# Kontoor Brands
# First Quarter Earnings
# May 4, 2023

**Presenters**
**Eric Tracy, VP, Corporate Finance and Investor Relations**
**Scott Baxter, President, CEO, & Chair of the Board**
**Rustin Welton, EVP & CFO**

**Q&A Participants**
**Mauricio Serna--UBS**
**Will Gardner - Wells Fargo**
**Bob Drbul - Guggenheim**
**Peter McGoldrick - Stifel**
**Brooke Roach - Goldman Sachs**
**Sam Poser - Williams Trading**

**Operator**
Greetings and welcome to the Kontoor Brand's first quarter 2023 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 call over to Eric Tracy, Vice President of Corporate Finance and Investor Relations. Thank you. You may begin.

**Eric Tracy**
Thank you, operator. And welcome to Kontoor Brand's first quarter 2023 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, and documents filed with the SEC. We urge you to read our risk factors cautionary language and other disclosures contained in those reports. On today's call, we--we will make comparisons to prior year results. Comparisons will be in constant currency unless otherwise stated.

Joining me on today's call are Kontoor Brand's President, Chief Executive Officer, and Chair Scott Baxter, and Chief Financial Officer Rustin Welton. 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 thanks for all those joining us on today's call. I'm going to focus my comments today on three areas. First, I'll walk through a few select Q1 highlights, including our continued

strength and POS, ongoing share gains, and momentum in D2C, which we believe most accurately reflect our brands' health and relative performance in the marketplace.

Second, I'd like to provide an update on how our strategic investments and key enablers, including demand creation, should support more diversified into creative growth across categories, channels, and geographies over time. And finally, before I turn it over to Rustin, I'll share some thoughts on why I'm confident about the go forward for Kontoor, despite the uneven macro backdrop allowing us to reaffirm our 2023 guidance here today.

Turning to the first quarter, I'm pleased to share that we delivered Q1 results consistent with both our expectations and commentary we provided on our fourth quarter call. Global Kontoor revenue decreased 1% in line with our prior outlook, as increases domestically were tempered by expected softness internationally, particularly in the China region. Within the US market, we continue to see strong TOS outpace shipments as retailers remained working through various inventory rebalancing efforts, muting domestic wholesale and top line upside for the quarter.

But let me be clear: the Wrangler-Lee brands are winning in driving competitive separation in a challenging macro backdrop, as evidenced by the solid momentum and POS, as well as share gains in robust D2C performance during Q1. So let me further dimensionalize the great positives around share gains in D2C both within the US and international markets that reflect improving brand equity on a global basis. From a share perspective, according to NPD, which focuses on the US total measure market, both the Wrangler and Lee brands continue to outpace the market and largest competitor.

A few brand-specific highlights: on a 12-month basis, POS for Wrangler and Lee men's bottoms have grown 10% and 8% respectively, significantly beating the market of 1% growth. And in denim bottoms, Wrangler and Lee men's outperformed our largest competitor by over 300 and 190 basis points, respectively. In women's on a 12-month basis, Wrangler and Lee denim long bottoms have outpaced the largest competitor by over 90 and 70 basis points perspective.

But I think one overarching data point captures how Kontoor is winning in the marketplace. For the core US long bottoms business, so denim and casual pants, Kontoor combined men's and women's have taken a significant share from our largest competitor on a 3 month, 6 month, and 12 months basis. In fact, over the last year, Kontoor has gained roughly 100 basis points of share while our largest competitor has lost 150 points, so an approximate 250 basis points Delta. We are unequivocably driving competitive separation in the market as we enhance our core to investments in innovation, elevated design, and demand creation.

Augmenting these core share gains, category extensions continue to diversify our product portfolio while taking our brands to new points of distribution. Globally, non-denim long bottoms grew 15% in the quarter while outdoor in workwear each increased 17% over last year, further demonstrating that our brands are resonating with consumers. Our D2C business delivered broad based strength in the quarter. Globally, Kontoor D2C increased 15% with owned .com and owned retail both growing double digits.

In the US, D2C grew 13% balanced across brands with Wrangler DTC increasing 16% and Lee up 8% versus last year. And D2C strength wasn't just confined to the US, with Kontoor international D2C up 17%, once again seeing great growth across both brands as Wrangler and Lee international D2C increased 22 and 15% respectively compared to Q1 22.

These first quarter results in D2C provide great proof points of not only brand health, but better investments in building a world class omni channel ecosystem are paying off. And what I love is we remain in the early innings of this D2C journey in significantly under penetrated relative to our competition. As we distort growth in this accretive channel, we diversify beyond wholesale while also driving enhanced connections with our consumer.

As you know, demand creation has and will be a critical piece of the brand elevating investments. The category expansion I spoke to earlier focused on casualization, comfort, and outdoor activities. It’s only matched by our investments in demand creation that puts our consumers first with both brands focusing on freedom— freedom for our consumers to express themselves how they want and where they want.

