

Kontoor Brands, Inc.
Fourth Quarter 2022 Earnings
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Presenters

Scott Baxter, President, Chief Executive Officer, and Chair

Rustin Welton, Chief Financial Officer

Tom Waldron, Co-Chief Operating Officer and Global Brand President of Wrangler

Chris Waldeck, Co-Chief Operating Officer and Global Brand President of Lee

Eric Tracy, Vice President, Corporate Finance and Investor Relations

Q&A Participants

Jay Sole - UBS

Bob Drbul - Guggenheim Securities

William Gardner - Wells Fargo

Brooke Roach - Goldman Sachs

Sam Poser - Williams Trading

James Duffy - Stifel

Operator

Greetings, and welcome to the Kontoor Brands Fourth Quarter and Fiscal Year 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Eric Tracy, Vice President, Corporate Finance and Investor Relations. Thank you, Eric. You may begin.

Eric Tracy

Thank you, operator. Welcome to Kontoor Brands Fourth Quarter and Fiscal Year 2022 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.

Select comparisons to 2021 results will be on an adjusted basis, and in certain cases, we will make comparisons to 2019 adjusted results. Reconciliations of GAAP measures to adjusted amounts can be found in the supplemental financial tables included in the news release that was issued early this morning and 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. Comparisons will be in constant currency unless otherwise stated, with the exception of comparisons to the 2019 period.

Joining me on today's call are Kontoor Brands President, Chief Executive Officer, and Chair Scott Baxter, and Chief Financial Officer Rustin Welton. In addition, we will also be joined by Tom Waldron, Co-Chief Operating Officer and Global Brand President of Wrangler, and Chris Waldeck, Co-Chief Operating Officer and Global Brand President of Lee. Following our prepared remarks, we will 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, Tom and Chris will be joining us as usual for this year-end review. We believe these year-end calls 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 in functional areas. 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. I'm even more excited to discuss our incredible opportunities ahead as we begin 2023 from a position of strength.

While we expect macroeconomic challenges to persist, our results afford us great proof points that, when we execute on our playbook, all of our key stakeholders win. Beginning with some highlights from the fourth quarter and full-year 2022: In Q4, global Kontoor revenue grew 9 percent, well above our internal forecast, as shipments in the U.S. accelerated, augmented by continued share gains in AUR growth. And profitability in the quarter was outstanding, with adjusted operating income increasing 19 percent.

Despite the significant macro pressures during 2022, we were able to deliver another year of healthy growth, with revenue increasing high single digits. And we returned a total of \$166 million to shareholders through a combination of dividend payouts, which you will recall we increased last quarter, as well as share repurchases.

And stepping back a bit, we think it's important to note, relative to pre-pandemic 2019 levels, during 2022 we were able to grow revenue mid-single digits, or double-digit growth, excluding proactive actions to exit our VFO fleet in lower quality points of distribution, expand reported gross margin 230 basis points compared to adjusted 2019 gross margin, even with the impacts of inflation, supply chain challenges, retailer inventory rebalancing, and COVID lockdowns in China. And finally, we've grown adjusted earnings 17 percent over 2019. These results are a direct function of our catalyzed growth strategies we laid out at our last Investor Day.

Let me remind everyone of these focused areas and some great proof points for how we are tracking: First, enhancing our core U.S. denim business; in 2022, our U.S. business grew 11 percent, again with broad-based strength in share gains; second, diversifying our categories with expansion across outdoor, work, and tees; during the year our non-denim business grew

13 percent and now stands at 38 percent of our global mix; third, amplifying the connection to our consumers through channel expansion, focused on digital and, more recently, owned retail. In 2022, global digital own.com grew 17 percent, and revenue in this important growth vehicle has doubled since 2019; and lastly, driving accretive growth geographically, broadening our reach beyond domestic borders. Excluding China, international markets grew 7 percent in 2022.

Rustin will go through our full-year 2023 guidance in more detail in a bit, but continued execution of these strategies will be critical in driving this year's performance, even as we assume macro challenges will weigh on consumer brand throughout 2023. And we want to prudently account for this in our full-year guide. I'm excited that our domestic POS, share, and AUR gains have continued here in the first quarter.

As you would expect, we've seen some lag in wholesale shipments relative to the solid sell-through, as retailers normalize their order patterns, and we have factored that into our plans accordingly. But the combination of strong quarter-to-date POS, coupled with robust gains in our own D2C, with U.S. accounts up 20 percent year-to-date, gives us confidence that the Wrangler and Lee brands are healthy and well-positioned in the marketplace as we begin 2023.

In addition, I would note, we expect these positive U.S. trends to be somewhat subdued by near-term softness in the international markets, particularly China. Chris and Rustin will touch on this later. But, the overall healthy, fundamental performance, coupled with the significant actions taken over the last several years to fortify our balance sheet and enhance our capital structure, provide us increased flexibility to deliver in the face of uneven conditions.

This is reflected in our strong returns to shareholders, totaling \$455 million since becoming a publicly traded company. And while the individual components of our fundamental outlook may differ a bit from the long-term targets we laid out at our Investor Day back in May of 2021, I'm pleased to share that 2022 revenue and earnings came in ahead of those strategic targets, despite the incremental impacts from 40-year inflation highs, massive supply chain disruptions, and significant regional lockdowns due to COVID.

These operational results are a testament to the incredible efforts of our amazing colleagues that I'm fortunate to partner with every day. I want to close by thanking each and every one of our people around the world for their agility, perseverance, and dedication to Kontoor, both in navigating the near term and in setting the foundation for our future success. This commitment to excellence inspires me and gives me confidence that we can continue to yield superior returns for all KTB stakeholders.

