.0%	21.5%	9.7%
Three-Month DSO	76	64	54	47	54
Twelve-Month DSO	52	51	53	55	47
YOY					
Accounts Receivable (%)	-22.5%	-8.3%	8.6%	17.0%	17.6%
AR to 3M Sales (bps)	1,538	296	216	187	378
AR to 12M Sales (bps)	-178	-138	1	75	56
Three-Month DSO (%)	41.8%	16.8%	8.8%	2.8%	2.5%
Twelve-Month DSO (%)	10.1%	5.1%	5.7%	3.6%	7.2%

Chart 7: COLM AR-to-3M Sales Trends (Reporting Both ASC 606 & 605)



Excerpts from COLM's annual filings corroborate our thoughts regarding extending payment terms to customers:

> We extend credit to our wholesale customers and international distributors based on an assessment of the customer's financial condition, generally without requiring collateral. Wholesale customers may receive extended payment terms when placing advance orders and taking delivery of finished goods prior to peak seasonal shipping periods. We generally utilize credit insurance or standby letters of credit to minimize our risk of credit loss for customers in certain markets or with qualifying circumstances. We manage our inherent risk of uncollectable receivables by maintaining and investing in information systems, processes and personnel skilled in credit, risk analysis and collections.

The continued increase of AR diagnostics is a harbinger for a heightened extension of payment terms in two ways. First, the spike in receivables relative to sales portends finished goods being shipped earlier in the sales process to the retailer, but the cash payment is then delayed. Second, the salient rise of bad debt expense leads us to believe that the receivables are badly aged, as COLM is not being paid in a timely manner, if at all.

Finally, we would like to highlight an excerpt from COLM's risk factors in their 10Q filing that appears to be clairvoyant in nature:

> Our Orders from Customers Are Subject to Cancellation
> We do not have long-term contracts with any of our wholesale customers… If any of our major customers, including distributors, experience a significant downturn in business or fail to remain committed to our products or brands, these customers could postpone, reduce, cancel, or discontinue purchases from us. As a result, we could experience a decline in sales or gross profit, write-downs of excess inventory, increased discounts, extended credit terms to our customers, or uncollectable accounts receivable, which could have a material adverse effect on our financial condition, results of operations or cash flows.

We are floored with the accuracy of COLM accountants/lawyers regarding the above excerpt. Literally everything they discuss above is playing out in front of their eyes in real time and is only going to get worse. However, by the tone and direction of management on the latest earnings call, they will have you believe that H2 will bring a surplus of demand out of nowhere which will solve their earnings quality woes. This is wishful thinking. In our later sections, we will reveal how ill-prepared COLM is in an everlasting COVID-19 world.

Outsized Prepaid Expenses Responsible for $18.8 million of Operating Gains

In general, we view growth of prepaid expenses and other current assets (AKA prepaids) ahead of revenue and/or total operating expenses as a potential indicator of excess costs stored on the balance sheet (i.e., excess relative to their expected future benefits). Regardless of whether the build-up occurred as a result of deterioration in (macro or micro) economic circumstances or a relatively higher rate of capitalization (slower amortization) than in prior periods, the end result is the same. Absent similar growth in revenues, margins will decline as these costs must ultimately be amortized against earnings.

Columbia has been fairly tight lipped with regards to their prepaid assets. However, GlassHouse believes a large portion of these excess costs revolve around several IT infrastructure endeavors the company is taking on. No matter the reasoning behind it, the remaining excess costs stored on the balance sheet will unwind in future periods, compressing margins and profits.

- GHR observes a consistent rise in prepaid expenses and other current assets on COLM's balance sheet. In Q3 2017, the company reported a balance of only $36.1 million, however since then, this balance has accelerated in a parabolic fashion up to $102.6 million in the latest period.[6] Lacking from COLM's footnotes, the firm reported an increase in this account at a time when revenues were down 39.8% YOY. GlassHouse finds that a divergence of this magnitude with no clarifications highly peculiar, especially with a blessing from Columbia's auditor.

- Prepaid expenses, other current assets and non-current other assets are not discussed at all in COLM's 10K report, notwithstanding a small amount of currency forward contracts disclosed. While this figure continued to increase in 2020, there was little to no disclosures as to why the current balance stands at $102.6 million.

- In the excerpt below from the 2019 10K filing, we see that prepaids consumed over $15.1 million, $9.78 million, and $19.2 million in 2019, 2018, and 2017, respectively – all highly material amounts. Other assets consumed a material $3.55 million and $12.4 million in 2019 and 2018, respectively. We are perplexed to find no mention of this highly material consumption of cash in the liquidity and capital resource section of the company's 10K filing.

[6] As a result of ASC 606, prepaid expenses increased by $12.2 million on 01/01/18.