So let me now share some examples from the first quarter as well as upcoming highlights from our robust demand creation pipeline. First, with the Lee Brand. During the quarter, we continue to drive momentum through strategic partnerships and targeted digital campaigns. We reinforced brand equity and category leadership, reintroducing one of our most iconic and original products, a Lee rider jacket. Partnering with world class media platforms, we reintroduce the rider jacket to a brand-new generation with celebrities like Chris Stapleton organically showcasing the next gen product as he performs around the world.

During the quarter, we also saw Channing Tatum, outfitted and Lee overalls in Vanity Fair, and Pedro Pascal in our iconic rider jeans in Esquire. Simply put, cultural influencers are seeking the brand like never before. Lee continues to fuel its digital business through increasingly seamless connections, expanding the brand's audience and engaging newer, younger brand loyalists. Our social community grew 255% year over year in Q1, and our strategies drove 62% growth in social traffic to our owned .com during the quarter. And we are continuing to reinforce Lee's leadership and legacy across the globe, launching two powerful collaborations in our APAC region with Disney and 7 Up.

We're excited to bring compelling alliances to the China region, driving newness and authenticity with consumers both online and at our elevated retail stores. These collabs demonstrate the brand's leading position in the market. And Lee is just getting started. ‘23 will see more incredible collaborations with global and culturally relevant brands such as recently launched Dragonball Z and upcoming partnerships with Bearbrick and elevated storytelling with partners like

Whalebone and sponsorship of music events such as Rock the Bells, all propelling the brand team that support sustained longer-term growth.

Similar to Lee, the Wrangler demand creation platform is only gaining momentum as we start 2023. In the first quarter, Wrangler partnered with the iconic guitar brand Fender with the second drop of this highly successful collaboration hitting the market in Q1. The product collection skewed more female with key styles globally selling out in the first week. Additionally, select products such as neat guitar accessories, including shoulder straps, pics, and denim guitar cases sold on wrangler.com in a national retailer, Guitar Center, across the US.

And just two days ago, we formally announced Wrangler’s new women's brand ambassador with the signing of reigning CMA, Female Vocalist of the Year most nominated female at the 2023 ACM Awards and Yellowstone actress, Lainey Wilson. As the most recognized female artist in recent country music history and a leading voice in the western movement, we're thrilled to have her represent Wrangler as our first female country music endorsee. Lainey continues our legacy of partnering with authentic brand ambassadors that embraced a core while simultaneously broadening and enhancing Wrangler’s reach to a whole new audience.

The brand will deepen its focus on the music scene in 2023 by continuing to activate unique brand partnerships. And we're excited to announce today that Wrangler has been named the official denim sponsor of the Academy of Country Music Awards as well as the Academy of Country Music. The ACM awards show will air on May 11, and the Wrangler brand will have unique on site programming leading up to and during the show, including having our own Wrangler network team on the red carpet interviews with the biggest names in country music.

Wrangler’s connection to country music has never been stronger. Our artists are nominated for multiple awards, including Album and Song of the Year. We will continue our partnership with Live Nation throughout the year at key summer festivals across the US. And looking forward, Wrangler’s upcoming 2023 pipeline of collaborations and partnerships is more robust than any time in history. Alliances with premium brands, such as new Lucchese, Pull&Bear, and Buffalo Trace are all natural extensions that continue to elevate Wrangler’s positioning and reach new consumers. As you can see, the current breadth and depth of our demand creation efforts for both brands are tremendous. Just one of the reasons that gives me confidence in the Kontoor story.

So let me close with some thoughts on the go forward. While we expect macroeconomic pressures to remain prevalent, our Q1 results, particularly in brand relevant areas, such as share gains in D2C provide us with solid evidence that when we execute on our strategies, we increasingly strengthen our position, regardless of the environment. Rustin will get more detail on our reaffirmed full year 23 guidance in a bit, but continued execution of these strategies will be key in support of this year's performance.

Even as we assume macro challenges will weigh on consumer demand throughout 2023 and we want to prudently account for this in our full year guide, I'm excited that domestic POS and share gains continued in the first quarter. As I stated earlier, 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. And we are amplifying our actions with our own inventory, managing our internal production with plans to have year over year growth in line with revenue growth during the third quarter. So while US wholesale may be a bit more tempered near term as demand and supply find equilibrium, we will continue to focus on what we can control in driving POS, in diversifying our growth in D2C, and international.

And within international, we are seeing great signs in Q2 that China is recovering at a faster pace than we previously expected. And we now anticipate significant gains in the second quarter with momentum carrying to the second half. These actions, improving fundamentals when coupled with our fortified balance sheet and strong cash generation, afford us rate flexibility to deliver in the face of uneven conditions.