Tom?

Tom Waldron

Thanks, Scott, and hello to everyone joining us on the call today. I want to echo Scott's comments in thanking our teams across the organization. Wrangler's fourth quarter and 2022 results are because of the extraordinary efforts throughout the year. Before I get to our Wrangler results, let me share some thoughts from my seat as Co-COO, specifically in leading our supply chain platform.

We know supply chain, and in particular inventory management, is on everyone's mind, so I'd like to provide some perspective. Kontoor, similar to most of the apparel industry, experienced global supply chain disruptions into 2022, including significant retail inventory rebalancing affecting our operations, with the most pronounced impact occurring in the third quarter. These actions, combined with cost inflation and improved lead times on source goods, has led to higher inventory dollars to end the year.

Rustin will take you through the numbers, but let me provide some context on how we are addressing the elevated inventory position. As we have discussed last quarter, we have flexed our internal manufacturing as well as adjusted receipts on source goods, to right-size our inventory position in a profitable manner.

While this production downtime impacted Q4 gross margins, and we expect will continue to weigh on margins in the first half of 2023, we believe these actions are the right ones in preserving long-term brand health. Importantly, we remain on track to see more normalized inventory levels by mid-2023. No doubt, there is much work to be done here, but I am confident we are executing the right plan to optimize our inventory position in a prudent and profitable manner as we move through the year.

Let me now turn to discuss fourth quarter and full-year highlights for the Wrangler brand. I couldn't be prouder of the team's accomplishments during 2022, our 75th anniversary year, which saw a multitude of successes, culminating in our largest fourth quarter ever. And for the first time, the brand experienced a quarter with revenue above \$500 million. Revenue grew 16 percent globally in the quarter and 19 percent in the U.S., our largest market, with a healthy balance across categories and channels.

In our core, we continue to drive share gains in the quarter, with Wrangler Men's bottoms outpacing the U.S. market by 160 basis points and our largest competitor by nearly 500 basis points, according to NPD. These gains were once again led by continued AUR momentum, up 8 percent in the quarter. And this strong sell-through and share momentum only improved as we moved through the year.

From a category perspective, fourth quarter sales of outdoor, workwear, and tees were up approximately 20 percent. And once again, our own digital led our quarter performance with global wrangler.com up 18 percent in Q4, sequentially improving from Q3. And looking at highlights for the full year, Wrangler brand performance during 2022 demonstrates our

commitment to diversified, accretive growth across categories, channels, and geographies, all while enhancing our core business.

Full-year Wrangler revenue increased 12 percent globally and was up 13 percent in the U.S. And while we continue to drive share gains in our core U.S. denim business, I am excited about the progress we've made in our diversified strategies. Within categories, tops and non-denim bottoms now account for over 40 percent of Wrangler's business, driven by a 12 percent CAGR since 2019. And from a channel perspective, we are clearly still driving growth in wholesale. But digital has significantly outpaced with both digital wholesale growing at a 31 percent CAGR and wrangler.com increasing at a 37 percent CAGR since 2019.

The evolution of our product innovations within outdoor, including our performance ATG line, as well as work wear, female tees, and Western Specialty, combined to give us a greater permission to play in different categories and channels of distribution and rates new customers like never before. Internationally, and Chris will provide more detail, clearly, COVID impacted our results, particularly in ramping up the Wrangler brand in China, but the opportunity for accretive growth internationally remains significant for the brand.

In addition to the investments we've made in product design and innovation, we've also amplified our demand creation efforts; 2022 saw us evolve our incredible partnerships with brand ambassadors, Leon Bridges, and Georgia May Jagger, and build out authentic brand-enhancing collabs with Yellowstone, Fender, and Billabong, as well as sponsorships of music events, such as Lollapalooza in the U.S. and Berlin and Austin City Limits.

And our pipeline of product category extensions, innovations, and new demand creation platforms gives me great confidence that our investments will support continued momentum for the Wrangler brand. Perfect examples of this include new, highly elevated, but still authentic partnerships with premium brands such as Buffalo Trace, Pendleton, and Lucchese.

The collaboration with Lucchese showcases a new collection of Wrangler premium denim with AURs approaching \$500. Stay tuned for more Wrangler brand activation events in the year to come. As you can see, Wrangler has begun 2023 from a position of strength. Our strategic investments allow us to not only participate in movements but, more importantly, create and lead them.

I'll now turn it over to Chris.

Chris Waldeck

Thanks, Tom. We enter 2023 with significant momentum and enhanced brand equity matched by a tremendous global growth opportunity long term. Our strategies are beginning to unlock the brand's true potential as we continue to build on Lee's premium international positioning, while amplifying investments in design and demand creation, bringing new consumers into the

brand, and opening elevated points of distribution, including our D2C, which I will touch on in a bit.

Before I discuss the go-forward, let me first share some of Lee's Q4 and 2022 results. In the fourth quarter, globally revenue declined 3 percent, with strength in the U.S. offset by challenges in international markets. Excluding China, Lee global revenue was up 2 percent versus the prior year. In the U.S., Lee grew 5 percent, led by digital, with lee.com up 11 percent. Internationally, the Lee brand was down 13 percent during the quarter, primarily driven by COVID lockdowns and restrictions in China. I will provide more perspective on China in a minute.

Importantly, AURs in Q4 were up 9 percent, a direct function of our continued investment in quality of sales, enhanced product, and mix shifts. And we are seeing sequential improvement come through in the NPD market share data, highlighted by Lee women's, which grew significant share in Q4, outpacing the market and our largest competitor by 80 basis points.

