



Kontoor Brands' Q4 and 2021 Year End Earnings Conference Call Transcript

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Kontoor Brands Corporate Participants:

Eric Tracy - Senior Director, Investor Relations

Scott Baxter – President, Chief Executive Officer and Chair of the Board

Tom Waldron - Global Brand President of Wrangler

Chris Waldeck - Global Brand President of Lee

Rustin Welton– EVP, Chief Financial Officer

Operator

Greetings, and welcome to Kontoor Brands' Fourth Quarter Earnings Conference Call. At this time all participants are in a listen-only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press "*0" on your telephone keypad. As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Eric Tracy, vice president of Corporate Finance and Investor relations. Thank you. And over to you, sir.

Eric Tracy

Thank you, Operator, and welcome to Kontoor Brands' fourth quarter and fiscal 2021 earnings 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 materially differ. These uncertainties are detailed in documents filed with the SEC. We urge you to read our risk factors, cautionary language, and other disclosures contained in those reports.

Amounts referred to on today's call will often be on an adjusted-dollar basis, which we clearly defined in the news release that was issued earlier this morning. Adjustments during the fourth quarter and fiscal years 2021 and 2020 primarily represent costs associated with a company's global ERP implementation and information technology infrastructure build-out. Adjustments during the fourth quarter of fiscal year of 2019 primarily represent restructuring and separation costs, a non-cash impairment charge related to a Rock & Republic, trademark, and other adjustments.

Reconciliation of GAAP measures to adjusted amounts can be found in the supplemental financial tables included in today's news release, which is available on our website at kontoorbrands.com. These tables identify and quantify excluded items and provide management's view of why this information is useful to investors. Unless otherwise stated, growth rates are in constant currency compared to the fourth quarter of 2020. Also, given the impacts of COVID-19 had on our prior year results, we will

provide select references to the same period in 2019 for additional context where appropriate.

Joining me on today's call are Kontoor Brands' president, chief executive officer and chair of the board, Scott Baxter and chief financial officer, Rustin Welton. In addition, we will also be joined by Tom Waldron, global brand president of Wrangler, and Chris Waldeck, global brand president of Lee. Following our prepared remarks, we'll open the call for questions. We anticipate this call will last about an hour.

Scott?

Scott Baxter

Thanks, Eric. And thank you all for joining us today. As Eric mentioned, our global brand presidents, Tom Waldron and Chris Waldeck, will be joining us for this year in review. We believe these urine polls provide a great opportunity to have them share insights from the past year, as well as go-forward strategies for each of their respective brands. You'll hear more from them in a bit.

Let me first provide some thoughts at a Kontoor level, as I'm pleased to share our strong results for the fourth quarter and full year. And I'm even more excited to discuss the building momentum of our brands and how our Horizon Two strategy begins to take hold, which gives me great confidence in what lies ahead.

Our solid fundamental performance during 2021 was driven by the incredible spirit, perseverance, and effort of our teams around the world. I want to thank each and every one of our Kontoor colleagues whose resilience and dedication to excellence allowed us to not only deliver near-term results, despite the ongoing macroeconomic challenges, but also set the foundation for a brighter future ahead. Kontoor is not immune to the obstacles facing companies in individuals around the world. But I wouldn't want to face these tests with any other team. At Kontoor we truly do win together.

I said this on our last call, and I have even greater confidence today. Kontoor and our Wrangler and Lee brands are now uniquely positioned to win in the marketplace, to drive more sustainable and profitable long-term growth, and to create future value for all of our stakeholders. What gives me this confidence? First, the proof points from our fourth quarter and full-year '21 performance. If you look at our results relative to our initial '21 guidance, we delivered significant upside for the year on all fundamental metrics. Revenue of \$2.48 billion represented roughly \$150 million or seven points of upside to our original guide, even while supply chain challenges weighed on the top line. Gross Margin of 44.6% came in almost 200 basis points ahead of our original guidance, despite incurring higher transitory freight costs, as we taste strong demand. As a result, our EPS of \$4.28 for fiscal '21 was 73 cents, or 21% above our initial guide.

And what I love is that this outperformance was really broad-based and accelerated from the first half to the second half of the year compared to 2019. Total Kontoor reported revenue increased 6% for the full year and 13% in Q4, excluding the impacts of our proactive strategic actions taken with our VFO in India businesses late last year. Investments in innovation, demand creation, and elevated design helps to drive significant share gains in both the Wrangler and Lee brands versus 2019 with increasing AURs domestically. This is a tremendous sign that our strategies to enhance our core US wholesale business are working, allowing us to elevate brand equity, mixing into higher price points, and having greater permission to take incremental price.

To augment this core, we continue to extend our reach into new creative channels of distribution, including premium specialty, outdoor, sporting goods, and the rapid evolution of our digital platform. Compared to 2019, our digital wholesale business grew 85% and our own dot com grew 74%. Here again too, AUR gains, our powerful story of increasing brand health, experiencing low double-digit growth over '19 in US-owned dot com. At year-end, our own dot com reached 6% penetration, nearly doubling from just two years ago and is well on track to hit our investor day target of 10% penetration.

The evolution of our digital ecosystem is a direct function of the incredible talent we've added to the organization and enhanced demand creation for our brands. Further diversifying our product portfolio, new category expansion continues to play a huge role in catalyzing top-line growth. Again, it's really important to understand the breadth of category strength beyond our core across outdoor, with our performance ATG line, work, tops and tees, as well as female, and western, just an incredible range of product momentum. With respect to our western business, Tom will provide more detailed insights. But we believe this is more than just a trend. Similar to our view on denim not just being a cycle, but part of a larger casualization movement, we see our western business not just participating in, but driving a movement towards freedom of expression, authenticity, and connection to the outdoors.

