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**VF Corp.** (VFC)

Q3 2023 Earnings Call

## CORPORATE PARTICIPANTS

**Allegra Perry**

*Vice President-Investor Relations, VF Corp.*

**Matt Puckett**

*Chief Financial Officer & Executive Vice President, VF Corp.*

**Benno O. Dorer**

*Interim President, Chief Executive Officer & Director, VF Corp.*

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## OTHER PARTICIPANTS

**Laurent Vasilescu**

*Analyst, Exane, Inc.*

**Brooke Roach**

*Analyst, Goldman Sachs & Co. LLC*

**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*

**Jay Sole**

*Analyst, UBS Securities LLC*

**Michael Binetti**

*Analyst, Credit Suisse Securities (USA) LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Greetings, and welcome to the VF Corporation Third Quarter 2023 Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note that this conference is being recorded.

I will now turn the conference over to our host, Allegra Perry, Vice President, Investor Relations. Thank you. You may begin.

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**Allegra Perry**

*Vice President-Investor Relations, VF Corp.*

Good afternoon, and welcome to VF Corporation's third quarter fiscal 2023 conference call. Participants on today's call will make forward-looking statements. These statements are based on current expectations and are subject to uncertainties that could cause actual results to differ materially. These uncertainties are detailed in documents filed regularly with the SEC.

Unless otherwise noted, amounts referred to on today's call will be on an adjusted constant dollar basis, which we've defined in the press release that was issued this afternoon, and which we use as lead numbers in our discussion, because we believe they more accurately represent the true operational performance and underlying results of our business.

You may also hear us refer to reported amounts, which are in accordance with US GAAP. Reconciliations of GAAP measures to adjusted amounts can be found in the supplemental financial tables included in the press release, which identify and quantify all excluded items and provide management's view of why this information is useful to investors. Unless otherwise noted, results presented on today's call are based on continuing operations.

Joining me on the call will be VF's Interim President and Chief Executive Officer, Benno Dorer; and EVP and Chief Financial Officer, Matt Puckett. Following our prepared remarks, we'll open the call for questions.

I'll now hand over to Benno.

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## Benno O. Dorer

*Interim President, Chief Executive Officer & Director, VF Corp.*

Hello, everyone. Since I stepped into my new interim role about two months ago, I have been fully immersed in the business. I have uncovered areas of strength and promise, but also gained a deeper understanding of where we must improve. And I have been impressed with our talent at all levels and their leadership and commitment to VF on which our future success is dependent.

Many of you know about my career history, which culminated in roles as CEO and Chair of The Clorox Company until my retirement from a full-time corporate career two years ago. This gave me the opportunity to lead a global, purpose-driven consumer portfolio company towards more profitable, sustained and responsible growth with financial discipline, a fully engaged organization, brands people love, consistently strong product innovation and a differentiated approach to the portfolio to maximize value.

You also know that, I have served on the board of VF for the last six years, including as lead independent director from July 2021 until December 2022. I believe that, my deep insight into VF, my passion for the company, its people and brands, coupled with my prior career experience gives me a solid foundation for the Interim CEO role. And I do plan to use my time to make a positive difference to VF's business and organization.

My overall theme for today is that, VF will sharpen its near-term focus on the biggest consumer opportunities within our existing brand portfolio and on enhanced operational performance. Consistent with this objective, we are shifting resource priorities across the company. This will include rightsizing our dividend, exploring the sale of non-core assets and cutting costs in lower value areas to strengthen our execution and to enable incremental targeted investments in our brands and the consumer.

With that, I'm pleased to speak with you today about four topics. VF's results in Q3, our near-term priorities to address performance, how we're taking prudent steps to build a stronger company for the future, and why I'm even more optimistic than I was two months ago about the long-term prospects for VF.

First, we overcame a very challenging environment in Q3 where our performance highlighted examples of success while also clearly showcasing areas to improve. Amidst the difficult geopolitical and economic backdrop, we grew Q3 revenue 3% in constant dollars. And today, we are reaffirming our revenue outlook at the low end of our prior range and also the midpoint of our EPS outlook for fiscal year 2023.

Our EMEA business continues to be a bright spot, with Q3 revenue up 10%, our seventh consecutive quarter of double-digit growth driven by broad-based strength, including The North Face up 13% and Vans up 7%. Another strength in Q3 has been our consistent performance of the outdoor brands led, of course, by The North Face where revenue was also up 13% globally with growth achieved in each region and channel. We also saw nice growth in Timberland, up 6% in the quarter with solid performance in EMEA and in wholesale globally. And our outdoor emerging brands continued to grow strongly, up 10% highlighted by Ultra. Finally, in Asia, we saw a sequential improvement with Q3 revenue up 4%. This was driven by the beginning of what could be a return to stronger momentum in Greater China, which was close to flat at minus one.

Secondly, we are clear-eyed about VF's performance barriers, which are predominantly operational in nature. And our near-term priority is to put aggressive plans in place to improve our execution. We are not reaching our full potential as a company. The good news, though, is that doing so is largely within our control. We must consistently delight consumers with exciting products, engaging content delivered with effective marketing tools and with great shopping experiences in-store and online.

Where we do this well, see The North Face and the broader portfolio in EMEA, our brands continue to thrive. Where we are inconsistent with Vans being far the highest impact, but not the only example, we must improve our consumer execution to return to full strength. We must also return to delivering products to our consumers and customers on time and at lower cost to VF. Supply chain has long been a core competitive advantage of VF, but our recent performance also requires focus.

So, to improve execution, we have two near-term key priorities, which represent significant value creation opportunities. First, turning around our Vans performance through improved consumer execution; and second, returning to supply chain excellence across the company.