Turning to the full year, globally, revenue increased 1 percent. Excluding China, Lee grew 7 percent for the year, with EMEA growing 8 percent. Again, the U.S. core was strong, increasing 7 percent over 2021, with a combination of share gains and improving AURs driving a healthy balance growth profile. And while geographic mix, owing to China lockdowns, weighed on 2022 gross margin, the Lee brand repositioning and focus on more accretive growth drove over 400 basis points of adjusted gross margin expansion since 2019.

Similar to Wrangler, Lee maximized investments in brand, building across talent, design, innovation, and demand creation. We continued our partnership with Creative Director Mark Seliger, enlarged our second global brand equity campaign, Lee Originals. From the Lee Originals campaign to sponsoring the 2022 Bonnaroo Festival or up-and-coming music duo, Tiger Lilly, and fashion collaborations like Forbidden City in China and the Brooklyn Circus here in the U.S., we connected with new, younger consumers in 2022, and that momentum continues into 2023.

A great example of this, a few weeks ago, in kicking off our celebration of Black History Month, Lee had the honor of sponsoring The 50 years of Hip-Hop Style exhibit at the Fashion Institute of Technology in New York City. We are proud to have been woven into the history of this influential cultural movement, and we look forward to further expressing Lee's impact with brand activation events planned in the coming months. Again, we are just beginning to unlock the full potential with this brand. And I couldn't be more excited with the opportunity ahead and to share future developments with you as we move through 2023.

Speaking of potential, I'd like to share some perspective from my role as Co-COO overseeing Kontoor's international and D2C businesses. As you all know, the opportunity for growth in these areas' importantly highly accretive growth remains significant for both brands. First,

touching on international markets, when we discussed geographic expansion as a key growth catalyst at our last Investor Day, we knew the path wouldn't necessarily be linear.

We did not, however, contemplate a war in Europe or prolonged COVID lockdowns and restrictions in China. And there is no doubt these macro factors have impacted and altered our trajectory of growth. In the near term, you will see us continue to navigate through challenging conditions but with an eye to the future, focusing on the health of our brands and positioning each for long-term, profitable growth.

In China, we are seeing two things. First, consumer demand for the Lee brand continues to be strong, and that is best represented through the digital marketplaces that have not been impacted by COVID restrictions. Like others in the market, we are seeing significant fluctuations in comps around the country. With the China New Year timing shifts, festival travel, and people now getting back to work, we exited 2022 clean in our own inventories, but inventories at retail remain elevated.

Given these dynamics, we expect the China business will be challenged during the first half, with the most pronounced headwinds in the first quarter. We do see the stabilizing in the coming quarters as consumers get back to normal course of daily life, and pent-up demand is released. I would like to emphasize, we are taking a measured approach, including the ramp-up of Wrangler in China, but the China market, and, more broadly, Asia and Europe, represent substantial white space for Kontoor.

There is no reason why our brands shouldn't operate at a similar level to our peers, which suggests an opportunity to double our international business over time, not only a positive for the top line but, again, materially accretive to the gross margin, given our brand's premium positioning, higher AURs, and greater D2C mix outside of the U.S.

And as we drive closer connections with our consumer, this is no more important channel than the continued evolution of our own retail and digital platforms. As you all know, we remain in the early days here, well below our competition in terms of penetration. Within digital, Kontoor global own.com increased 17 percent over 2021, while our U.S. own.com experienced 23 percent growth over last year, great proof points that our investments, including digital demand creation in this highly accretive growth channel, are paying off.

Last quarter, you heard us begin to discuss the development of our own brick-and-mortar retail strategy; first, in Europe, during the fourth quarter, we opened three new Lee Wrangler premium retail stores, with plans to expand our footprint in the region during 2023. These brand-enhancing retail destinations offer consumers a unique, immersive experience, with a full lifestyle assortment for both brands.

We also recently launched our Retail Excellence Initiative, a comprehensive program across retail operations, talent and training, combined with merchandising and planning, aimed at

transforming Kontoor into a world-class retailer. Based on the success of the early testing, we are now rolling out the Retail Excellence Initiative across the Asia region now. And over the next 12 to 18 months, we will do so globally.

The opportunities to leverage our learnings in Asia as we fully develop our brick-and-mortar strategy globally are significant. As you would expect from us, we will be deliberate in evolving our retail footprint. We will test and learn, building in concert with our branded digital sites to create a seamless omnichannel experience as we build an ever-closer connection to our consumers.

Before I turn it over to Rustin, I, too, want to sincerely thank all of our teams for all their tremendous work in collaboration through 2022, delivering great results for the year but also setting Kontoor up for incredible things to come.

Rustin?

Rustin Welton

Thank you, Chris, and thank you all for joining us today. As the team stated, we are very pleased with the strong finish to the year, with revenue and earnings coming in well above expectations. For additional detail on the quarter and full-year results, I will refer you to today's release. For the balance of the call, I am going to cover key highlights for the quarter before discussing our guidance for 2023.

Beginning with revenue, global revenue increased 9 percent compared to the prior year. Growth in global digital and U.S. wholesale was partially offset by softness in international markets, driven by lockdowns and restrictions in China as well as heightened inflationary and macro pressures. On a regional basis, U.S. revenues increased 16 percent, driven by gains across both Wrangler and Lee.