A critical piece of our catalyzing growth playbook, extensions into new categories is well ahead of schedule in delivering outsized, incremental business for Kontoor. And while we love the strong US performance we are seeing, geographic expansion propels new diversified in a creative growth as well. Europe saw further wholesale improvement in the quarter as countries opened up, which supported the gains from our evolving digital platform in the region. Compared to 2019, Europe was up 12% for the quarter. In China, despite the much-discussed uneven market conditions, we once again experienced nice growth in the region with Q4 reported revenue up 25% compared to 2019, or 13% in constant currency. We will continue to monitor macro complexities going forward, seeking to optimize productivity in the region near term while positioning both brands to capture the significant market opportunities long term.

Before I turn it over to Tom and Chris, let me close with this, Kontoor is increasingly well positioned to win. This is demonstrated by our fourth quarter in 2021 results and even more buy or building momentum, as evidenced by our fiscal '22 guidance in which we expect high, single-digit, top-line growth. Rustin will provide further details, but this guidance assumes prolonged macro headwinds continue into '22. Said another way, our solid outlook would have been even stronger if not for expected ongoing transitory impacts from demand outstripping supply in inflationary pressures.

These accelerating fundamentals include '22 revenue of around \$2.7 billion, which as a reminder was our fiscal year '23 target established an investor day so we expect to achieve this goal of full a year ahead of our initial plan, even as we assume continued macro challenges. We are in fact catalyzing growth. And we're doing this by investing in critical growth enablers, including demand creation, ESG, innovation, and an increasingly purpose led, consumer-centric organizational mindset, all of which are incrementally different from how these brands were previously run.

Importantly, this future growth should be more profitable, driven by enhanced AURs in mixed shifts to creative areas such as digital and international. This improving operating model when combined with our increasing cash flow optionality should allow us to continue to deliver superior returns to all of our stakeholders.

Before I turn it over to Tom, on behalf of all of us at Kontoor, we want to acknowledge the deeply saddening events that have unfolded in Ukraine over the last week and sincerely hope that you and your families around the globe are safe and healthy.

Tom?

Tom Waldron

Thanks, Scott. It's great to have the opportunity to speak with you all today. I've got a lot to cover, so let's get to it.

This time last year, I stated the Wrangler brand was positioned better than it ever had been. And that was true. But it's even more accurate today. As we begin our 75th-anniversary year, demand for the brand has never been stronger. It would be easy to assume that recent strength has been driven by fiscal stimulus supporting consumer spending. And no doubt the health of the US consumer has contributed. But that would significantly underestimate what is new and incremental to our business. And it would certainly underestimate the breadth of our product portfolio. Whether compared to five years ago, or one year ago, the evolution of our brand has been tremendous. And we are just beginning stages of harnessing strategic investment to catalyze future growth.

As evidenced that our investments are yielding superior returns, let me take you through some highlights of our fourth quarter and full year. For fiscal '21, Wrangler global revenue increased 4% first 2019. But excluding our strategic actions, we even saw stronger up 8% and our business only accelerated in the fourth quarter versus the year-to-date trend with global revenues up 10% versus '19, excluding our strategic actions. In Q4, PLS outpaced shipments as well, in North America across planned accounts worth approximately 60% of our shipments to US increased 11% versus '19. Further demonstrating strength in our core US wholesale business during '21, the Wrangler brand in men's bottoms drove over 100 points of share gains compared to 2019.

Augmenting our core denims bottoms' business, we are seeing broad strength with category, channel, and geographic growth. First within category expansion, Wrangler is rapidly evolving the product assortment becoming much more of a lifestyle brand. Our ATG outdoor line using highly-differentiated performance innovation diversifies our portfolio, both from a product and distribution standpoint. Compared to '19 revenue in our outdoor business and US increased 45% during '21. A great proof point of our building momentum in the category, our recent ATG test in Academies Sports was extremely successful, affording us additional expansion in '22.

ATG is driving incremental penetration of the sporting goods and outdoor specialty channels, allowing us to extend the Wrangler brand to new consumers domestically and internationally. In fact, globally, ATG is now selling through nearly 900 retailers within just three years since the line launched. Within work, we are seeing great sell-through with our recently launched programs at a key US retail partner, and we expect to build with new styles and expanded to more doors during 2022.

Looking at our female category, elevated design and marketing continues to have tremendous halo effect that cascades across the brand, but it's also scaling with long-term opportunities for much greater volume. In fiscal '21, our female business in the US grew 84% over last year. As evidence of this recent success, female achieved the number one style on wrangler.com for the fourth quarter, the first time in history female represented the top spot. This is a great reflection on how the team is elevating design and enhancing demand creation.

Within Western, let me echo what Scott said earlier, we truly believe what we are seeing is much bigger than category trend but a larger movement centered on authentic freedom of expression and adventurous spirit. As a premier Western apparel brand, we are unequivocally leading this movement. During '21, our US Western business grew 30% Compared to 2019 and this momentum has continued with our strong fall '22 order book.

We are also catalyzing growth for the Wrangler brand through channel diversification. In addition to the sporting goods and outdoor specialty channels, we are driving significant growth across premium and Western specialty. But perhaps most importantly, we continue to drive a greater connection with our consumer through the evolution of wrangler.com. During Q4, our US-owned dot com grew 45% over last year and was up 128% versus Q4 of '19. The evolution of our site has been transformative with gains across traffic, conversion, and AOV, and we are just getting started in creating and building a more consumer-centric digital ecosystem that is a creative to our model.