On Vans, we clearly have been challenged for some time now. This is predominantly a challenge in the Americas, and it is mostly executional in nature. For perspective, Vans Q3 revenue rose by 7% in EMEA, but declined by 13% in the Americas, which is primarily North America and accounted for 90% of the global Vans Q3 revenue decline.

While there are differences in EMEA compared to the North American markets, the relatively stronger performance of Vans in EMEA also reflects the benefits of a clear growth strategy and stronger marketplace execution. We must do better with Vans in its home markets, and we will.

Our action plan follows the four growth drivers laid out in our Investor Day last September; consumer, products, marketplace and operating model. Here are a few specific examples of actions. We will sharpen our view of the changing consumer landscape through a new consumer segmentation, which is underway and will inform the business' overall growth strategy and begin to influence our direct-to-consumer plans as of summer this year. We need to delight consumers in ways that are relevant to their specific needs. And to do so, we must be more intimately familiar with them.

We will also better turn data and insights into significant consumer opportunities available today. For example, a strong untapped opportunity exists with our UltraRange product line. Here, awareness is very low at around 10% among all consumers and at below 30% even among Vans loyalists. So we've started to boost awareness, and this is starting to yield results. UltraRange revenue grew 34% in Q3 with much more growth to be had.

The MTE and Half Cab product lines have similar potential. And going forward, we will drive these and other promising platforms longer and more continuously. We will significantly increase our investment in product innovation, funded by a reduction in costs in lower value areas with actions, including SG&A reduction and improving store profitability.

Vans product development investment as a percentage of revenue lags well behind the company average. We will change that starting with fiscal year 2024. This will help us aggressively pursue new styles and make our innovation pipeline more consistently strong. We will also eliminate unnecessary SKU complexity to simplify and importantly, amplify the shopping experience.

A small test at our Irvine, California store led to a footwear revenue improvement of plus 12 percentage points with 30% fewer SKUs. We will begin to expand this initiative as of fall fiscal year 2024. We will move our digital spending principle from budget cap based to flexible and ROI-based to take advantage of available spending opportunities that translate into incremental revenue and profits. It is early days, but we have already seen an improvement in profitable DTC growth rates only a few weeks into this change.

We will sharpen our processes. In fiscal year 2024, we will go-to-market at retail, including wholesale customers with clearly aligned and integrated product calendars. This will lead to better plans that are more centered around the consumer.

And to drive Vans forward, we have made tremendous progress putting a world-class Vans leadership team in place. Two critical leaders, our new Chief Product and Merchandising Officer; and our new Chief Digital Officer, have both joined in December, and they're off to a fast start.

Vans continues to be a fundamentally strong brand. The number of consumers buying Vans during the last 12 months was up, as was brand advocacy. But many people buy the brand less often. So what we do need to do is to fuel the brand more consistently and give people more reasons to buy more Vans. That is on us, and that's what we will do.

The momentum we continue to generate with The North Face further proves this point. The brand continues to perform strongly, driven by strong consumer engagement and iconic products. And we will keep investing to fuel that momentum.

Our XPLR Pass membership continued to grow significantly in Q3, up 2.1 million members to approximately 17 million in total. It's more than a jackets marketing campaign, launched the season and drove strong outerwear growth globally with the Nuptse jackets, and the recently relaunched Summit Series premium product line leading the business.

Our recent first-ever performance-led collab launch with American artist and designer, KAWS, was highly successful. Net, the brand's momentum is strong and broad-based. The North Face is a solid and transferable execution blueprint for Vans, and frankly, the entire VF portfolio in the Americas, where we must grow with consumers more consistently.

The second near-term priority at VF is to return to the company's hallmark standard of excellence in the supply chain arena. We are working through a variety of external and internal issues that impacted revenues and profits in the high-volume quarter like Q3. Lengthened manufacturing and freight lead times, larger upfront product buys, unpredicted demand spikes from elevated promotional activity in the quarter, plus higher than normal customer order cancellations add up to unsatisfactory customer service, elevated inventory and significantly higher costs. So we're taking aggressive actions to address these issues.

We expect to be able to work excess seasonal inventory down to more normalized levels by the end of Q4 this fiscal year. Our customer service levels are also improving, albeit still below our own and our customers' expectations. We have a plan in place to get back to target levels by the end of the first half of fiscal year 2024.

We will also leverage our logistics partnerships to reduce costs by improving ocean and parcel rates for the next fiscal year. And we will see a return to more normalized and predictable promotional patterns and anticipate moderated inflation, which we expect will contribute to lower costs through fiscal year 2024. We are committed to

...serving our customers better and to getting back to strong supply chain performance at improved costs. Again, much of this is within our control.

My third message is that we're taking prudent steps to strengthen VF's financial position and build a stronger company. VF is committed to strong financial discipline. This all starts with a strong core and growth that is profitable and sustainable. And to reinforce this, we are taking significant actions now.

We will focus our near-term growth efforts on our existing portfolio. Smart acquisitions will remain part of the VF playbook, but near-term, we believe we are best served to return to strong shareholder value creation by taking advantage of the many opportunities offered by our portfolio of beloved brands, including those acquired in the recent years.

Our growth strategy laid out in the company's Investor Day last September, continues to be a solid foundation to achieve this, but we will lean into the consumer even more strongly than in the past. We will also pursue strategic alternatives for our Packs business. This business is performing well, but we need to make sure that we are the highest value owner and that we focus our resources against the highest value opportunities within our existing portfolio.

To grow margins and profit while supporting strong investments in the business, we will lean into cost savings through a more systematic and ongoing cross-functional approach to eliminate costs that do have lower strategic value and are less consumer oriented.