As Scott, Tom, and Chris discussed, we are seeing sell-through at wholesale, fueled by brand investments and diversification into strategic growth categories. In own digital, we are seeing similar momentum, with revenue increasing 19 percent in the quarter. International revenues decreased 12 percent. COVID-related restrictions and lockdowns in China had a significant impact in the quarter. In EMEA, revenues decreased 4 percent, driven by growth in D2C, offset by wholesale pressure as retailers navigate macro and inflationary headwinds while normalizing inventories. Despite the Q4 decline, EMEA revenues increased 7 percent for the year.

Turning to our brands, global revenue of our Wrangler brand increased 16 percent. In the U.S., revenues increased 19 percent, driven by broad-based strength, including double-digit gains in western, outdoor, work, and tees. Female also closed out the year, delivering positive growth in every quarter. Wrangler international revenue decreased 9 percent, driven primarily by softness in EMEA wholesale, more than offsetting gains in D2C.

Turning to Lee, global revenue decreased 3 percent. Lee U.S. revenue increased 5 percent, driven by double-digit growth in digital, while Lee international revenue decreased 13 percent. COVID-related restrictions and lockdowns in China had a significant impact on the quarter and region, with APAC decreasing 26 percent. In EMEA, revenues decreased slightly and were flat, excluding the Russia exit. And, finally, from a channel perspective, U.S. wholesale increased 17 percent, non-U.S. wholesale decreased 14 percent, and global own.com increased 11 percent.

Now, on to gross margin, reported gross margin decreased 180 basis points, compared to adjusted gross margin last year. As expected, inflationary pressures, downtime, and foreign currency, weighed on margin rates in addition to inventory provisions. Somewhat offsetting these headwinds were ongoing structural mix benefits to accretive channels and strategic pricing.

In addition, we have seen relief in transitory headwinds such as airfreight as the global logistics environment has improved. Adjusted SG&A expense was \$213 million, or a \$5 million decrease versus fourth quarter 2021 adjusted SG&A. Tight discretionary expense controls, lower compensation costs, and a decrease in credit loss provisions were somewhat offset by higher distribution expenses as well as continued strategic investments in IT. As a percent of revenue, adjusted SG&A leveraged by 290 basis points in the quarter. Adjusted earnings per share was \$0.88 compared to \$0.88 in the same period in the prior year.

Now, turning to our balance sheet, fourth quarter inventories increased 64 percent compared to last year and increased 30 percent compared to 2019. On a dollar basis, inventory levels decreased \$81 million from the third quarter. A few additional points on inventory. First, the quality of our inventory is good, with approximately 90 percent in core styles. In fact, the majority of it is in North America, where we are currently seeing the strongest brand heat and point-of-sale momentum.

Second, we will be leveraging our ability to take downtime in our facilities while balancing the need to service our largest and growing U.S. business, as we did in the fourth quarter. And as I will discuss in our outlook, we anticipate to more meaningfully utilize downtime in the first half of the year. We expect this to result in sequential year-over-year improvement in our inventory growth rate as the year progresses.

As we have discussed, this is an important lever we are uniquely positioned to pull to right-size in a manner that is more brand appropriate. The combination of these factors gives us confidence we have the appropriate strategy to achieve normalized inventory levels by mid-2023. We finished the fourth quarter with net debt, or long-term debt less cash, of \$733 million and \$59 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 1.8 times, within our targeted range of 1 to 2 times. And as previously announced, our Board of Directors declared a regular quarterly cash dividend of \$0.48 per

share. We returned a total of \$166 million to shareholders during 2022 for a dividend and share repurchase program. Finally, at the end of the fourth quarter, we had \$62 million remaining under our share repurchase authorization.

Now, on to our outlook, revenue is expected to increase at a low single-digit percentage on an annual basis, with growth being relatively balanced between the front and back halves. I want to highlight a few additional points as you think about the cadence that will affect both revenue and gross margin. During the first half, we expect growth to be driven by the U.S. and tempered by International. In the U.S., we expect the momentum from strong POS, share gains, and D2C growth to continue.

As Scott mentioned, while U.S. shipments have slightly lagged sell-through in early 2023 as retailers normalize their order patterns, we are seeing great strength in our own channels, as evidenced by the 20 percent year-to-date U.S. D2C comp growth mentioned earlier. We expect International to be softer in the first half, due largely to China. As Chris discussed, the region continues to recover from COVID-related restrictions, lockdowns, and elevated inventory levels at retail. We are taking a thoughtful approach for both brands and working closely with our partners to reduce inventory levels in the first quarter, while ensuring the long-term brand health.

Accordingly, we expect our year-on-year declines in China to accelerate from Q4 levels in Q1 before returning to growth in Q2. These proactive actions in China are expected to offset domestic growth, with global revenue flat to modestly below 2022 in Q1 before returning to growth in Q2. During the second half of the year, we expect growth to be driven by international, as China becomes more fully reopened and tempered domestically as macro conditions are expected to place increasing pressure on U.S. consumer demand.

Gross margin is anticipated to increase 40 to 90 basis points to 43.5 percent to 44 percent annually compared to reported gross margin of 43.1 percent achieved in 2022. For the year, we expect structural mix shifts to accretive channels, such as digital and International, moderating inflationary pressures on input costs, and higher AURs to offset downtime and drive improved margin rates. However, as the margin components are expected to flow through the P&L at varying points of the year, I want to provide a bit more context.

First, the impacts from China mix will have the most pronounced impact on the first half, particularly in the first quarter. Second, we anticipate taking the majority of manufacturing downtime in the first half. And, finally, as you would expect, the lag from moderating input costs will more meaningfully flow through the P&L starting in the second half. Based on these factors, we expect modest year-on-year gross margin pressure in the first half of the year, with the first quarter most impacted before sequentially improving as we move through the year, with second half margin up on a year-over-year basis.