COLUMBIA SPORTSWEAR COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Year Ended December 31, 2019	2018	2017
Cash flows from operating activities:			
Net income	$ 330,489	$ 274,948	$ 112,315
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, amortization, and non-cash lease expense	121,725	58,230	59,945
Loss on disposal or impairment of property, plant, and equipment	5,442	4,208	1,927
Deferred income taxes	(1,808)	1,462	44,851
Stock-based compensation	17,832	14,291	11,286
Changes in operating assets and liabilities:			
Accounts receivable, net	(37,537)	(25,601)	(24,197)
Inventories	(84,058)	(94,716)	46,662
Prepaid expenses and other current assets	(15,068)	(9,771)	(19,241)
Other assets	(3,547)	(12,421)	931
Accounts payable	(10,419)	19,384	30,568
Accrued liabilities	18,863	66,900	11,581
Income taxes payable	(9,402)	(3,958)	58,702
Operating lease assets and liabilities	(54,197)	—	—
Other liabilities	7,137	(3,387)	5,798
Net cash provided by operating activities	285,452	289,569	341,128
Cash flows from investing activities:			
Purchases of short-term investments	(136,257)	(518,755)	(130,993)
Sales and maturities of short-term investments	400,501	352,127	36,282
Capital expenditures	(123,516)	(65,622)	(53,352)
Proceeds from sale of property, plant, and equipment	—	19	279
Net cash provided by (used in) investing activities	140,728	(232,231)	(147,784)

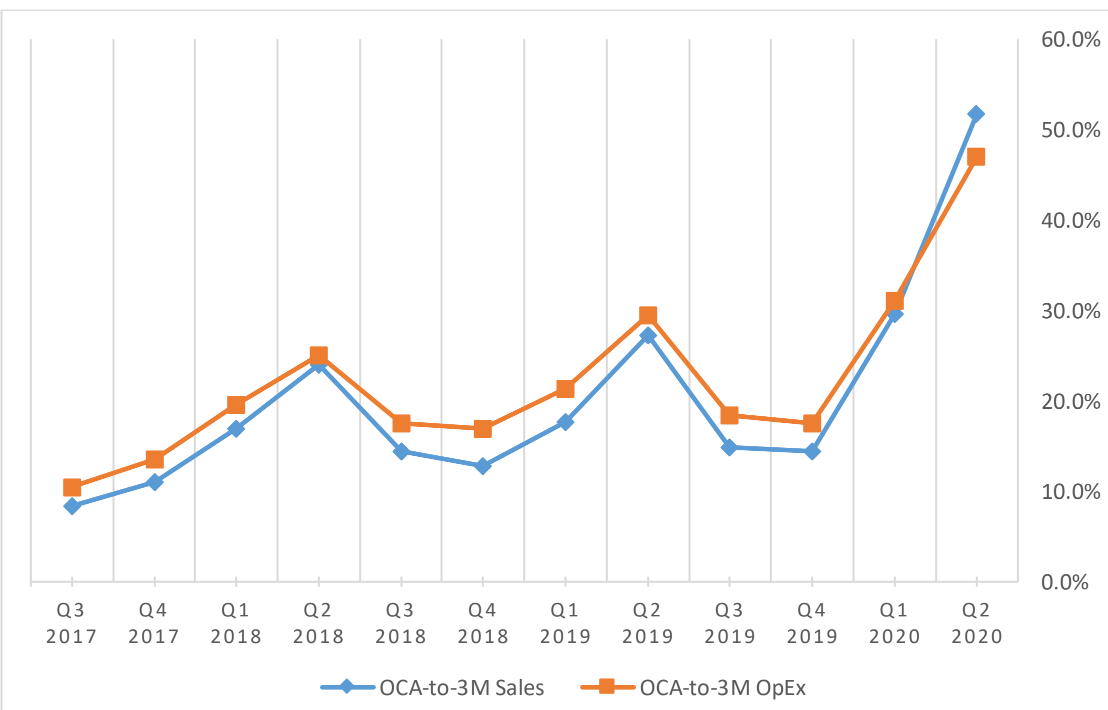
- Digging into the numbers, prepaids have outpaced both 3M sales and 3M OpEx on a YOY basis by 1,324 bps and 864 bps, respectively as of Q2 2020. As a result of the recent growth in this account, prepaid expenses are up to 32.4% (29.4%), relative to 3M sales (3M OpEx). Both these ratios are at their respective five-year high, showing the severity of this unusual increase.

- We find similar results when the level of prepaids is added to long-term other assets (AKA Total Other Assets or TOA). For instance, total other assets jumped 2,449 bps YOY to 51.7% of 3M sales. Again, analyzing total other assets versus 3M OpEx, TOAs also increased 1,744 bps YOY to 47.0%; both historical maximums for Columbia (see Chart 8). Longer-term trends reveal a similar trend with TOAs rising 101 bps YOY to 6.8% of 12M OpEx in the period, representing an all-time high.