And we're making the tough, but what we believe to be a principled and financially responsible decision to cut our dividend by about 40%. We do not take this last step lightly and fully understand the value of a solid dividend as part of a comprehensive approach to total shareholder value creation. But we also believe that it is prudent to right-size the dividend to accelerate the path back to our target dividend payout and debt-to-EBITDA ratios, and to rebuild the dividend from there based on solid expected cash flows and a return to sustained earnings growth beginning with fiscal year 2024.

Returning cash to shareholders through a strong dividend remains a key capital allocation priority. In a continued difficult environment, we are committed to return to a more profitable and consistent growth next fiscal year. Matt will talk you through these actions and the shape of our initial fiscal year expectations in more depth in a moment.

My last message for you is that I'm even more optimistic today than I was two months ago about VF's future and our ability to return to strong long-term shareholder value creation. We have significant potential to unlock value from our unique brand portfolio. While not immune to the challenging macroeconomic environment near-term, these brands will benefit from significant long-term category and consumer tailwinds. We will leverage these tailwinds and apply VF's best practices, scale, and capabilities, a distinct competitive advantage.

We have a clear set of near-term priorities to inject consistency of execution, which will improve performance across the business over time. We will sharpen our consumer growth strategies on all our brands and ensure we have the right investments against each of them to realize their full potential funded by cost savings.

And we have permission from consumers to broaden our reach by taking many of our brands into new financially-attractive categories and countries, and we are putting in place strong future plans to do so. We are committed to returning to strong operational discipline, which will help drive predictability, profit and margin growth and strong and consistent cash flow generation. And we will remain committed to the dividend as part of our comprehensive shareholder value creation plan after today's adjustments.

Lastly, we have a talented, engaged, and passionate workforce. And we continue to nurture our superb internal talent and attract great new outside hires, reinforcing our confidence that VF remains a top destination for exceptional leaders. Thank you.

With that, I'll hand it over to Matt to talk through the financials.

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## Matt Puckett

*Chief Financial Officer & Executive Vice President, VF Corp.*

Thank you, Benno, and good afternoon, everyone. As Benno mentioned, our Q3 results amidst the continued difficult macro environment, exhibited areas of continued strength, as well as parts of the business with clear opportunity for improvement.

During the quarter, revenue was up 3%, with balanced growth across both direct-to-consumer and wholesale. Adjusted gross margin was down 140 basis points and adjusted operating margins declined by 280 basis points, leading to adjusted EPS of \$1.12, down 17% or 10% in constant currency.

Taking a look at our revenue results across geographies, the Americas region was down 1% during the quarter. As Benno alluded to in his remarks, North America was particularly challenging at Vans and also at Dickies due largely to the continued impact of inventory actions taken by their largest wholesale partner, as well as softer performance across the [ph] value end work (00:21:26) consumer.

Momentum continued in the EMEA region, with revenue up 10%, which marked our seventh consecutive quarter of double-digit growth and represented broad-based strength across brands, with 10 out of 11 brands in the geography growing during the quarter, including the five largest brands.

Looking at the countries, all major markets were growing with four of the top five by volume, up double digits. Lastly, in our APAC region, we saw further sequential improvement versus half one, with revenue up 4%, driven by improving performance in Greater China, which was down 1%, coupled with strong mid-teens growth in the rest of Asia, where most countries were up double digits.

Moving on to gross margin, which was down 140 basis points during the quarter. As anticipated, we saw mix become a tailwind in Q3 for the first time in several quarters, driven by the strength of our international business and channel mix. However, this was more than offset by rate, which was down 170 basis points at higher discounts and an increased promotional environment, also impacting our direct channels, were partially offset by strategic pricing actions and FX transaction benefits.

Moving down the P&L. Our adjusted operating margin was down by 280 basis points, reflecting the lower gross margins and 110 basis points of deleverage in SG&A, which grew at a 6% rate in constant dollars in the quarter as compared to the revenue growth of 3%. The primary driver of deleverage was higher marketing spend, which accounted for about 75% of the increase in the SG&A ratio. In addition, deleverage in distribution and freight spending and some direct-to-consumer costs were mostly offset by spending reductions across G&A.

As it relates to our cash position at the end of Q3, as anticipated, our liquidity increased during the quarter to approximately \$1.9 billion, benefiting from the seasonality of earnings and a reduction in working capital. Within the quarter, we paid the Timberland tax deposits of approximately \$875 million, funded by the issuance of a \$1 billion term loan, which will mature in December 2024. As Benno outlined earlier, we are taking clear actions to

improve our operating performance while maintaining cost discipline and continuing to support our brands' growth opportunities.

Turning to the supply chain environment. We continue to see higher lead times across the supply chain during the quarter impact the business. In addition, higher volatility on the distribution and logistics side of things, particularly in the Americas, coupled with the higher volumes of the quarter and event driven spikes in demand, led to inconsistent on-time delivery performance to our wholesale partners and inefficiencies in support of our direct-to-consumer business in the US during parts of the quarter.

Looking forward, lead times are improving as anticipated, which will lead to better on-time performance, and we're seeing that with spring deliveries. Importantly, the predictability of ex-factory dates or when the product leaves the factory is more reliable and aligned with historical performance. This is an important data point that will better position us to more fully service the business in fall of 2023 and beyond.

In addition, we expect to see reduced and more normalized levels of airfreight volumes moving forward, a continued easing of ocean and air rates and generally more modest FOB inflationary impacts expected for fall 2023 and spring 2024 versus what we have seen over the last few seasons.

Let me take a couple of minutes to unpack our elevated inventory position today and the work we are doing to reduce it over the next few quarters. Net inventory levels are up 101% versus last year. With gross inventory, excluding the increase relating to change in eco terms to support the supply chain financing program, up 67% or approximately \$850 million.