SG&A is expected to increase at a mid-single-digit rate compared to adjusted SG&A in 2022. As Scott mentioned, we are entering 2023 with strong POS momentum and will continue to support both brands through investments that offer the greatest TSR potential. This will include investments in areas such as digital and IT that support the long-term data transformation of the business, demand creation, as well as the normalization of compensation expenses.

From a cadence perspective, we anticipate investments to ramp through the year, with second half stronger than the first half. EPS is expected to be in the range of \$4.55 to \$4.75 a share. Due to the combination of the factors just discussed, we expect EPS on a dollar basis to be more weighted to the second half of the year, with the first quarter being the most challenged on a year-on-year basis.

Finally, to help you build out your models, other expense is expected to be in the range of \$5 million to \$10 million. The effective tax rate is expected to be approximately 20 percent to 21 percent annually, with quarter-to-quarter volatility driven by discrete items, interest expense in the \$33 million to \$38 million, and average shares outstanding to be approximately \$57 million before any additional share repurchases.

Lastly, as we enter the third year of the catalyzing growth strategy we outlined at our Investor Day in 2021, I want to take a moment to reflect on the significant progress we have made, despite numerous macro and industry headwinds over the last couple years. First, revenues have grown at a low double-digit CAGR over the last two years versus the high single-digit growth implied in our original algorithm. While macro events have had an impact, particularly in international markets, this relative outperformance is reflected in guidance approaching the \$2.7 billion target, despite these headwinds.

Margin rates have been impacted by inflationary pressures, including cotton at the highest level since 2011. But the structural drivers, including mix shifts to accretive channels and geographies, remain very much intact, and we continue to see significant opportunity for gross margin expansion over time as conditions normalize. Furthermore, as evidenced in today's earnings results and guidance for the year, we have considerable levers at our disposal to support continued earnings growth in our long-term TSR algorithm.

And, finally, we discussed our capital allocation strategy evolving to reflect significant optionality, including introducing an opportunistic share repurchase program and increasing our dividend payout last quarter. The power of this optionality has allowed us to pursue our strategy, funding investments in both brands, including a new global ERP system, supporting our dividend, and buying back stock. Over the last two years, we have returned \$337 million to shareholders.

To close, I want to thank our incredible colleagues around the world. As I stated at the onset, I am very pleased with the way we finished the year, which is a direct reflection of their extraordinary efforts. The market and macro environment remains highly dynamic, which we

have reflected in our expectations for 2023. But, as Scott mentioned, we are entering the year from a position of strength.

This concludes our prepared remarks, and I will now turn the call back to our operator.

Operator?

Operator

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

One moment, please, while we poll for questions. Thank you. Our first question is from Jay Sole with UBS. Please proceed with your question.

Jay Sole

Great. Thank you so much. I have a two-part question. The first part is, can you talk a little bit more about your fiscal 2023 revenue guidance and sort of the confidence you have in that guidance or what gives you confidence in the guidance? And then secondly, it sounds like Q1 is starting out strong as well. Could you expand a little bit on that and give us a little bit more color on what's driving the strong growth in Q1? Thank you.

Scott Baxter

Jay, I'll go ahead and start, and then Rustin will jump in. Coming out of Q4, we had real strength in both of the businesses and had strength in the breadth of the portfolio, too, so the geographies and the channels. And that gave us confidence coming into the year relative to how we set our plan for the year. But if you think about it, how we looked at the business midway through the quarter, we had really good POS. We talked about that. Our own to D2C, which is a good indication, has been very strong and also in its infancy, so it puts us in a really good place.

Now, naturally you know from a business standpoint that there's a little bit of a lag between the POS and the shipments, and people are a little cautious out there right now. And how we're thinking about the first year, excuse me, the full year in the first half, is that it will be strong in the first half domestically, because we can see that right now. It might taper off a little bit, how we set up the plan going forward.

But, we think China will continue to get stronger throughout the year as the Chinese consumer comes back into the marketplace, and China opens up. But, I would tell you, this is a testament to the work that the teams have been doing to stay really close to the consumer, stay really focused on the initiatives that we've laid out. And we are dialed in, we're humble, and we're

just working really hard to make sure that we're delivering for all of our consumers and shareholders around the globe.

Rustin?

Rustin Welton

Yeah. Thanks, Scott. Good morning, Jay. So, just to add on to a couple of pieces that Scott mentioned, obviously a strong fourth quarter in the U.S., Jay, of mid-teens and certainly seeing that continued momentum of POS. And Scott talked about the confidence we've had in the D2C. The U.S. D2C comps up 20 percent year-to-date. Certainly, China will put a pressure on that first quarter as we work proactively with our retail partners to really improve their inventory levels. As Chris indicated, we are elevated at retail levels in China. And we want to make sure that we're working with the partners to preserve the long-term brand health.

So, that, China growth is expected to return to growth in Q2. So, as you think about sort of the cadence of that first quarter, Jay, we've got kind of the POS lag, as Scott mentioned, kind of tempering the Q1 shipments with the strong growth we're seeing. Certainly, as we work to get China into the right position, we'll put some pressure on it. Globally, we expect revs to be flat to modestly down in Q1 before returning to growth in Q2. So, hopefully that gives you a little more sense of the cadence of the quarters in that first half.