And finally, from a geographic perspective, the Wrangler brand continues to push into new frontiers with full-year international revenue of 22% versus 2020. As Scott mentioned earlier, Europe continues to improve as countries and retailers open back up, which combined with our digital strength is a really positive sign. And in China, we continue to build on our successful digital launch into the region with the addition of a new premium brick-and-mortar store opening.

As we stated at our investor day we will be measured in our approach to growth in the region looking to build and scale over the next few years. The strength of this broad-based performance during '21 and the momentum we see in '22 is absolutely the result of significant incremental investment the Wrangler brand has made and key strategic areas including demand creation, digital innovation, and talent.

As you can imagine, our 75th-anniversary celebration this year we are dialing up the Wrangler demand creation efforts even more. Our For the Ride of Life campaign is truly global in nature, supported by partnerships with brand ambassadors such as Georgia May Jagger, and the recent signing of Leon Bridges that allow the Wrangler brand to reach new, younger, and more diverse consumers. And we couldn't be more excited about how our collaborations with other iconic brands like Billabong, Yellowstone, and most recently, Fender authentically take Wrangler to new heights. And speaking of new heights, we are thrilled to be dipping our toe into the metaverse designing our first ever NFT with Leon Bridges, ensuring that Wrangler plays at the speed of culture.

These critical investments in demand creation and the broad-based nature of our growth give me great confidence and Wrangler's unique position of strength, even as we continue to operate within an uneven macro backdrop. As a testament to these investments, we expect our most mature market, the US, to lead our growth in fiscal '22 driven by both units and AUR gains. We expect the core strength to be augmented by an increasingly diverse portfolio extending into new categories, channels, and geographies. As a result, we expect Wrangler revenue to surpass our top-line growth targets we laid out at our investor day.

Chris?

Chris Waldeck

Thanks, Tom. And it's great to speak with you all today. Let me start with stating how incredibly proud I am of our team and what they've accomplished this past year. We've embarked on a significant repositioning of the rebrand and have now successfully established a healthy foundation for more sustained profitable growth. Globally, demand for the Lee brand has never been stronger, and I am confident we are well positioned to meet or exceed the targets we set during investor day. Through investments and quality of sales, enhanced design, and elevated demand creation, all in support of better MCS and higher AURs, we have significantly improved the Lee operating model. Globally over the last two years we've exited a significant portion of margin-diluted wholesale business and have more than offset this with growth-oriented margin and creative volume.

As evidenced of this, our core US bottoms' business has grown share since 2018, even while exiting underperforming points of distribution. With the AURs in the category expanding over 10% during this time, this is a testament to our laser focus on TSR. And the impact on our global profitability has been meaningful. From '19 to '21, we grew gross margin by 500 basis points. Now with the foundation in place and the momentum we have created for the brand, I am confident that we will continue to drive more profitable top-line growth.

So let me provide some insights into how this growth is come together over the last year and how we see it evolving in '22 and beyond. For fiscal '21, Lee global revenue grew 26% over last year. And we love that we ended the year strong with W4 revenues of 14% compared to '20 and up 19% versus Q4 of '19 excluding the strategic actions. Within our core US business, we made significant investments to optimize our distribution, which impacted growth to give you some perspective, compared to '19 the Lee US business grew 1%. However, if you were to exclude the impact from strategic actions with VF Outlets, the Lee US business grew 6% versus '19. And again, these gains are even more significant in Q4 growing 21% compared to '19, excluding our proactive actions.

From a category perspective, in fiscal '21, both our US male and female categories grew over 20% compared to last year and our male category, elevated design and innovation platforms, such as MVP and extreme motion continues to resonate with consumers. And our heritage collection is delivering uncompromising style and comfort leveraging our ultra-luxe innovation platform in our female category. And further diversifying our product portfolio, we've significantly expanded our t-shirt distribution, adding over 2000 doors in 2021 with meaningful opportunities to drive growth in the category long term.

And as we look to channel expansion, these very same investments are allowing the Lee brand to play in higher tiers of domestic distribution, including premium specialty, more closely aligned with the brand's premium positioning in international markets. And our digital ecosystem has taken meaningful strides over the last year. Our own digital platform, historically more transactional in nature, is rapidly evolving into more of an experiential pinnacle expression of the brand.

US lee.com was up 68% compared to '19 with AURs up mid-teens and beyond the creative volume of our own digital business brings, our domestic site is now having a significant halo effect that cascades across all channels of distribution. And we continue to see solid performance internationally with geographic expansion is a key element of Lee's long-term growth algorithm.

In China, we can definitively say that Lee is now the number one premium-denim brand in the region. Despite COVID and other macro pressures, we delivered another strong quarter. And our equity campaign supported double-digit comps in our own and partner stores. And we're really excited about our new premium retail concept we're calling Pioneer. We opened seven of these new formats in '21. And based on our early success, we intend to roll out the concept more aggressively in '22. As Scott mentioned, we will look to optimize our China business near term and continue to position the Lee brand for opportunities in the region long term.

Our investments in demand creation over the last year have been a key driver of this broad-based, top-line momentum. We reframed our 130-year-old brand through a modern lens without losing sight of who we are. Our Lee Originals campaign launched late last year is resonating with existing consumers and bringing new young consumers into the funnel. With over 127 million digital media impressions across social and live streaming platforms targeting the key 18 to 24-year-old demographic. We are reaching a new younger consumer like never before. Our increasing ability to partner with other influencer brands like recent collaborations with Pendleton in the US and Forbidden City internationally, further enhanced our positioning with a more diverse consumer base.