Importantly, from a makeup standpoint, the dollar increase is primarily driven by core and excess replenishment inventory across brands, particularly in the Americas. This is primarily driven by COVID challenges affecting the supply chain with prolonged lead times leading to earlier and less accurate inventory buys, coupled with higher cancellations and lower demand, as well as the prior year value comparison having been lower than optimal.

We expect to reduce total inventory levels by about \$300 million during Q4, but will carry higher levels of core and replenishment inventory into fiscal year 2024 across Dickies, The North Face and Vans, which are contemplated in the assortment and buy plans of the next season, and which will moderate throughout the back half of calendar 2023.

Moving on to the outlook for this fiscal year, we are affirming our EPS guidance at the midpoint of and our revenue outlook within the previous range. Within our revenue guidance of about 3% constant dollar growth, we now expect The North Face to be up at least 14% as the brand's broad-based momentum has continued through Q3 and into Q4. In fact, year-to-date, the brand is growing 17%.

On the other hand, Vans is now projected to be down high single digits as the performance in the Americas region decelerated in Q3, and we expect Q4 will be impacted by the high inventory levels in the wholesale channel in the US particularly. On a reported basis, we now see about five points of impact from the translation of foreign currency, which is slightly less negative than our previous outlook.

As a result of higher promotional and markdown activity and also reflecting higher order cancellations, we expect full-year gross margins to be down about 200 basis points. We expect our operating margin to be around 9.5%. Our tax rate is expected to be 13% as we have a greater portion of the mix of regional profit from lower tax regimes, mainly in international markets. These changes lead to a tightened EPS range of \$2.05 to \$2.15, which sits within our previous outlook of \$2 to \$2.20.



Our adjusted cash flow from operations, excluding the Timberland tax deposit made during Q3, is expected to be about \$700 million as we continue to generate solid cash flows despite near-term setbacks in our operating performance. As we highlighted earlier in the year, we will be disciplined with our approach to spending on non-strategic areas. And today, we've moderated our projected CapEx for the year to approximately \$200 million from \$230 million previously as we sharpen our investment focus on value creation opportunities and specifically those things that impact the consumer experience.

In summary, despite the challenges impacting our financial results this year, I'm pleased with the great progress and performance we're seeing in several of our businesses and geographies. And at the same time, the clear enterprise focus on improving our results in those areas where we are underperforming.

So, let me say a few words about the next fiscal year, particularly our mindset and preliminary financial expectations. First and foremost, with the heightened intensity on planning, we will sharpen our execution in order to strengthen our operating performance and deliver more profitable and consistent financial results in fiscal year 2024.

We are watching very closely several factors that will have a bearing on our plans. The macroeconomic environment impacting consumer sentiment in spending on discretionary goods, particularly in Europe and the US; the recovery trajectory, travel and spending of the Chinese consumer as that market now fully begins to open back up; the inventory rightsizing that is happening across the marketplace; and finally, our own progress in turning around Vans, and the timing of an inflection in that business.

As we focus on driving profit margin expansion during the year, we expect continued broad-based growth across much of the portfolio and all geographies. And as a result we expect revenue will increase in the range of at least low single-digits.

As for Vans, you heard Benno reference a number of actions to sequentially advance our plans to reset and reaccelerate, some of which will impact the business more quickly and others which will take longer. In addition, our wholesale partners have adopted a more conservative approach to the spring/summer order book impacted both by higher inventory levels in the channel and the ongoing challenging macroeconomic environment. As a result, we will continue to see declines in the business, particularly in the Americas through the first half of fiscal year 2024.

We would expect to generate low double-digit operating earnings growth with an expansion in both gross and operating margin. Our actions to increase earnings will include improving profit margins at Vans while revenue stabilizes, generating cost savings from a more efficient supply chain and continuing to realize the benefits of our ongoing SG&A optimization.

We'll also benefit from the efforts to realign inventories over the next few quarters. And coupled with earnings growth, we expect to deliver meaningful increases in both operating and free cash flows in fiscal year 2024. In fact, we expect operating cash flow to grow at an accelerated rate relative to earnings. I look forward to updating you with more details when we provide our full outlook and plans in May.

Our capital allocation priorities in the near to medium term will be focused on supporting and driving the performance of our current portfolio, reducing leverage and returning capital to shareholders in the form of the dividend. And today, we announced a number of strategic actions to accelerate the path to our target leverage ratios, while enhancing our focus on value creation.

First, the board has declared a dividend of \$0.30 per share, or a reduction of approximately 40% relative to the last quarterly payment. An action that demonstrates the company's financial prudence, considering both an uncertain macro environment and recent inconsistent operational performance as we look to right-size the dividend to our target pay-out ratio of about 50% and accelerate the path to our gross leverage target of 2.5 times.

In fact to do a little math for you based on the adjustment to the dividend and the comments today about earnings growth next fiscal year, the payout ratio would be in the mid-50% range in fiscal year 2024. We will then increase the dividend in the future in line with earnings growth.

In addition, as part of our ongoing active portfolio management, we are announcing our intention to explore strategic alternatives for our Packs business, including the Kipling, Eastpak, and JanSport brands as we take another step in streamlining and focusing our portfolio of brands.

As an outcome of this process, we're committed to ensuring these brands are optimally positioned to achieve their full potential while enhancing VF's management focus on our top strategic priorities. Also, we are executing a number of asset sales, which are aligned with our strategic priorities and combined will generate more than \$100 million in cash proceeds.