- To quantify the rise in TOAs relative to earnings, we calculate that if Columbia would have kept the TOA-to-12M sales ratio constant at its Q2 2019 value of 6.0%, **the company would need to reduce operating income by $18.8 million, or 8.4% of all TTM operating income.**

> *Capitalizing expenses is the easiest way for CEOs and CFOs to create faux earnings in any given period. Prepaid expenses are rarely discussed on conference calls, as analysts are too busy digesting management's guidance and updating their models.*
>
> *In our experience, it is the perfect account to manipulate, as it is often overlooked.*
>
> *--- GHR*

<u>Chart 8: COLM Prepaid Expense + Other Assets Trends</u>



COLM is Positioned for Failure in New Normal

So far, our report has detailed how management got into this mess at Columbia. A stuffed inventory channel, pulling revenue forward, collection risks, and heightened deferred expenses are major red flag accounting risks that will reverse violently in future periods. Yet, in the face of these headwinds, management has told sell-side analysts with a straight face that it believes it is better positioned than the competition for H2.

Bad decision after bad decision have put the company into this precarious situation:

- First, management under-procured enough inventory to satisfy demand in the 2018 winter season.
- In order to combat this bad decision, management over-purchased inventory from China throughout 2019, which it completely overshot. In later conference calls, management discussed ageing of inventory being higher than normal, saying that some may need to carry into future seasons.
- As a result, COLM pulled forward sales and stuffed the channel to rid itself of inventory on the books.
- At the beginning of 2020, management panicked at the thought of not being able to procure inventory for the Fall 2020 season, due to China disruptions. It then procured excess inventory, assuming that COVID-19 was contained in Asia.
- Two weeks later, COVID-19 spread to the United States and COLM shut down all its brick and mortar stores.
- In the latest earnings call, management had the audacity to talk about their "great position" after doing so much wrong over the past two years.

> Timothy Boyle – CEO
> But what we've seen is, frankly, an opportunity where we have inventory present where we believe that, frankly, later in the season, there will be a likely shortage of inventory in winter products. Many of our competitors canceled all orders for merchandise coming in from Asia in winter... So I think, frankly, we're in a great position here.

- Finally, in a period when competitors have smartly leaned on their e-commerce and digital platforms, COLM's internet/mobile presence is nowhere near other market leaders such as Nike and Lululemon. Making matters worse, their main digital mobile experience "X1" was set to be released in early 2019, which was delayed to early 2020, and now will not be released until late 2020 … maybe.

Failed X1 E-Commerce Roll-Out Another Blunder by C-Suite

In 2018, Columbia introduced Experience First (X1) as this would revolutionize the company's e-commerce system:

> Experience First ("X1")
> We have also made the decision to launch a new initiative, X1. This initiative within our DTC operations is designed to enhance our e-commerce systems to take advantage of the changes in consumer browsing and purchasing behavior towards mobile devices. It encompasses an upgrade of our e-commerce platforms to offer improved search, browsing, checkout, loyalty, and customer care experiences for mobile shoppers, and is expected to be implemented in the first half of 2019. The project will be fully integrated with our C1 initiative, and will be implemented across all of our brands.

How prescient it was for Columbia to launch a brand-new revolutionary e-commerce platform right before a global pandemic that would highly reduce foot traffic just one year later. But oops, the X1 e-commerce platform did not launch in early 2019; however, Columbia promised it would be ready in late 2019.

"*While we are continuing to work towards 2019 implementations of C1 and X1, we may shift that timeline to ensure completeness of each system and to align timing of go-live with our retail calendar and store rollout plan*." – Q4 2018 Earnings Call

Ok ready to roll out in late 2019…

"*While we are continuing to work toward North American implementation of C1 in the second half of 2019, we are now working towards a phased implementation of X1, beginning with Europe-direct in 2019, followed by the launch of North America in '20*." – Q1 2019 Earnings Call

Well at least it would be ready before the pandemic hit…

"*We continue to invest in our Experience First initiative or X1 and intend for the platform to go live for the Columbia, SOREL and Mountain Hardwear brands in North America prior to the peak holiday [2020] sales period*." – Q1 2020 Earnings Call

Looks like a wasted opportunity to us at GlassHouse. We find it hard to believe that consumers who were sitting at home for six months, underwhelmed by Columbia's legacy digital platform, would sign back on in the winter with an X1 product that may or may not be ready. The gold standard in the space lies within Nike and Lululemon. Their recent margin expansion and stock price rise is justified based on their digital presence (discussed in next section).