Before I hand it over to Rustin, let me summarize with this, the Lee brand has truly transformed and is in a better position than it has ever been. We've established an incredibly healthy and sound foundation of which to grow. And I see broad strength across categories, channels, and geographies. Our marketing is resonating with consumers and demand for our products has never been stronger. Our strategy and investments are delivering and Lee is on track to meet or exceed the targets of low teens growth we established at our investor day.

Rustin?

Rustin Welton

Thank you, Chris, and thank you all for joining us on today's call.

As you have heard from the rest of the team, we are extremely proud of the results we delivered in 2021 and are entering the New Year with incredible momentum. Our global strategies are working and not just against a challenging macro backdrop, but in transforming the fundamentals of the business.

I will touch on the progress we are making against our long term catalyzing growth strategy towards the end. But as Scott mentioned, we are well ahead of where we expected to be just 10 months ago. I will start with a review of the quarter. As a reminder, comparisons will be in constant currency unless otherwise stated. My comments will focus on key highlights, and I will refer you to this morning's release for additional detail on the quarter and full-year results. Beginning with revenue.

Global revenue increased 3% or 8%, excluding the impact of the 53rd week. Compared to revenue in the fourth quarter of 2019, global revenue increased 4%. Excluding the combined impacts of the previously announced strategic actions related to VFO store closures, discontinuation of the sale of third-party branded merchandise in all domestic stores and the India business model changes, global revenue increased 7% compared to 2020 and 12% compared to 2019.

On a regional basis for the quarter, US revenues increased 1% or up 6%, excluding the 53rd week from last year, reflecting strong demand that exceeded supply as we navigate through global supply chain disruptions. The demand we are seeing is broad-based with strengthen in key categories and channels such as outdoor, western, and workwear. In our digital business, US-owned dot com delivered its highest ever quarterly revenue, increasing 39% compared to 2020 and 108% compared to 2019, fueled by increased traffic and rising AURs. This result is a testament to the investments we have made and continue to make that are supporting a healthier business and driving our digital evolution.

International revenues increased 12%. We saw strength across most markets and channels, including continued growth in Europe and China, as well as in our digital business. Compared to 2019, our European business grew 12% and China grew 13%. Turning to our brands, global revenue of our Wrangler brand decreased 1% compared with 2020 and increased 6% compared to 2019, excluding the 53rd week revenue increased 4% compared to the prior year. As Scott mentioned, we are seeing strong demand that is outstripping supply. This is particularly true in the US where our planned point of sale increased double-digits versus 2020 and 2019 driven by outdoor, western, workwear, modern, and female.

In addition, we saw continued momentum in Wrangler's digital business, with domestic-owned.com increasing 45% and 128% compared with 2020 and 2019, respectively. We are extremely encouraged by the strong pull market we are seeing in the US and are working to align supply to meet accelerating demand as we move through 2022.

Wrangler international revenue increased 9% driven by new business development wins and strengthened digital. And in China, building on the success of our team-all launch in late 2020, Wrangler opened its first retail store in the fourth quarter as expected. We remain excited about the long-term opportunity for Wrangler in the China market.

Turning to Lee. Global revenue increased 14% compared to not only last year, but 2019 as well. As discussed last quarter, Lee was impacted by select, transitory factors in the third quarter, but returned to strong growth in Q4 as expected. Lee US revenue increased 13% driven by wholesale, new distribution wins, and our digital business with US-owned.com increasing 22% and 66% compared with 2020 and 2019 respectively. As Chris highlighted, we are encouraged by overall demand, which similar to Wrangler, continues to exceed supply.

Lee international revenue increased 14% driven by 23% growth in Europe. In addition, despite macro challenges in the region, Lee grew 7%. In China, strengthened both regions was supported by amplified investments in digital and the ongoing recovery in our brick-and-mortar business.

And finally, from a channel perspective, we saw continued broad-based strength compared to the same quarter in 2020. US wholesale increased 3%, non-US wholesale grew 13% and global-owned dot com increased 28%. Now onto gross margin, adjusted gross margin decreased 60 basis points to 42.6% of revenue. We continue to see benefits from structural margin enhancements, including favorable customer and product mix and business model changes that support our improving gross margin algorithm.

These items drove approximately 80 basis points of net improvement in the fourth quarter, which more than offset inflation, inventory adjustments, and higher distressed sales. In support of strong demand and as you would expect, we have also seen higher transitory expenses such as air freight, as we move through Q4 that negatively impacted gross margin by 140 basis points in the quarter. I will touch on these factors and our expectations for 2022 shortly.

Adjusted SG&A increased \$31 million versus last year to \$218 million. Higher demand creation, digital investments, distribution expenses, and compensation costs drove the increase. Prior year comparisons were also impacted by reduced spending in 2020 in light of COVID uncertainty. As we have discussed, amplifying investments in strategic areas such as digital and demand creation are important drivers of our catalyzing growth strategy, and are expected to support strong demand in 2022. Adjusted earnings per share was 88 cents compared to \$1.23 in the same period in the prior year, and compared to 97 cents in the fourth quarter of 2019.

Now turning to our balance sheet, fourth-quarter inventories increased 7% compared to last year, we finished the fourth quarter with net debt or long-term debt less cash of \$606 million and \$85 million in cash and equivalents. Our net leverage ratio or net debt divided by trailing 12 month adjusted EBITDA at the end of the fourth quarter was 1.6 times within our targeted range of one to two times.