Jay Sole

It does. That's helpful. And maybe, Rustin, just, if I can ask one more, just following up on your inventory comment, could you just talk through the inventory position a little bit more? I mean, obviously, you mentioned inventory is up 64 percent. Could you just talk about how the downtime impacts your plan to address the inventory and how that downtime impacts maybe gross margin a little bit more specifically? Thank you.

Rustin Welton

Yeah. Thanks, Jay. I'll go ahead, and then I'll flip it over to Tom to add a little bit color on sort of how we're addressing the inventory situation. So, as you indicated, we did finish the quarter up 64 percent versus the prior year. That's up 30 percent versus 2019, just to dimensionalize that, and down \$81 million from where we ended Q3. Again, we feel good about the quality of the inventory, Jay, which I think is important, with approximately 90 percent in core styles. And as I indicated in my prepared remarks, the majority is in North America, where we're really seeing the strongest brand heat and POS strength.

As we think about how this plays out, it does create some near-term gross margin pressure as we take downtime in the plants. But, it also reduces the markdown in brand equity risks that are out there relative to liquidation in off-price channels. And I think that's a really meaningful and unique position we're in, given our internal manufacturing. We do expect that to sequentially year-over-year improve as we move through 2023 in our inventory growth rate as the year progresses and to be more normalized by mid-2023 in our inventory levels.

Tom, do you want to add some color on exactly what we're doing to address the inventory situation?

Tom Waldron

Yeah, absolutely. Hey, Jay, thanks for the question. As you saw, we had some really nice demand in the fourth quarter. And it's important for us to balance service and bringing inventory down. As you mentioned, downtime is a great strategic lever we have, given our internal manufacturing. And we'll be using more of that in the first half than we did the second half of 2022. And additionally, we do have as another strategic lever, our 30-plus outlets. So, we are able to move through our inventory in a very brand right way. And as Rustin mentioned, we'll be more normalized by the second half of 2023. Thanks, Jay.

Operator

Thank you. Our next question is from Bob Drbul with Guggenheim. Please proceed with your question.

Bob Drbul

Hi. Good morning. Just a couple questions. On the D2C business, I guess, for Chris, can you talk a little bit more sort of where the growth is coming from, like the customer base? Essentially, those are — those numbers are pretty impressive. I was just wondering if you could expand a little bit more in terms of what you're seeing there. And then, the second question is really, if we go back a little bit I think to Jay's question, but, Scott, on the demand side, when you think about the category, I guess both from the denim now, the non-denim is actually getting to be pretty significant as well, could you talk about the demand expectations either, just in those core categories tiers, really important to the long-term growth for our brands. And we led our strategy with our investments in digital. And those investments, as you said, are showing some really solid returns. We're seeing that you're seeing and how you think about that? Thanks.

Chris Waldeck

So, I'll lead off, Bob. It's Chris. Thanks for the question. As we think about D2C building an ever-closer connection with our consumers, really important to the long-term growth for our brands. And we led our strategy with our investments in digital. And those investments, as you said, are showing some really solid returns. We're seeing our overall penetration doubling since 2019.

But, an important part of that, really, is connecting the retail experience for that true omnichannel consumer experience. And that's really always been part of our strategy and looking at doing that through full-price stores like the three new stores we just opened up in Europe, with more to follow. And as I go around the world and think about this, in APAC, we already have a really great retail strategy already.

As I talked about, we're now rolling out our Retail Excellence Initiative throughout the region, and we're going to be leveraging those learnings globally, taking those to our European stores and then also bringing that over here to the U.S. So, it's really a way for us to connect experientially with our consumers in all of our markets and tell the story we want to tell around our brand. So, thank you for the question. I look forward to giving you more on that in the coming year.

Scott Baxter

Hey, Bob. How are you? It's Scott. And the second question, from a demand standpoint in our core, so we've done a really nice job as far as focusing on our core. We've brought a lot of new people into the category, which I think is really important. But for us, we've brought new people into the category in our digital platform, in our D2C platform, in our international platform. And then, we were very, very thoughtful, Bob, as we laid out our strategy going forward about where we could play and how we could win.

And we picked tees, outdoor, and work wear as three categories that would be significant going forward that play into the heritage of our businesses, that we have expertise within our company in, and that we know the channels and the geographies really well. And that has been a really good decision. And I think the single most important thing relative to that for us is the opportunity to move forward with those because they're all still really small categories for us but very large macro categories. So, we have a chance to really make and take a big position in those categories going forward.

But, I do want to emphasize, Bob, before I finish here, that we haven't taken our eye off the ball from a core category standpoint, still been extremely important. As you can see, the numbers look really good. We still focus a lot of our demand creation and our consumer platforms around our denim categories, and we will stay laser focused on that going forward. Thanks, Bob.

Bob Drbul

Thanks, Scott.

Operator

Thank you. Our next question is from Will Gardner with Wells Fargo. Please proceed with your question.

William Gardner

Hey, guys. Good morning. Thanks for taking my question. The Wrangler 4Q was all, I mean, they were really impressive, particularly in the U.S. wholesale. Maybe just speak to what drove that growth in 4Q, the sustainability of that growth, and how you're planning revs for the U.S., for the U.S. and internationally in 2023.

Tom Waldron

Yeah. Thanks so much for the question. This is Tom. We're really, really happy with the balanced growth that we had in the Wrangler brand. Certainly, what we've been doing from a brand standpoint in terms of executing what we consider a very advanced playbook, investing behind the brand, bringing a beautiful product to life, and then really, just from a demand creation standpoint, inviting in new consumers, utilizing Georgia May Jagger, Leon Bridges, but also connecting with our core consumer.