E-Commerce Metrics Nothing to be Excited About at Columbia

During the latest earnings call, management touted the performance of their DTC e-commerce division, which grew by 72% YOY. While this percentage alone may seem a success to some, our analysts are not convinced.

Management has been tight-lipped about their e-commerce figures. It has not provided absolute numbers of e-commerce sales, and this quarter was one of the first times it discussed specific e-commerce numbers (although they are discussed in vague terms in the CFO commentary).

Reverse-engineering e-commerce sales based on comments made by management, we find an e-commerce trend that does not stack up well versus industry leaders (see Chart 9, Page 33). Prior to the pandemic, COLM's e-commerce sales decelerated into single-digit growth in Q3 and Q4 2019. Only after the pandemic reduced traffic in brick and mortar stores did e-commerce begin to resurge. Finally, analyzing e-commerce sales as a percentage of total sales, we find a ratio of only 11% in 2019 to be highly insufficient compared to COLM's peers.

Here is market laggard Under Armour discussing an appropriate amount of e-commerce sales in a recent earnings call:

> Although we expect e-commerce sales to represent a higher portion of our overall business in 2020, sales in this channel have historically represented a small percentage of our total revenue. For example, in 2019 sales through our direct to consumer channel represented 34% of net revenues, with our e-commerce business representing less than half of the total direct to consumer business [17%].

Even Under Armour realizes that e-commerce sales under 20% of total sales in the new digital environment are not enough to attract modern customers.

Market leader Nike discussed the appropriate amount of online sales in a recent earnings call:

> This next phase of our Consumer Direct Offense is expected to drive sustainable growth and profitability as we accelerate NIKE to a digital-first company. We are committed to the execution of this strategy, despite the short-term adverse impacts to our business from a novel strain of coronavirus (COVID-19). As such, our long-term financial goals on average, per year, remain the same and are outlined below… digital is fueling how we create the future of retail… And looking ahead, we now expect our overall business to reach 50% digital penetration.

Nike understands the ever-changing customer and is shooting for an astonishing 50% in digital sales, which would have sounded crazy just three years ago. Another market leader, Lululemon, is astoundingly already there, reporting over 60% of sales from their direct-to-consumer channel as of 08/02/20.

There is a new normal in retail. There will be winners and losers. Columbia is a loser. Management teams like COLM that are praying for a return to normal will get decimated over the next year, as consumer preferences to online accelerate. COVID-19 is not going away, rather, it is resurging in Europe and in areas of the U.S. If management were truly adapting to this pandemic, X1 would have been released six months ago and management would have cleaned the inventory off its books, like most of the retail industry.

Chart 9: COLM E-Commerce Sales[7] Versus Nike & Lululemon
($ in millions)