Finally, during the quarter, we repurchased \$65 million in common stock. At the end of the fourth quarter we had \$125 million remaining under our current share repurchase authorization. When combined with a strong dividend, we returned a total of \$171 million to shareholders in 2021. A reflection of our increasing and powerful capital allocation optionality that allows us to return cash to shareholders as market conditions warrant while investing in our business to support future growth.

Before getting to our outlook, and as a reminder, 2021 was affected by various factors including ERP timing shifts, as well as temporary COVID shutdowns and supply chain disruptions that resulted in quarter-to-quarter volatility. As we turn to 2022, these factors will have an impact on year-over-year comparisons on a quarterly basis, but are not expected to impact the full year.

And now on to our 2022 outlook. Revenue is expected to increase in the high-single digit range to approximately \$2.7 billion. Based on strong momentum we are carrying into 2022, we expect first-half revenues to increase in the low teens range, up from low double-digits we indicated last quarter. Gross margin is expected to be consistent with 2021 adjusted gross margin of 44.6%. I know there is considerable interest in many of the individual elements including inflation, pricing and transitory costs. But let me simplify by saying we expect improvements in structural gains to be relatively offset by higher transitory costs in 2022.

In terms of structural gains, we anticipate strategic pricing actions, continued mix improvements from distorted growth in a creative channels and geographies, and cost savings initiatives to more than offset inflationary pressures. Consistent with our gross margin algorithm we outlined at our investor day, we expect up to 100 basis points of improvement from structural margin gains on a full-year basis.

In terms of transitory cost, we expect to incur higher expenses almost exclusively first-half weighted as we chase demand given our accelerating top line. Again, on a full-year basis, we expect up to 100 basis points of headwind from higher transitory cost. SG&A investments will continue to be made in our brands and capabilities. In support of the strong demand we are seeing in the marketplace we expect to make incremental SG&A investments in demand creation, digital and international.

From a phasing perspective, compared to adjusted SG&A in 2021, we expect SG&A growth to be relatively consistent with revenue growth for the full year, with second-half investment stronger than in the first half. EPS is expected to be in the range of \$4.65 to \$4.75 per share. This EPS guidance does not assume the benefit of any future share repurchases.

Finally, I would like to close with additional perspective on the progress we have made against our Horizon Two and catalyzing growth strategies. Starting with revenue, as indicated, we anticipate 2022 revenue of approximately \$2.7 billion well ahead of our investor day algorithm, and, as Scott mentioned, at our 2023 target a full one year ahead of schedule. And as we have highlighted on today's call, there is no one single driver of this outperformance but rather the combination of our growth catalyst driving broad-based, sustainable strength from both brands across the globe.

On margins since 2019, gross margins have expanded 380 basis points driven by structural gains of 520 basis points while we have absorbed 140 basis points of transitory headwinds due to global supply chain disruptions. Excluding the impact of these transitory costs, we are approaching our 46% long-term target two years ahead of plan. Stepping back, our strategies have fueled our virtuous cycle, the ability to invest behind the top-line momentum we are seeing while improving operating margins by 190 basis points.

So where are the investments going and are they working? As a percentage of revenue since 2019, we have increased our investments in digital by nearly 140 basis points, and in-demand creation by nearly 70 basis points. Since 2019, digital wholesale and owned com have increased 85% and 74%, respectively. We plan to continue investing in strategic areas while leveraging top-line growth and efficiencies in non-strategic areas.

And finally, on our strong cash flow and powerful optionality. In 2021, our net income increased 15% over 2019 levels, and help drive cash generation. Despite the pandemic we have generated over \$525 million in operating cash flow since 2019 and have returned \$225 million to shareholders through dividends and share repurchases, decreased our net debt by \$200 million and completed a major investment in our global ERP initiative.

I am extremely proud of the results we have been able to generate in a dynamic environment, a true testament to the power of our model and the strategies we are executing. While we remain in the early days of our Horizon Two transformation, it is clear we are well on our way to deliver against our long-term targets. And I look forward to sharing more on our progress over the coming quarters. This concludes our prepared remarks and I will now turn the call back to our operator.

Operator?

Operator

Thank you. At this time, we will be conducting a question and answer session. If you would like to ask a question, please "*0" on your telephone keypad. A confirmation tone will indicate your line is in a question queue. You may press "*2" if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick your handset before pressing the "*" keys. One moment, please while we pause for questions. Thank you. The first question comes from the line of Jay Sole with UBS. Please go ahead.

Jay Sole

Great. Thank you so much. You know, my question is, is it possible to elaborate a little bit on what gives you confidence in your raised '22 top-line guidance? You know, especially in light of some of the concerns that sort of priced into stocks right now around inflation, and, you know, laughing stimulus, and, you know, just some of the other macro headwinds that are out there. Thank you.

Scott Baxter

Hey, Morning. Good morning. Thanks. Thanks for joining us today. And I'm happy to do that. You know, for us, Jay, you know, you think about '21 and then our Q4 results, and just the solid proof points that we have, you know, made in our business relative to the investments that we're making our brand, how they're working, and how our people are thinking about brands going forward.

I think for me though, if you step back and look at it in a holistic view, because the broad basis, top-line growth. So it's not just happening in a specific category or a channel or what have you, it's happening in the US wholesale biz, it's happening in China, it's happening in Europe, it's happening in our category extensions, right? It's happening in ATG, happening in work, you know, tees. But things that we have taken a stand-in and decided to invest behind, is really working. And then what makes me feel really good going into this coming years, you know, we have strong visibility for the first half, obviously, and taking our guidance up from mid-single digits to low teens, you know, relative to what we see in our business is just, you know, a real catalyst relative to all the great things that our people are doing.