We will reduce working capital and align inventories to optimal levels over the next few quarters. And finally, we will increase our efforts to reduce costs in order to point resources toward the company's highest value creation opportunities. This includes several previously announced cost-saving actions, which have been progressively building towards delivering approximately \$225 million in annualized savings once completed in fiscal year 2024.

I'm confident these actions will enable us to strengthen our financial position and sharpen our focus, specifically providing the financial flexibility to enable an accelerated path toward our target leverage metric, ensure even if facing ongoing macroeconomic challenges, we'll have continued capacity to fully support our biggest organic value creation opportunities. And finally, to continue returning cash to shareholders through the dividend.

In summary, VF's brand portfolio is well positioned to deliver long-term, sustainable and profitable growth. That hasn't changed. And importantly, in the near-term, I'm confident the steps we are taking now will lead to elevated shareholder value creation through improved operating performance and consistent earnings and cash flow growth.

With that, we'll open the line to your questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. And ladies and gentlemen, at this time we will be conducting a question-and-answer session. [Operator Instructions] And our first question comes from Laurent Vasilescu with BNP Paribas. Please state your question.

**Laurent Vasilescu**

*Analyst, Exane, Inc.*

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Thank you very much for taking my question. Benno, I'd love to ask about Vans. What gives you the confidence that changes you're implementing at the brand are the right strategies and will make a difference in turning this business around? And then I have a follow-up question regarding the dividend.

**Benno O. Dorer**

*Interim President, Chief Executive Officer & Director, VF Corp.*

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Yes. Thanks for the question, Laurent, and hello – several ways of answering your question. The first one is that we have a role model in-house that does exactly what we're trying to do at Vans and that's North Face. And that's performing exceedingly well as was also evident this last quarter.

The second thing that gives me confidence really is that it's clear that improving the performance is not some obscure concept, but it's entirely within our control. We know how to do this. And the way to do – the way to bring Vans back is by consistently executing against consumers with excellence. What that means is great product, great marketing, great shopping experiences and of course, the customer service issues that we talked about.

And then when we think about the specific plan in which we indeed have quite a bit of confidence, there are a number of actions that impact the business now. As I said in my remarks, we're moving to ROI-based digital spending, and we're seeing really strong results behind that. We're boosting awareness of existing product platforms like UltraRange, and we're seeing good results behind that. We have new products expanding now like a Lowland and our New Skool shoes and also UltraRange VR3, those are going out now, and we think that those are attractive new products.

And finally, I have seen the new challenge that we've brought in to complement our leadership team in action, and I have high confidence in them. And if you add to that some of the more fundamental changes that we're making, which will begin to impact the business in the second half of next fiscal year, like the new consumer segmentation, like a digital-first operating model and a new go-to-market upgrades, which again, we've already applied in EMEA, in Europe, and that's working well, the SKU reduction for which we have a store test with really strong results. And then add on top the increased spending that we're planning to put in place behind product innovation, those are all very tangible things. Those are things that have worked for Vans in the past. Those are working elsewhere in the portfolio, and those are all on us.

And that's really the good news here. The good news/bad news, I should say. The bad news is that we're in this situation but the good news is that addressing the performance opportunity that we have on Vans is entirely within our control, and we're pursuing a plan that is very specific, very credible with a high sense of urgency. That's where my confidence comes from.

**Laurent Vasilescu**

*Analyst, Exane, Inc.*



Very helpful, Benno. And then Matt, on the dividend, what changed since your last update? Is this an indication that capital allocation priorities has shifted? How do we know there isn't a bigger dividend cut coming? And then on the Packs business, I think it's about a \$500 million, \$600 million revenue business. Can you kind of give us some framework, I think you talked about \$100 million cash proceeds from noncore assets. Any kind of benchmark on how we think about potential cash proceeds from the sale of these noncore assets?

**Benno O. Dorer**

*Interim President, Chief Executive Officer & Director, VF Corp.*



Yes. Laurent, I'll get going on the dividend, and I'll let Matt comment on your second question around Packs. So, as I also said in my remarks, right-sizing the dividend is not a step we took lightly and but we strongly believe it's necessary and prudent. What this does is it strengthens our balance sheet. Our gross debt to EBITDA right now is about 4.5x, and this gets us much closer to our target of 2.5:1. It realigns to our target payout ratio of 50%, and we expect to land close to that in fiscal year 2024. Of course, we'll continue to offer strong dividends to our shareholders, which is important.

So, to answer your question directly as for this one-time adjustment, we remain very committed to the dividend. This was an important part of comprehensive TSR package for our shareholders and we expect to grow it in line with earnings from here on out. And then what are we going to do with the capital, pay down debt, serve the dividends. And then I would say, secondarily, but still importantly, it gives us flexibility to invest in our brands and consumers. And as you've heard, that's the core theme for us today, free up money from within our P&L that we can invest in our brands and consumers. But this would protect us against the potential downside scenario macroeconomically if there's a downturn, we will still be able to execute this plan. But in an ideal scenario, we'll also invest incrementally in the progress against our plan.

As you've heard, we have confidence in it, but it's also early. But what we'll do is stay agile to invest and when we think we can get a return, we'll also be confident to increase our investment. And this dividend cut will put us in a position to do so.

Matt, do you want to comment on Packs?

**Matt Puckett**

*Chief Financial Officer & Executive Vice President, VF Corp.*



Yeah, Laurent. Really, both of these announcements, the dividend and Packs, we believe are the prudent actions to take at this time. Specific to the Packs, active portfolio management has long been a core competency and strength of VF and remains a priority of our board. The evergreen evaluation efforts that are always underway and the process has led us to the determination, we're likely not the best owner of these brands at this time. And we need to ensure the focus of our management team, and the focus of our capital, while at the same time, giving these great brands the best opportunity to reach their full potential.