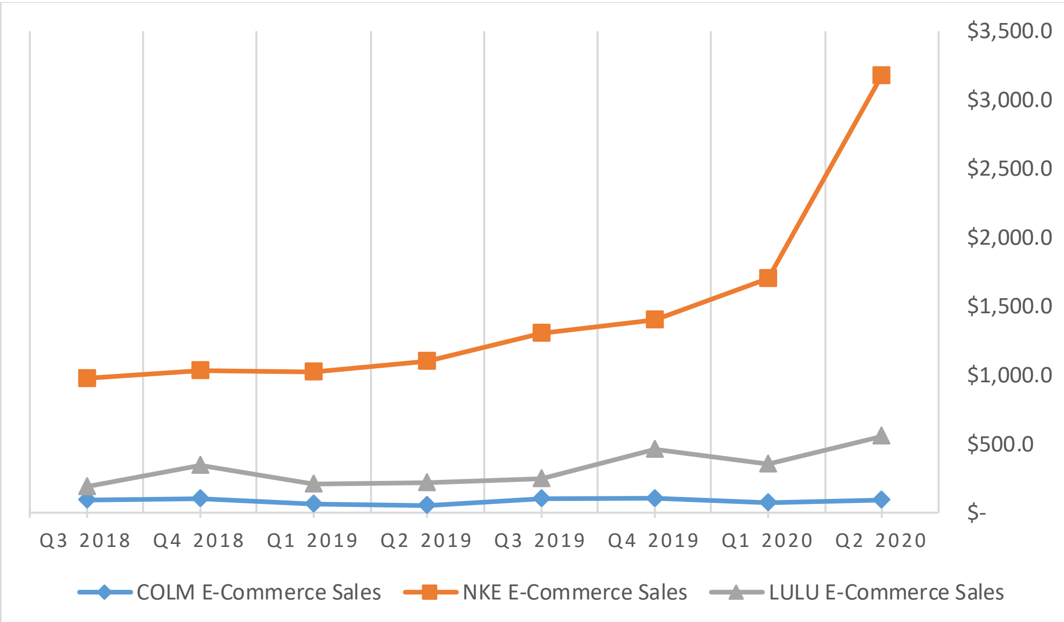
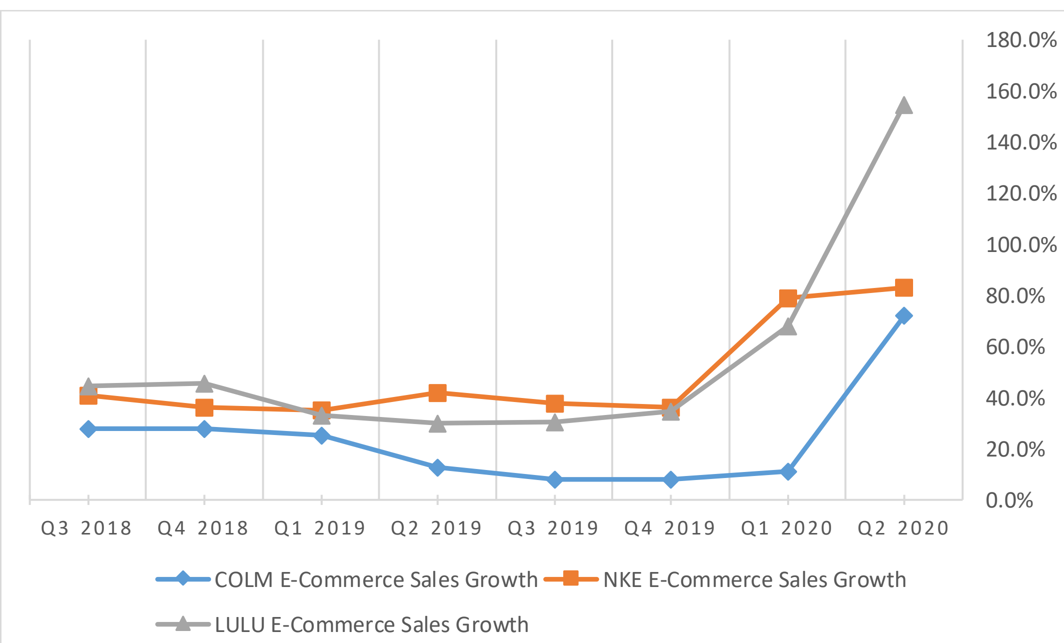
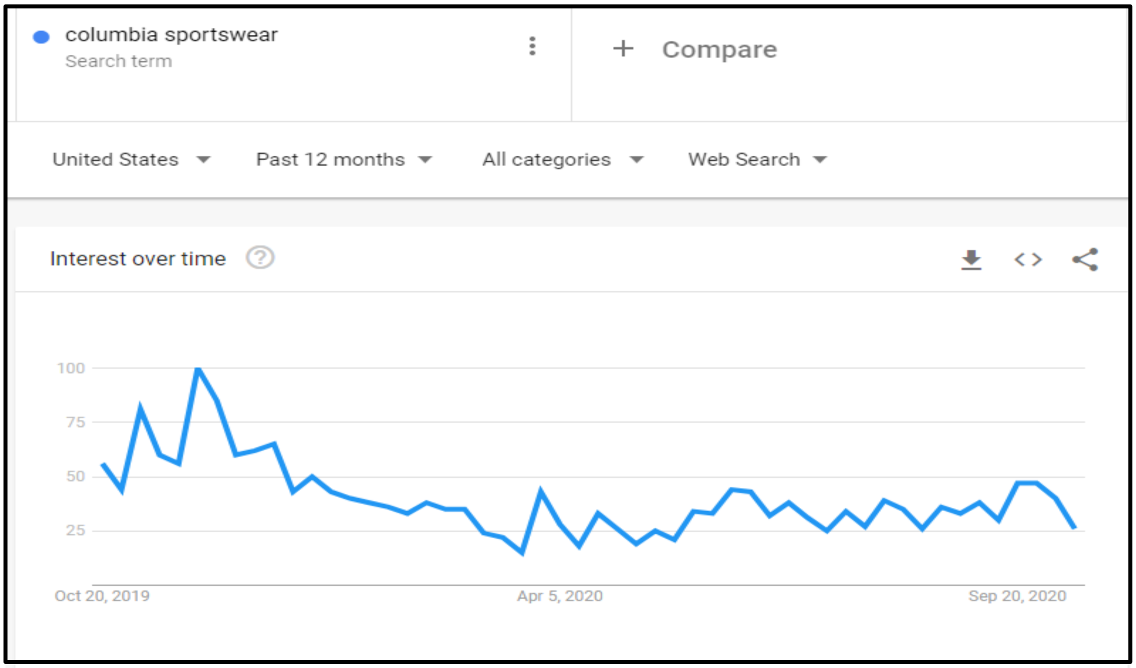