So, you know, I think, as we think about our incremental investments, and how we're making those power, and how we're making those work for our business, that's what gives me great confidence. And I'll leave you with this. If it weren't for, you know, 22 weeks would be stronger if it weren't for some of these transitory things that we're going

through right now. So that's what gives me confidence in '22, you know, the escalations. And just one last quick comment and how we've guided ourselves into our Horizon two.

Jay Sole

Got it. Thank you so much.

Operator

Thank you. The next question comes from the line of Brooke Roche with Goldman Sachs. Please go ahead.

Brooke Roche

Good morning. And thank you so much for taking our question. I'd love to follow-up a little bit on Jay's question. And ask a little bit about how you're thinking about the revenue strengths that you anticipate in the first half in particular, between brands and channels? Any sense of what proportion of this momentum is driven by new program wins across the portfolio relative to comp growth in existing distribution?

Rustin Welton

Yeah, good morning, Brooke. It's Rustin. And thanks for the question. Thanks for joining.

So I think if you step back, and you look at the back half of claim one, you know, both brands were up double-digits in the second half of '21. So approaching '22, with significant momentum. As we talked about in our prepared remarks, we do see low teen growth in the first half of '22. And it's really broad-based across our growth catalyst in both brands, as Scott talked about, we're seeing that momentum really across the entire business.

Now, as you step back, and you think about new distribution and cost growth, you know, it's predominantly driven by growth within the existing accounts, including category expenses. So one of the drivers for us in the back half of 2021 and you heard in our prepared remarks, just really broad strength across outdoor, ATG, workwear, female, and just really proud of those accomplishments. And that momentum will continue in period four and into the first half.

Brooke Roche

Thank you. And then, Rustin, just a quick follow-up on the gross margin expectations for the year. Thanks for all the color that you provided so far, but would love to hear about how you're thinking about the benefit of higher pricing across the portfolio, relative to the

higher cotton and raw material input costs that the industry is seeing? How do those factor into the 100 BPs of structural margin gains relative to the 100 BPs of transitory costs that you're expecting for the year?

Rustin Welton

Yeah, creating growth. So let me step back again, you hit it exactly right, we expect 100 basis points of structural margin gains being offset by 100 basis points a transitory headwind, again on a full-year basis. So for competitive reasons, I won't itemize the individual elements. But let's talk about kind of how we are assuming inflation, transitory expenses, and then those offsets. If you will pricing NICs, cost savings, and how we expect those to evolve through 2022.

So as we look at inflationary pressures with product costs, obviously being the biggest driver, yeah, that really began to emerge in the second half of '21 for us. We expect that to accelerate in the first half of '22 and then really peak in the second half of '22. You know, as we talked about on last quarter's call, you know, as cotton moves and input costs move, it takes a few quarters for it to come through the P&L, and we see the inflationary impact stronger in the second half. You know, transitory expenses, as we said, in our prepared remarks, they really kind of accelerated in the second half of '21, we expect those to peak in the first half of '22, as we chase demand, as we said, and then we anticipate those to moderate and taper modestly in the second half of '22.

And then, as you think about pricing, NICs, and cost savings, and we think about those in one broad bucket, you know, those last that inflation in the incremental transitory expenses. Those benefits are expected really begin accelerating in the first half of '22, with significant acceleration in the back half of '22.

So hopefully, that lays out a little bit more about the gross margin changes that we've seen, or we project. And again, I just want to highlight that relative to our investor day algorithm, those structural gross margins are on track with up to 100 basis points improvement in 2022.

Brooke Roche

Thanks so much, Rustin. And then just as a final follow-up, with the global ERP initiative in the rearview mirror, and significant debt pay down completed in 2021, can you put an update on your capital allocation strategy from here? Thank you.

Scott Baxter

Yeah, you know, Rustin, I can take that's how you doing, Adrian?

Unknown

It's Brooke.

Scott Baxter

I'm sorry. So, Brooke, I apologize. You know, so for us, it's the capital-efficient nature of our model, right? We've talked a lot about how we're thinking about that. We're creating a billion dollars from \$21 to \$23, we paid down debt, we feel really good about where we are, we've increased our dividends, as you know, last quarter, which was significant for us. Rustin talked about our share repurchase. And, you know, we'll think about M&A, but it's got to be a good fit, it's got to be complimentary. You know, we want to keep consumer-focused, we want to leverage our model. So all of those things.

But right now, we feel really good about the optionality that we have, and how quickly we got there as a company, and the cash that we're generating as a company. Rustin?

Rustin Welton

Yeah, I think Scott hit the high points, Brooke, you know, just again, draw you back to the prepared remarks of the cash we've generated and how we've deployed that today, again. You know, net income has increased 15% since 2019 and we've generated over \$525 million in operating cash flow, returning a large portion of that \$225 million to shareholders, decreased the debt, and completed the ARV investment. So that optionality only increases as we continue to move forward here at Horizon Two with some of the debt reduction we've done and the completion of the ERP.

Brooke Roche

Thanks so much. I'll pass it on.

Scott Baxter

Thanks, Brooke.

Rustin Welton

Thanks, Brooke.

Operator

Thank you. The next question comes from the line of Adrienne Yates with Barclays. Please go ahead.