Let me state though, and really to those brand teams as well. These brands are terrific brands and businesses and they're performing well. We've seen strong revenue and margin growth in fiscal year 2023 from all these brands. And this is Eastpak, JanSport and Kipling collectively as they're benefiting from a return to the usage occasions that they really are leaders in travel gear, school packs, and school care, other activities. It's a process we've begun. It's going to take some time. We certainly won't rush it. We don't need to do that, but we're very confident with the term and find the right and best owner of these brands.

And as it relates to proceeds, it's kind of the same message that we Benno – reiterated in terms of the proceeds, in terms of the use of capital, accelerating our path to deleverage, supporting growth in value-creating opportunities in our organic business and we continue to prioritize the return of capital in the form of the dividend, and we'll grow with earnings moving forward.

And lastly, on the non-core assets that I mentioned in my remarks, \$100 million, that's really primarily non-strategic land and real estate. Also includes the previously announced at least it's certainly an external known the sale and leaseback of our headquarter location in Stabio, Switzerland, which we thought made infinite economic sense. So that's all inside that \$100 million, which will all be finished in cash in the bank, so to speak, by the end of our fiscal year.

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**Laurent Vasilescu**

*Analyst, Exane, Inc.*

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Very helpful. Thank you very much.

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**Operator:** Our next question comes from Dana Telsey with Telsey Advisory Group. Please state your question.

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**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*

Q

Good afternoon, everyone. As you think about the initiatives for enhancing the business in all the brands, frankly, what do you see is the inventory structure going forward, how that changes given the wholesale account base and how they're placing orders go forward? Thank you.

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**Matt Puckett**

*Chief Financial Officer & Executive Vice President, VF Corp.*

A

Yeah, hi, Dana, thank you. Yeah, I mean certainly, inventory has been a challenge. It's been an overhang for us for a couple of quarters and continue to certainly persist. Our inventories kind of nearly doubled on – in absolute value, if you just look at the balance sheet, clearly, there's an impact there of the in-transit inventory on the comparison. When you back that out, we're up about 67% on a gross kind of comparable basis year-over-year with most of the increase in the Americas.

I think as you think about moving forward, we actually think there's opportunity to get more efficient with our inventory as we get closer to market. One of the challenges that we faced this year is the elongated lead times led to earlier buys, which ultimately led to lower forecast accuracy, which created excess inventory that's been exaggerated by the higher level of cancellations through the fall and even the late deliveries at the same time, which also led to higher cancellations.

So, we've got a lot of inventory today. Fortunately, it's primarily in core carryover replenishment inventory. We'll carry that moving forward into fiscal year 2024, even after a pretty substantial reduction in inventory here in Q4. And we've got plans in place. It really is contemplated in the next season in terms of merchandising and assortment plans, and we'll work our way through it. But when you think about where we're moving forward, our direct-to-consumer business becoming a larger percent of the total, we think that's a good thing, overall. I mean, from an inventory management standpoint, certainly, we love the idea that we have a large outlet network to move through excess inventories, and that's always our first avenue. But the work that we're doing to more modernize the supply chain, and Benno talked about some of the things that we need to be doing there, we think will allow us to be more efficient from an inventory utilization moving forward, not less.

**Dana Lauren Telsey**

*Analyst, Telsey Advisory Group LLC*



Thank you.

**Operator:** Thank you. And our next question comes from Michael Binetti with Credit Suisse. Please state your question.

**Michael Binetti**

*Analyst, Credit Suisse Securities (USA) LLC*



Hey, guys. Thanks for taking the question, here. I guess, just the first one, Benno, the company is known over long periods as a best-in-class supply chain operator. You pointed to a medium-sized list there of items that you think – it sounds like you think got off track. I'm curious what you think happened in the supply chain, what do you think has changed there?

And then maybe, this one is for Matt. But I think to get to double-digit EPS growth on the low single-digit revenue growth next year, trying to think about how you're building that. I think you need to pencil out to about 100 basis points of EBIT expansion – EBIT margin expansion. Maybe just trying to help us think about some of the high-level drivers there? I'm assuming it tilts to the back half of the year, given the comments on Vans revenues in the first half and how to think about the gross margin expanding next year with the inventory up relative to sales in the fourth quarter heading into the year?

**Benno O. Dorer**

*Interim President, Chief Executive Officer & Director, VF Corp.*



Hey, Michael, thanks for the question. I'll take the one on supply chain. And I will say coming into this role, clearly, as you say, supply chain is known to be a hallmark strength for VF. And I think, in general, and over a prolonged period of time, that's a reputation that's well deserved. But that doesn't mean that we can't be clear eyed about the issues.

And some of the issues, certainly, I think, were known before, especially the longer lead times on the manufacturing and freight. But I would say, these issues were exacerbated in Q3, given that it's the high-volume quarter, but also because there was so much volatility, high promotions to get rid of inventory, order cancellations from customers in part because the consumer, of course, is somewhat cautious, but in part also because we haven't been able to meet their expectations and therefore, they cut cancellations in anticipation of perhaps further customer service issues. And then, you add the strain from the longer lead times, that really gives you a confluence of issues that created a perfect storm in this quarter.

And I would say that, part of it is maybe that my added perspective coming into the business shift is the perspective within our team a little bit and our own role in these issues. But the fact is this quarter had a lot of volatility and pressure on the supply chain. And it did expose some of the internal issues, and we'll talk about them all fixable, but certainly requiring a lot of focus.