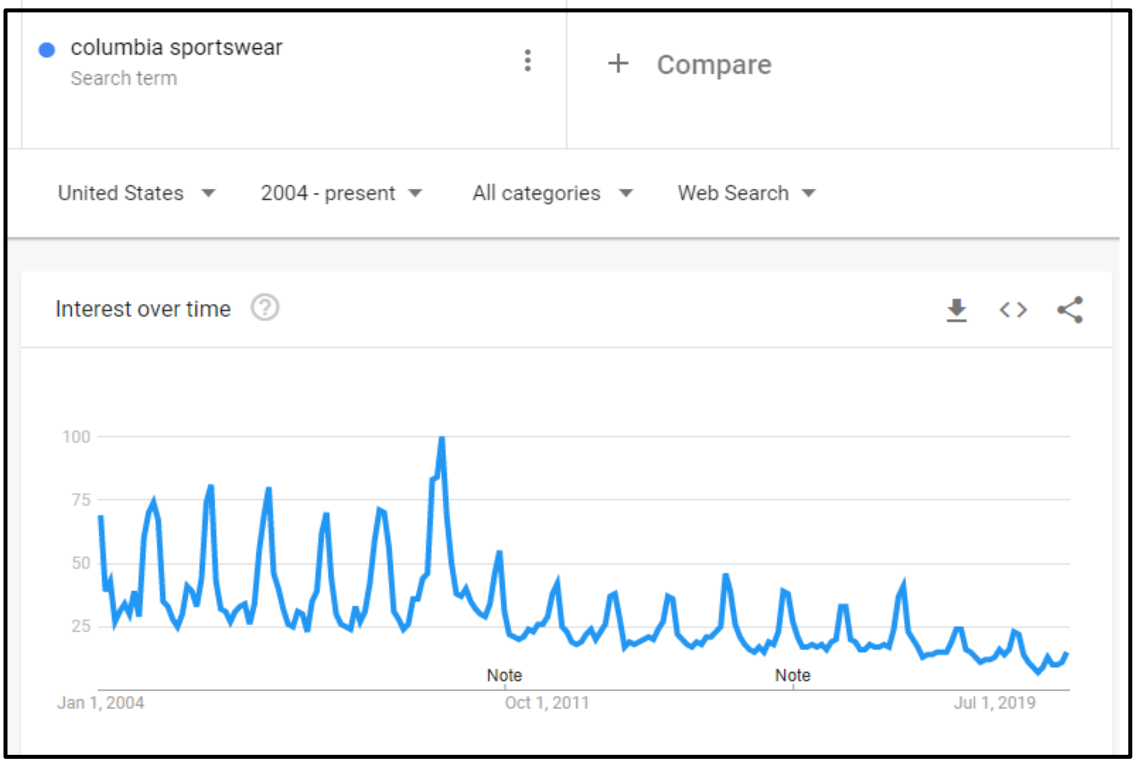
Chart 10: E-Commerce Sales Growth Versus Nike & Lululemon