Adrienne Yates

Thank you very much. Good morning to the team and well done. I mean, this is it's very rare we're seeing people, you know, have an optimistic outlook. So it's really structural here.

Scott, I'll start with you. Your digital penetration doubled from a few years ago, it's nesting at 6%, the investor day targets 10%. That seems like it's going much faster. How should we think about sort of a new target and how that flows into kind of the P&L? If you have any color on the amount of accretion that we have from that channel? Thank you so much.

Scott Baxter

So yeah, I'll start Adrienne, and good morning, and thanks for joining us today. You know, we're really, really pleased but certainly not, you know, happy with where we are. We are still working very hard at this and it's at the forefront of everything we're doing. And I guess the thing that as we sit back and think about it most is that we made a decision focused on we hired great world-class talent, continue to augment that, and then we backed it up with investments, right? And now we're seeing that investment really work. We're touching the consumer in a really good way. And then the demand creation piece that we're putting into the model, you know, show them real significant gains because of that.

So, you know, we are ahead of our investor day targets like we've talked a lot about. And we'll continue to go ahead and push really hard to invest in this area significantly. And we haven't come out with any new targets yet that we've shared with anyone. But at some point in time in the future, we certainly will do that to the update.

Rustin, anything to add?

Rustin Welton

Yeah, I would just say the proof points we talked about, Adrienne, in the prepared remarks. I mean, we have increased the investment in digital up three basis points since 2019. And again, our own dot com was up 74% since 2019. So obviously in a creative channel for us for generating returns and we're certainly under-indexed even at that 10% target out in 2023 your relative to a lot of years.

Adrienne Yates

Okay, great. I'm actually going to switch to Tom and Chris about demand creation. I was wondering how you take the global or the corporate demand creation budget? How you're splitting it between the two? And what exactly are the strategies that you're each using to drive that brand momentum?

Tom Waldron

Yeah, I agree. This is, Tom, I'll go first on that. From a strategy standpoint, you know, we're really excited to be in our 75th-anniversary year. And we're excited to be investing behind a multifaceted demand creation approach, kind of broken into three areas.

One is our equity campaign for the Ride of Life is certainly contributing to the broad rate-based growth that we're seeing. Secondly, the partnerships we're doing like the Georgia May Jagger, Leon Bridges, you know, if you saw the female growth up at 84%, we know that is driving significant growth for us and bringing in new consumers. Then there are the collabs that we're doing, which is bringing new consumers whether it's Billabong, Yellowstone or Fender. We just couldn't be more excited about this 75th-anniversary year.

Chris?

Chris Waldeck

Yeah, Adrienne, it's Chris Waldeck. Just a little on the Lee side, you know, we really had a repositioning of the Lee brand and we had to go out and really drive through with the objective, bringing that new younger consumer into our Lee franchise. And I'm really excited about the progress we've made. We kicked off in Q4 our equity campaign, The Originals and it's really resonating both with our existing consumers, but also with that new younger consumer that we're at.

And, you know, we think about that into the first part of it, we're really focused on driving our core US wholesale business then regions, and we think about that, especially for the revamp, rebrand. It's China that we're after. So that's how we think about allocating our marketing and where we are. And it's, again, really the premiumization of these brands and what we're trying to drive.

Adrienne Yates

Fantastic, Rustin, I have just three quick ones for you. So your gross margin's well ahead of plan. I was wondering where you are in kind of the spectrum of reaching those new highs in the gross margin? How much more opportunity is there? So that's number one. Number two on inventory. It sounds like you have a really good handle on kind of

the inventory. What have you done? How many more weeks of supply have you embedded into the organization to avoid some of the supply chain kind of shortages, I'll say for lack of a better term?

And then my last one is, you know, \$100 oil, we hit that today. And so remind us what happened in 2010 to '14, the business was part of VFC at the time, with your essential retailers did business pick up and how much of the inflationary side of it and how much of the potential demand-side do you have, if any, baked into the guidance? Not sure if those are quick. Sorry.

Rustin Welton

Well, thanks, Adrienne, let me start make sure I captured it here. So the gross margin option? Yeah, we talked a little bit about it at investor day. You know, the 2023 target was 46% and we really talked about mixing in to, you know, those more creative channels as we distorted growth, and you've seen us distort investment there. And you're certainly seeing distorted growth in those channels like digital and geographies, like the international side of the business.

So even with those targets, as I just mentioned on the digital side, but the 10% Penetration target out in 2023, we're still significantly under index. So we're in the early stages of this. We think there's opportunity beyond that. We have not ceased in any way and see that continuing to grow and that's why we're making those strategic investments in those areas because as you know, everything we do is on a TSR basis.

From an inventory perspective, if I can shift there. You know, we finished the year up about 7% in inventory. Excluding VFO and India, our inventory was up about 9% from the prior year, quality is good. And as we said in our prepared remarks, we're chasing demand, which implies our results would have been even strong. You know, as we think about our '22 revenue outlook, we considered a demand and supply imbalance. As we've said many times, we're not immune to the macroeconomic challenges that are out there. But certainly having a third of our global production in this hemisphere is an asset as we kind of chase demand.

We do expect inventory to grow during 2022, as we meet that projected demand and going forward. And that inventory gain or investment, if you will, be tempered, in part by some of the ongoing SKU rationalization initiatives that we talked a little bit about investor day. So again, we'll continue to chase and move through the inventory piece, but pleased with how we've managed it so far.

And then your last question around elasticity and kind of going back to, you know, 2010, 2011 time period, you know, I'll just remind you that we are in a materially different place today than when we were back then. And we've talked quite a bit about that, on the last

call, with some of the investments we've made, growth into some of these new categories, growth into premium channels, etc.