So maybe, first, where we are is against the higher manufacturing and shipping lead times, we're seeing improvements. Those have started to come down, and we need to continue to focus on that trajectory. The customer service clearly is unsatisfactory. And we're putting a lot of work in place to be back on track by the end of the first half and fiscal year 2024. Matt talked about higher excess seasonal inventory. We're making good progress and assuming that to be more normalized by the end of Q4 of this fiscal year. And our cost to serve

clearly are higher, and we'll see improvements throughout fiscal year 2024 starting with Q1. So this all is going to stay with us a little bit, but we're expecting improvements from here on out.

So specifically, what we're going to do about it is – first off, this is a business-by-business action plan. The businesses that are most affected by this are The North Face and Timberland. So those businesses saw growth in Q3, but they could have frankly seen more growth in the quarter had we not held them back somewhat through these issues. So we have a high focused on distribution network, optimization. We are working on peak warehousing capacity planning, so we don't have to use as many external facilities which you know, gives you inflexibility and also gives you higher costs. We need greater agility to react to short-term changes.

So, the business by business action plan is very detailed and varies a little bit by business. We're working with our strategic supply chain partners to address the lead times and costs, which will include improving ocean freight costs and we're starting to see positive movement there and expect quite a bit of improvements starting in fiscal year 2024.

Importantly, we need to return to better sales and operations planning. And again, to your question, what happened? I would say that's an area where the team would suggest that we've lost some focus during the COVID period, and we're now getting back to reestablishing strong routines. Routines that this company knows that this company is well capable of executing and as a complement, also as an executive team, we're spending a lot of time focusing on this. We have biweekly meetings. We are eliminating barriers to getting rid of these problems. And we're helping with agile decision-making, which certainly is going to make a big difference.

So, I would say the overall theme here is operating discipline, and that's something that VF has been very good at and that's something that we can reinstall in the business. We're taking aggressive actions, we're seeing improvements. And beyond that, we're also advancing the strategic work to transform our supply chain to be more digitally led, more automated, more agile and more consumer-centric. That's work that our EVP overseeing the supply chain, Cameron Bailey, outlined in the September Investor Day. And I would say, the short-term work that we're doing gets us back from where we are to good. And then this more strategic work gets us back from good to great, and that's certainly our aspiration. And again, that's all within our control.

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## Matt Puckett

*Chief Financial Officer & Executive Vice President, VF Corp.*

A

Yes, Michael, the second part of your question on the outlook for next year. And I think certainly, we're in the midst of our planning process. So, I'm sensitive here in terms of not getting too far ahead of ourselves, but we clearly wanted to provide some expectations and kind of how we're thinking and how we're seeing next year unfold as it relates to top and bottom-line.

I agree with your kind of sentiment in terms of what it would take. My comment today was about double-digit operating earnings growth, I haven't said anything yet about what it means below EBIT in essence. But we do need to see a little bit of margin improvement. And how I think about that and kind of what the puts and takes there are from a margin standpoint, it's primarily in gross margin, I would say, in my view.

There are tailwinds. We do expect an overall lower promotional environment through the year. We'll come into the year with a bit heavier inventory. But remember, most of that inventory is core carryover replenishment product that won't necessarily need to be marked down or discounted in a significant way next year. We're biting the bullet pretty aggressively here in Q4 to move through that seasonal excess, which is a bit heavy at the end of December, we're going to be back at the end of March, kind of at a normal level of seasonal excess coming out of our fiscal year, maybe a little elevated, but something pretty manageable.

So, we think the inventory position while heavy and will create some cost pressures in the short-term, we don't think it's a huge overhang from a promotional standpoint throughout next year. Freight, we expect to be a bit of a tailwind. That's both – the mode, we're going to see a lot less usage of air freight. That's already happened. We're not going to see a lot here in Q4, by the way. But as you look throughout the year, we're going to see, we think, some moderating costs on the freight side. We do have some targeted pricing actions; less than we've seen in prior seasons that we have some there. And we think mix will be a slight benefit. It was good to see mix come back and be a benefit here in this most recent quarter.

There are headwinds for sure. There will continue to be some FOB cost increase, a little bit more modest than we've seen over the last few seasons. We expect FX given our hedging program to be a little bit of a headwind as well. So, there's definitely some puts and takes that we would net on the side of our gross margin expansion opportunity, which will flow into operating margin.

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**Michael Binetti**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Okay. Thanks a lot for all the detail.

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**Operator:** Our next question comes from Brooke Roach with Goldman Sachs. Please state your question.

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**Brooke Roach**

*Analyst, Goldman Sachs & Co. LLC*

Q

Good afternoon. Thank you so much for taking our question. My question is on The North Face. As you exit the winter selling season, can you talk a little bit about the channel inventories that you have for that brand? And any initial order books that you're seeing for calendar 2023? Are there any new innovations or product pipelines that we should be focused on? Maybe said another way, how do you comp the comp following a very strong year for The North Face?

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**Matt Puckett**

*Chief Financial Officer & Executive Vice President, VF Corp.*

A

Let me take the first part of that and then maybe Benno will talk a little bit about kind of the innovation pipeline. Actually, inventories at retail with our wholesale partners are in a pretty good place for The North Face. We had a good selling season. We've had good performance in our own channels. Our DTC business grew 18% again in the quarter across the world. And we're seeing a similar kind of sellout results with our wholesale partners. If anything there, we would have probably benefited from having more inventory on the shelves. And Benno referenced the challenge that we faced with the higher cancellations in The North Face and Timberland as well, but certainly The North Face. So, inventories are really in a pretty good position.

Now, that said, the wholesale partners are taking a really cautious approach in the near-term as we look forward. We're not going to disclose anything about the orderbook. But certainly, contemplated and kind of the underlying expectations for next year is a cautious environment – a cautious wholesale environment in the US and to some degree in Europe as well.