I'm really proud of the way we were able to do this as an end strategy with collaborations such as Yellowstone, Lucchese, and Buffalo Trace. We will continue to do that. More to come on that in terms of collaborations into 2023. But, we're really excited about the brand momentum as we move forward.

William Gardner

And maybe just, how are you planning the business into 2023 from a top-line perspective?

Rustin Welton

Yeah. So, Will, it's Rustin. I'll just jump in there. As we kind of indicated, Scott talked about it a little bit in his opening remarks. As you think about the halves, really the front half is driven by U.S. growth and tempered by international and then kind of almost flipping as you get to the back half. Certainly, as China reopens more fully, expect International to drive more of that back-half growth and then partially offset by macro conditions, which we're taking a prudently conservative approach as we're thinking about increasing pressure on consumer demand in the U.S. So, hopefully that gives you a little bit of a sense of the halves.

William Gardner

Great. I'll pass it off. Thank you.

Scott Baxter

Thanks, Will.

Operator

Thank you. Our next question is from Brooke Roach with Goldman Sachs. Please proceed with your question.

Brooke Roach

Good morning, and thank you so much for taking our question. I was wondering if you could unpack your expectation from China reopening and what you've embedded in the guide? What proportion of sales in 2022 were from China? And what's the reopening opportunity for Kontoor Brands maybe from like a dollar and margin basis, as you get back to normalized operating levels in the country?

Chris Waldeck

Hey, Brooke. It's Chris. I'll kick this off. Clearly, there was mandatory COVID restrictions in Q4. That was a headwind for us, specifically the Lee brand. What I'm encouraged by is that we exited 2022 with our inventories clean. And consumer demand for our brand is strong, and we're seeing that come through in the digital channels where there wasn't the restrictions like we had in the brick-and-mortar stores. The issue we're dealing with, just our retail inventories remain elevated. That's why we think the first half could be a bit more challenged.

But, we expect most of that, really, to be in the first quarter. As Rustin said earlier, we're playing the long game here. We're working really closely with our partners. Our team was with them just this last week, going through business plans and really laying out the assortment for the back half of the year. And we're going to continue to invest in the brand and really monitor the geopolitical conditions that are out there. But, we believe the long-term growth in this really high accretive region is there for us. So, we're excited about the opportunities ahead. Thanks.

Brooke Roach

Thanks so much. And if I could just ask one follow-up on the U.S. business, given the strength of market share capture that you're realizing in the U.S. right now, particularly in Wrangler, can you square that growth with the deceleration that you have embedded in the back half of the year? How does that fit with your long-term targets that underpinned your Investor Day outlook? Thank you.

Scott Baxter

Well, from a macro standpoint, Brooke, we did our business, and the strength in Wrangler has continued from the fourth quarter into the first quarter. And then, you think about what we're doing to go ahead and make sure that that continues, incremental investments in brand advertising, incremental investments in some of the things that we've done from a Wrangler collab standpoint, you think about our 75th anniversary, Yellowstone, Buffalo Trace, Lucchese. And then, you think about the value that our brands bring to the marketplace.

So, in times of uncertain times, Wrangler is a trusted brand, incredible value, plays in multiple channels and multiple geographies. And it's at a price point that our consumers still can afford very easily. So, we think we've positioned ourselves very well. But, we are being, in looking at the broad marketplace and the macro conditions in a really specific way to make sure that we've set our plans accordingly.

Brooke Roach

Thank you very much. I'll pass it on.

Operator

Thank you. Our next question is from Sam Poser with Williams Trading. Please proceed with your question.

Sam Poser

Good morning. Thanks for taking my questions. I have a handful. The guidance that you're providing is a non-GAAP guidance, just to confirm?

Rustin Welton

No. It is on a GAAP basis, Sam.

Sam Poser

Are there adjustments that you are foreseeing into the numbers right now?

Rustin Welton

No, that's why we're guiding on a GAAP basis.

Sam Poser

Okay. With the inventory levels, what would be your normalized forward weeks of supply? You were running around 15 at the end of 2018, which is probably the best thing to look at, sorry about that. It's probably the best thing to look at, given the, given what happened in 2020. So, what would be that normalized forward weeks of supply? Is it like around 15? Because right now, on my numbers, it's around 18, which is an improvement from the last quarter.

Rustin Welton

Yeah. I'm not going to get into guiding the specific weeks of supply, but I think you're hitting on the right point, Sam, which is, as Tom sort of indicated, we're trying to make sure that we're balancing servicing the needs in the U.S. market, again, that's where the bulk of the inventory sits, with also reducing from these elevated inventory levels where we're currently sit at. So, we intend to continue to see that sequential improvement on that year-on-year growth as we move forward throughout 2023.

Sam Poser

And the wholesale, the unwillingness of retailers to, I guess, write fill-in orders based on the demand, is that a result of their overall inventory, not necessarily yours? Or are they heavy with you, with Lee and Wrangler in the U.S.? Are they heavy there, or is this we're overstocked in frying pans, and we can't fill in denim?

Rustin Welton

Yeah. I won't comment on the specific retailers' inventories. But, I think Scott hit it well earlier, Sam, in his prepared remarks where he kind of talked a little about, there are times where you get disconnects between POS and shipments. But, really, the brands here are really focused on the POS.

And as Tom indicated and Chris indicated in their remarks, really making sure that we're focused on delivering that compelling product and that great consumer value that we're known for and making sure that we're selling through a POS. And over time, as you have that strong

POS, certainly the shipments catch up and come better in balance. But, that's what we're seeing at the moment. Thanks, Sam.