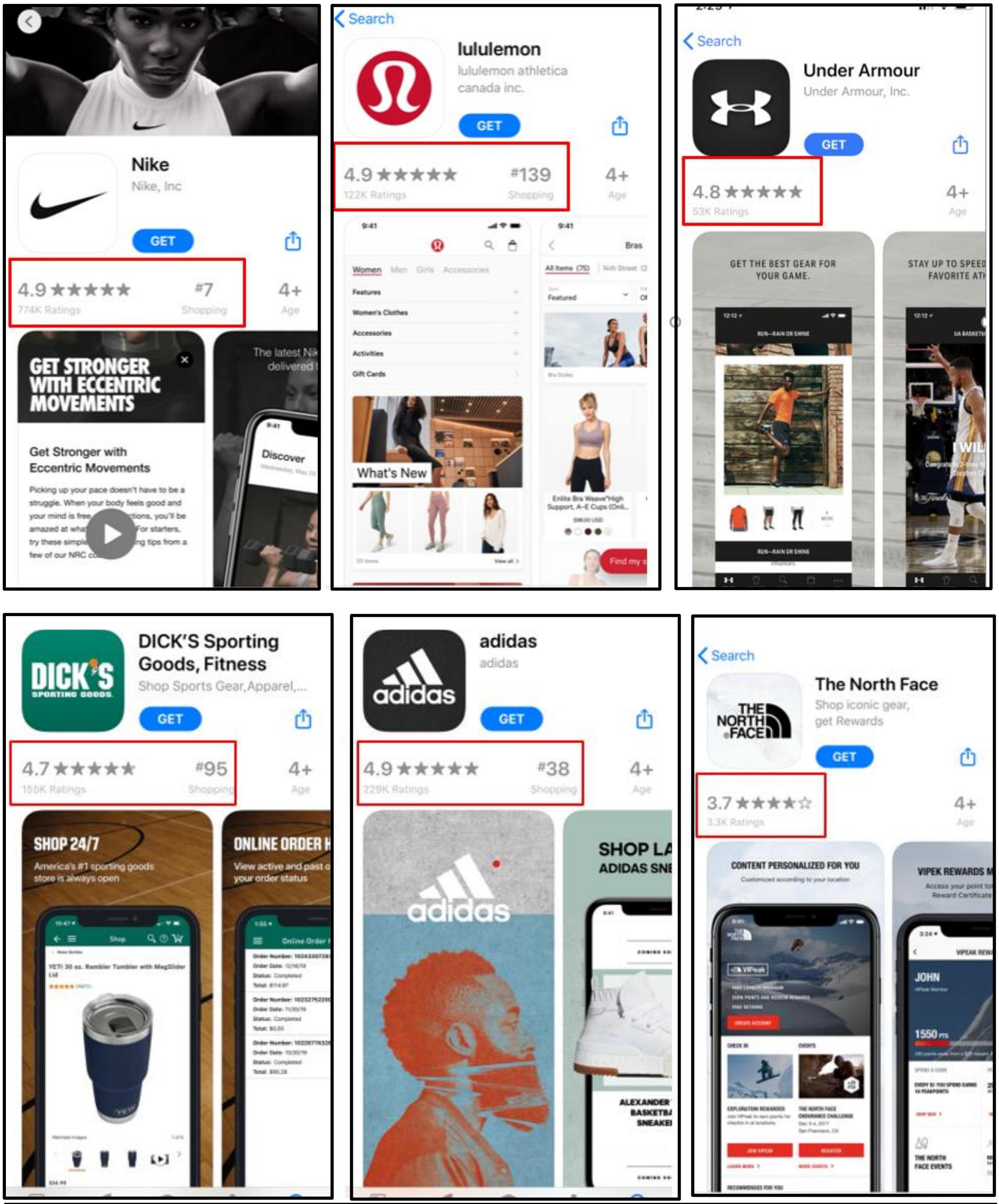


[7] GlassHouse Analysts needed to estimate certain period's e-commerce sales as management gave qualitative descriptions of total e-commerce sales.

Columbia's Web Presence Dwindles with App Virtually Non-Existent






Nike
Nike, Inc
GET
4.9 ★★★★★
774K Ratings
#7
Shopping
4+
Age
GET STRONGER WITH ECCENTRIC MOVEMENTS
Get Stronger with Eccentric Movements
lululemon
lululemon athletica canada inc.
GET
4.9 ★★★★★
122K Ratings
#139
Shopping
4+
Age
What's New
Search
Under Armour
Under Armour, Inc.
GET
4.8 ★★★★★
53K Ratings
4+
Age
GET THE BEST GEAR FOR YOUR GAME.
DICK'S Sporting Goods, Fitness
Shop Sports Gear,Apparel,...
GET
4.7 ★★★★★
155K Ratings
#95
Shopping
4+
Age
SHOP 24/7
America's #1 sporting goods store is always open
adidas
adidas
GET
4.9 ★★★★★
229K Ratings
#38
Shopping
4+
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The North Face
Shop iconic gear, get Rewards
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3.3K Ratings
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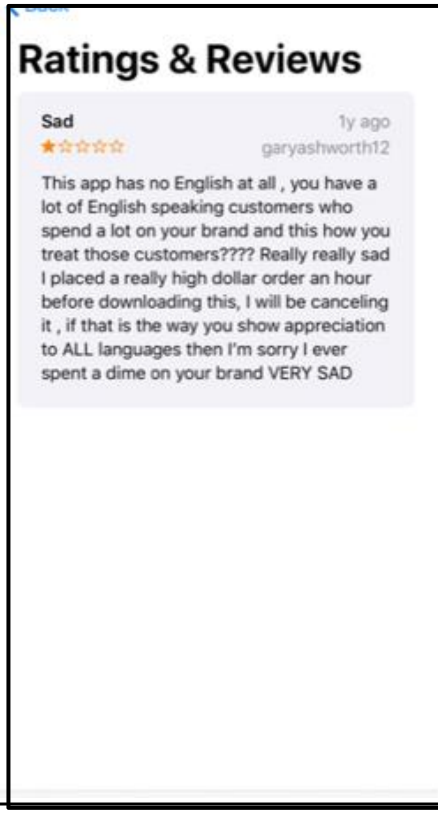
Age
CONTENT PERSONALIZED FOR YOU