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**Benno O. Dorer**

*Interim President, Chief Executive Officer & Director, VF Corp.*

A

Yes. And then to your good question, Brooke, on what we're doing going forward. So feeling – first of all, most importantly, I'm a product fanatic, and I think that's the backbone for every ongoing business success, and we feel



good about the pipeline. What The North Face does particularly well is to establish platforms, platform innovation that we can drive over multiple years. And the Summit series is one of those platforms that has done well for us for an extended period of time, and we'll continue to drive that, because there's so much growth left. Right now, we're relaunching the platform because there's a lot of extra awareness and trials to be had. They're also loyalists that are waiting to buy more products within the platform. And we're giving a new apparel and also new footwear. So you'll see that on our website starting now.

The business also does a nice job sequencing. So, obviously, the Nuptse jacket is very hot right now, but we have the next generation of jackets waiting in the wings. This winter, we started to see the Sierra jacket, and we expect to ramp up our efforts and growth on that jacket next season, hoping that, that can become the next generation of North Face jackets that will excite consumers. And we have successor to the Sierra already waiting in the wing. So this is a strategic and long-term approach to the innovation pipeline that is complemented by more tactical executions that drive excitement.

And the KAWS collab that we executed this last quarter was tremendously successful and is an example of how the brand is able to engage consumers with great products, but also great marketing content in particular, in digital. The North Face is the business that has the strongest digital growth among all of our brands, and that's another area that Vans can learn from, and we're reapplying some of The North Face learning on Vans.

Beyond that, what I would say also reflecting that perhaps knowing that high tides always 2020. When we saw the particularly strong growth on Vans, one opportunity we perhaps missed was to invest into it. And what we're doing on The North Face now and what you can expect on The North Face in fiscal year 2024, is an increase in our investment towards the consumer. And the money will go towards digital performance marketing, the money will go towards brand building and the money will go towards innovation. We fully realize that we cannot take growth momentum for granted, but that we have to keep earning it. And we will invest into that. And that coupled with the strong execution and what we know to be strong future plans give us really a lot of confidence on The North Face long-term. We have a lot of momentum, but we'll keep investing in it.

**Operator:** Thank you. And our final question for today comes from Jay Sole with UBS. Please state your question.

**Jay Sole**

*Analyst, UBS Securities LLC*

Q

Great. Thank you so much. Can you just talk about the business in China? Can you give us an idea of how the business of China has performed since the country started to reopen? And sort of what's embedded in your guidance for next year as you think about that market recovery? Thank you.

**Benno O. Dorer**

*Interim President, Chief Executive Officer & Director, VF Corp.*

A

Yeah, perhaps detailed. Too early to talk about the specific guidance for next year. But what I can tell you is what we're seeing. The business has certainly seen sequential improvements in Q3, was about flat at minus 1% in constant currency. And that's been better than in previous quarter. And we've seen that momentum carry forward into January, as the country continues to reopen. So we're certainly cautiously optimistic, especially for the back half of fiscal year 2024. But it's too early to say when and how much the momentum picks up. There's certainly a possibility that we may see more momentum earlier and we're watching that closely.

We should be in a much better place to predict that and give an update in May. But what we do know is, first, that there's a long-term investment case that's quite strong. We have a nascent, but growing outdoor and active markets, and we have leading brands that serve that. It's a great white space for many of our brands. It's a great space to apply our digital capabilities, as we all know, that market is very strongly driven by digital capabilities and that's, of course, an area of focus for us as a company.

And what you should also know is that, we're willing to invest in that momentum. So as we continue to see, hopefully, a pickup in consumer off-take, we will invest in an increase in brand penetration, which in many cases quite a bit lower than here in our home market. We have an opportunity to enter new categories and also enter with new brands and Supreme and Ultra are just two examples of brands that have a strong right to win in that market. And we will apply our marketing prowess to drive localized and engaging omnichannel experiences.

And the teams did a nice job there that maybe hasn't shown in results just yet, given the state of the country. But we feel bullish about the long-term prospects. And we could be, knock on wood, at an inflection point that could lead to much stronger momentum, certainly, throughout the calendar year of 2023.

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### Jay Sole

*Analyst, UBS Securities LLC*



Got it. Thank you so much.

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**Operator:** Thank you. And with that, I'll hand the floor back to Benno Dorer for closing remarks. Thank you.

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### Benno O. Dorer

*Interim President, Chief Executive Officer & Director, VF Corp.*

Yeah. Thank you all for joining today. As you hopefully will have heard from us today, our commitment to our consumers, our people, our shareholders and also VF's purpose in service of the greater good is what's going to continue to guide all of our actions. And the last two months in the CEO role, for me, have reinforced my excitement in the company's potential. And add to that, that we have a clear view of the areas which are critical to help us realize it.

And those are world-class leadership, the company's executive leadership team and its broader organization is stable. Talented and committed to leading this great company, improved execution near term. Clearly, we have a clear idea of what must be done to improve performance, and we're starting to implement aggressive actions to do so. And that starts with a much greater focus on the consumer to realize our brand's full potential, a future with sharpened strategies, the right investments, exciting product innovation and excellent marketplace execution, and importantly, financial strength and predictability.

The board and I are committed to strengthening our financial position and also to returning to consistent value creation, emphasizing a unique portfolio of core brands. So, in a nutshell, we're confident that – we're confident we're taking the right steps to improve the strength and consistency of VF's performance to deliver strong shareholder returns over the medium and long-term and we look forward to updating you on our progress in May.

Thank you all, and have a good rest of the week.

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**Operator:** Thank you. This concludes today's conference. All parties may disconnect. Have a great evening.

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