Operator

Thank you. Our next question is from Jim Duffy with Stifel. Please proceed with your question.

James Duffy

Thank you. I want to start with a follow-up to Sam's question. You spoke to POS trends in retail. Certainly, that's the most important thing. But, for us as investors, we're very curious where inventories stand in the channel specific to the U.S. market. Can you present where your inventory position is, maybe a few weeks inventory on hand relative to more typical levels or something like that to give us a view?

Scott Baxter

I would say, Jim, that we haven't really gone ahead and published that or talked about that in specifics. But, what I would tell you, Jim, is that we are very conscientious. We're working really hard on our inventory. I think we've been upfront about the fact that we weren't happy with it the last couple of quarters, and we've been very serious about getting that down.

It's been a full attack here from a company-wide standpoint. And we're going to continue to do that. One of the things that I'm fairly happy with is, as you know, our inventory is pretty good, right? So, our inventory sells, and owning our own manufacturing facilities allows us to go ahead and make it continue and make good inventory. But, we have a really good plan in place.

From a retailer perspective, we just can't comment. I don't know what they're going to do or how they're going to behave and react. But, we're going to continue to go ahead and put good demand creation platforms together, continue to make sure that we're doing all the things that we can to control our business in both the digital and our owned retail standpoint and with our wholesale customers and making sure that we put ourselves in a position to win.

Rustin Welton

And, Jim, it's Rustin. I would add a little bit. Just certainly, the U.S. retailer inventory rebalancing that took place in Q2 and Q3 has been well chronicled. And certainly, again, we're focusing on sell-through, not shipments. But, I do think there's a couple of important points to sort of call out. So, in terms of shipments or sell-in, there was quarter-to-quarter volatility in 2022 based on the retailer actions, particularly in Q2 and Q3 again.

But, I think focusing on the full year is really important. So, in 2022, our U.S. wholesale business was up 11 percent over 2021, with both Wrangler and Lee posting double-digit growth. So, again, you may have some near-term fluctuations between POS and shipments, but clearly, we're confident in our strategies, and the investments in the brands are working. And I think you've seen that retail inventories have come down from where they peaked earlier in the year.

James Duffy

Okay. Thanks, Rustin. And then, I wanted to ask about investments in retail. How does retail fit with capital allocation priorities? As I think back to your recent history, you've made a number of investments in infrastructure. With those presumably behind you, will retail represent a greater portion of CapEx budget, going forward?

Rustin Welton

Yeah. So, we talked a little bit, Jim, in sort of the assumptions of CapEx of \$35 million to \$40 million for 2023 in our full-year guide. And I think you're hitting upon some really important elements there. Chris talked a little bit in his prepared remarks about the three Lee Wrangler dual-branded stores that we opened up in Europe and the fact that we intend to continue to thoughtfully roll out additional retail stores, moving forward, along with additional CapEx, as we think about investing in areas like digital, like IT, to continue that evolution of our data-driven company.

So, I think that's where the CapEx certainly is coming out. But, if you draw it back, do a broader, more capital allocation, and, Jim, you've heard us talk about this many times, I think the optionality we have is really important and really kind of critical in this uncertain environment. Scott talked a little about the dividend increase that we approved, the 4 percent increase we approved last quarter. And certainly, in 2022, you saw us activate the share repurchase program in a meaningful way with 62 million in shares repurchased last year and returning \$166 million to shareholders in 2022.

Again, and a couple other data points there, we returned \$337 million over the last two years and \$455 million since the spin. So, I think it really talks to the cash generation aspects of this model, which we've talked about many times, and really the options that it gives us with the capital allocation, to continue to invest in the brands via capital, again whether that's stores or digital or IT, but also continue to look at the optionalities we've got around capital allocation with the dividend and share repurchase. Thanks, Jim.

Operator

Thank you. Our next question is from Will Gardner with Wells Fargo. Please proceed with your question.

William Gardner

Hey, guys, just one follow-up. And this is kind of piggy-backing off of Jim's question. Can you just discuss or give us some more color around the CapEx jump from last year to 2023? It just looks like it's a big jump relative to history as well. Thanks.

Rustin Welton

Yeah, a couple of things, Will. When you mentioned relative to history, let me kind of go back on that. Because certainly, this business pre-spin, we were about 1 percent of revs in CapEx and largely around kind of the manufacturing side of the business with our plants and our

distribution. You heard us talk from the spin on about how we're going to continue to invest in the brands and the capabilities. Certainly, early days with Kontoor, significant capital investments as we implemented the new global ERP system.

But, as we start to shift into Horizon 2, the CapEx number, again moving from 35 to 40 expected in 2023, it is really driven by those items and the investments we talked about, as Chris said, starting to build out more of those retail capabilities. So, think about the growth of new stores opening globally as well as building out some of the omnichannel capabilities with those stores on the digital and the IT side of the business.

And, again, we're just going to, we're going to continue to make those CapEx investments that are right for the long-term health of the business. So, hopefully that gives you a little bit of a sense of some of the drivers as our Horizon 2 continues to unfold here as we move into 2023. Thanks, Will.

Operator

Thank you. There are no further questions at this time. I'd like to turn the floor back over to Scott Baxter for any closing comments.

Scott Baxter

I just wanted to say thanks to all of our Kontoor employees around the world. And thanks, everybody, for joining us today, really appreciate your support of our company. And we'll look forward to talking to you in a short 60, I think 60 days from now as the calendar works out that way, but wanted to wish you all a great day and a great week. And we'll looking forward to talking to you soon. Thanks, everyone. Take care.

Operator

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