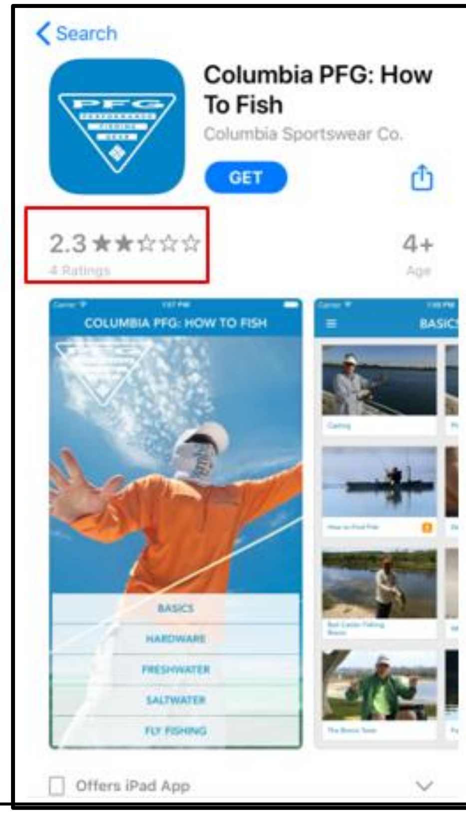


Table 2: Apple App Store Retail Metrics

Company / App	App Rating	# of Ratings	Shopping Ranking	Notes
Columbia Sportswear Japan	1.3	51	N/A	In Japanese
Columbia PFG: How to Fish	2.3	4	N/A	App doesn't work
Nike	4.9	774,000	#7	
Lululemon	4.9	122,000	#139	
Under Armour	4.8	53,000	N/A	
Dick's Sporting Goods	4.7	155,000	#95	
Adidas	4.9	229,000	#38	
The North Face	3.7	3,300	N/A	

Conclusion

The bull case regarding Columbia Sportswear's stock price revolves around the following tenets that we believe the sell-side community has misunderstood. Sell-side analysts believe:

- Retailers currently have lean inventories and will be ready to purchase inventory from COLM at heightened levels in the fall/winter season.
- COLM will expand gross margins in H2 2020 and beyond.
- The company's e-commerce sales will buoy COLM's top-line in future periods during the pandemic.
- The impact of COVID-19 is transitory and will not affect Columbia in the long-term.

We have gone step-by-step to debunk many of these flawed reasonings for investors and analysts. Based on our analysis, we believe that much of the recent sales growth in 2019 was attributable to channel stuffing and pulling revenue forward. We believe that the company's gross margins will fall off a cliff in H2 2020 and beyond as the firm deals with heightened markdowns and write-offs. On top of a gross margin decline, our prepaid expense analysis points to operating margin degradation over the next year as well. Finally, we detailed how management's handling of the X1 e-commerce platform is in disarray at the worst possible time.

As such, we believe Columbia's stock price will decline precipitously over the next twelve months as these accounting gimmicks reverse violently. Furthermore, we highly doubt that the sell-side community fully comprehends the magnitude of accounting headwinds that COLM will face over the next year.

For our valuation, we used COLM's peer group median FWD P/E value of 21.5x (see Table 3, next page) and our sustainable earnings ($2.11) to arrive at our fair value. In analyzing the firm's sustainable values, we made conservative adjustments to earnings figures that are detailed throughout this report. As such, we believe a fair share-price for the firm currently stands at $45.29, which represents a 51% downside to the share-price.

In light of our concerns regarding the myriad of accounting red flags laid out herein, GlassHouse finds the current stock price to be highly irrational. Accordingly, we initiate coverage on Columbia Sportwear (COLM) with a target price of $45.29.

Table 3: COLM Valuation Metrics vs. Peers

Company	Fwd P/E Ratio	P / CFOA	P / Fwd Sales	EV / Fwd Sales
Columbia Sportswear (COLM)	27.99	24.91	2.24	2.22
G-III Apparel Group (GIII)	9.22	1.67	0.30	0.48
Carter's, Inc. (CRI)	14.03	7.14	1.07	1.37
Under Armour, Inc. (UAA)	NM	68.02	1.36	1.62
Lululemon Athletica Inc. (LULU)	61.85	62.44	9.00	9.04
Nike, Inc. (NKE)	42.41	68.34	4.69	4.76
Kontoor Brands, Inc. (KTB)	11.98	8.81	0.77	1.18
Deckers Outdoor (DECK)	27.61	19.59	3.17	2.96
PVH Corp. (PVH)	21.91	4.59	0.54	1.03
Skechers, Inc. (SKX)	21.10	15.12	1.06	1.22
Wolverine World Wide (WWW)	17.71	8.77	1.10	1.49
V.F. Corporation (VFC)	29.27	21.43	2.74	3.13
Peer Median	21.50	15.12	1.10	1.49
% Difference	30.2%	64.75%	103.72%	48.62%

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