So, you know, certainly, we are watching the elasticity. But, again, I think, you know, during periods of uncertainty, consumers historically just gravitate towards brands they trust. And in this exacerbated period of rising prices, consumers look for those brands that deliver great fit, feel, performance, and of course value. And that is absolutely where both of our brands play. And we're really focused on delivering that compelling value, which is benefits received for price charge to that consumer when they walk onto the floor.

Adrienne Yates

Great, thank you very much. Great job.

Rustin Welton

Thanks, Adrienne.

Operator

Thank you. The next question comes from the line of Sam Poser with William Streeting. Please go ahead.

Sam Poser

Good morning, everybody. Thanks for taking my questions. I've got a few, many questions have been answered. Do you want them in order? Or should I go one at a time? So, if you want to break it up or something?

Scott Baxter

Why don't you give them to us, Sam, and we'll take them as you go.

Sam Poseur

Okay. The Lee and Wrangler business, when you think about it for the full year, is which one do you think will increase more within your guidance? Number two, and part of that, is there any sales shift because of the 53rd week changes? Were there any shift in sales? Or are we past that? And then, with the restructuring charges that happened in the fourth quarter, can you give some details there because I thought that a lot of those restructuring was pretty much going to be gone once you were done with the ERP.

So one, more details there as well as an outlook into '22 if there's any non-recurring charges on the horizon because I understand that your guidance is the GAAP guidance. And then lastly, within the inventory levels, can you give us some idea of your in-transit this year versus both last year and the prior?

Rustin Welton

Sam, I'll take those. So when we think about Lee and Wrangler for full year '22, as you know, we're all guided by brand, Sam, but again, I'll draw you back to the comments I made here. The second half, both brands are up double-digits, we've been investing, as Chris and Tom talked about in their remarks and in the Q&A here. Behind both of the brands, as you know, everything we do is on a TSR basis. So we're continually looking at that and we see great growth in both of the brands moving forward being at or above those investor day targets.

In terms of the sales shift for the 53rd week that is behind us, we do not see that carrying forward or having an impact, Sam. Restructuring charges, I believe you had a question there and I think that really relates to how it's classified probably in the appendix the restructuring charge, if you will, that was under their restructuring and other costs was around \$5 million, I believe in SG&A. And that was the conclusion of the ERP was the main driver of that, Sam.

So, again, that wrapped up with the implementation in the third quarter, we don't expect that moving forward. Right now, there's no non-recurring charges for '22 that we've talked about, which is why the SG&A has been guided on an SG&A basis.

And then as you relate the inventory, and if I got your last question, you know, certainly we're in chase mode, as we've talked about here quite a bit. So inventory and transit are finished here a little bit higher in '21 than it did in '20 certainly to meet this strong demand that we see in the first half with low-teen growth.

So I believe I hit all those, Sam. Thanks for the questions.

Sam Poseur

All right, let me just do two follow-ups real fast. Okay. On the in-transit, can you tell us what the percent was this year, last year, and the prior year, so we can have some idea? And number two was Lee and Wrangler, I understand you do it on TSR basis? I'm not asking for guidance. I'm asking for do you expect the Wrangler business today to grow more than Lee or vice versa for the full year? That's it. I'm just trying to get a large picture on, you know, which one you're anticipating higher growth from?

Rustin Welton

Yeah, on the inventory. Sam, on the in-transit, I don't have the percentages of my hands. We'll get back to you on that. You know, as you think about the growth rates, again, '22, we haven't broken out. But if we go back to the investor day targets, we had Lee growing modestly faster than that Wrangler. And again, that's over the '22, '23 time periods. So hope that helps. Thanks, Sam.

Sam Poseur

Thank you very much. Continue to discuss.

Scott Baxter

Folks, that concludes--

Operator

Thank you. The next question comes from Robert with Guggenheim, please go ahead.

Ari

Hi, good morning. This is our Ari; I'm supporting for Bob.

I guess, can you give us more color into the trends at higher end distribution partners? And I guess, any color on China business? Thank you.

Chris Waldeck

Hey, this is Chris, and just give you a little background on our China business. You know, we have made some significant investments behind it both on the Lee side of it with our new Pioneer store. And, you know, that format is really resonating well with consumers. Also on the Wrangler side, just with our new store format we have there. And I think what we're really encouraged by with wrangler in China is just how the brand positioning is resonating with consumers. So we're encouraged there.

Obviously, there's macro issues that we're all dealing with out there. And I think for us really looking at optimizing the business near term and continuing to position ourselves for the long term success in China.

Scott Baxter

And then I believe your second question was about the premium channels for the brands?

Ari

Yes.

Scott Baxter

I think Chris and Tom are best to answer that.

Tom Waldron

Yeah, no, absolutely. You know, we've been working very hard on the premiumization of the Wrangler brand, as evidenced with some of our partnerships with Georgia May Jagger and as we moved up channel, certainly partnering with specialty with our female line and really just better retail partners from a premiumization standpoint, creating this halo for the brand. I'm really proud of the progress there. Thank you.

Ari

Thank you very much.

Operator

Thank you. Ladies and gentlemen, we have reached the end of question and answer session. And I would like to turn the call back to Scott Baxter for closing remarks. Thank you.

Scott Baxter

Thank you, everyone, for joining us today. I apologize that we didn't get to all the questions today but certainly appreciate your participation. Thanks for the support and look forward to talking to everybody again next quarter. Have a great day and week everyone. Thank you again.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.