A solid start to the year is a direct function of our team's amazing efforts day-in and day-out. I want to thank all of our people around the world for their resilience, adaptability, and commitment to executing our strategies, both in managing through the near term, but also in building the foundation for our future success. This unwavering dedication to excellence is what gives me confidence that we can continue to yield superior returns for all KTB stakeholders, and we look forward to sharing the next evolution of our long-term strategic vision at our next investor day. Stay tuned for details in the coming months.

Rustin?

**Rustin Welton**
Thank you, Scott. And thank you all for joining us today. As you saw in this morning's release, we delivered Q1 results consistent with our commentary from last quarter. While the macro environment remains uneven, as you just heard, we have a tremendous number of Kontoor specific drivers supporting our brands in the marketplace.

For the balance of the call, I'm going to cover three areas. First, I will discuss key financial highlights from the first quarter. Second, I will provide an update to our full year outlook, including near term and back half drivers. And finally, I'll close with what gives us confidence to reiterate our full year expectations and the resiliency of our operating model in an uncertain environment.

Starting with the first quarter, global revenue decreased 1% compared to the prior year and consistent with the expectations previously provided. Growth in US and international D2C as well as gains in US wholesale were offset by softness in Greater China wholesale due to impacts for COVID policy changes. On a regional basis, US revenues increased 2% driven by continued momentum in D2C and owned .com, which increased 13 and 15% respectively.

In wholesale, we continue to see sell through outpace shipments resulting in a modest revenue increase in the quarter. International revenues decreased 9% driven by the previously mentioned impacts in China, more than offsetting 17% growth in D2C.

A few additional points on China. First, our retail partners made meaningful progress improving inventories in the quarter. While this had a near term impact on revenue, we believe this best positions our brands for long term success. Furthermore, consistent with our expectations from last quarter, we continue to anticipate Q1 to mark the most significant year over year declines with trends significantly improving in the second quarter and notably stronger than we previously anticipated.

In EMEA, revenues decreased 1% with double digit growth in direct to consumer offset by wholesale. Brand momentum remains healthy as evidenced by strong D2C gains, including 26% growth in brick and mortar. However, ongoing macro and inflationary headwinds, as well as tight retailer inventory controls, continue to weigh on the region.

Turning to our brands, global revenue of our Wrangler brand increased 3% driven by strengthened D2C, and strategic category extensions. Non-denim continues to increase in penetration fueled by our diversification initiatives, growing double digits in Q1 and now accounts for 46% of global Wrangler revenue.

In the US, revenues increased 3% driven by double digit gains in outdoor, work, and tees, as well as 16% growth indirect to consumer. Wrangler international revenue increased 5% driven by gains across both wholesale and D2C.

Turning to Lee, global revenue decreased 7%. Lee US revenue was flat driven by double digit growth in owned .com. Lee international revenue decreased 16%. As discussed, continued impacts of COVID policy changes in China had a significant impact on Lee's China wholesale business, more than offsetting 11% growth in D2C.

In EMEA, revenues increased 3% fueled by double digit growth in D2C. Excluding China, Lee global revenues were flat. And finally, from a channel perspective, US wholesale increased 1%, non-US wholesale decreased 15%, and global direct to consumer increased 15% including an 11% increase in owned .com.

Now, on to gross margin. Gross margin decreased 180 basis points to 43%. Consistent with our comments last quarter, inflationary pressures on input cost, China mix, and proactive actions in managing internal production, including downtime, weighed on margin rates. Somewhat offsetting these headwinds were strategic pricing and released in transitory costs, such as air freight.

SG&A expense was $192 million, or a $5 million decrease versus the prior year. As a percent of revenue, SG&A decreased 20 basis points to 28.7%. Lower compensation expense and tight expense controls were partially offset by investments in D2C. Earnings per share was $1.16 Compared to $1.40 in the same period in the prior year.

Now, turning to our balance sheet, first quarter inventories increased 52% compared to last year and sequentially improved from the fourth quarter. Compared to 2019, inventories increased 27%. We continue to feel good about the quality of our inventory with nearly 90% in core styles. And while lags between domestic shipments and POS combined with improved lead times on sourced goods has placed upward pressure on inventory balance, we're being proactive, leveraging internal production actions and adjusting receipts to prudently work down levels.

We anticipate this to result in sequential year over a year progress over the next couple of quarters. I will discuss inventory and margin expectations in our outlook. But based on current visibility, we expect inventory levels to be in line with revenue growth by the end of the third quarter.

We finished the first quarter with net debt or long term debt less cash of $788 million and $53 million in cash and equivalents. Our net leverage ratio or net debt divided by trailing 12 month adjusted EBITDA at the end of the first quarter was two times, within our targeted range of one to two times. And as previously announced, our board of directors declared a regular quarterly cash dividend of $0.48 per share. Finally, at the end of the first quarter, we had $62 million remaining under our share repurchase authorization.

Now on to our outlook, revenue is still anticipated to increase at a low single digit percentage over 2022 with first and second half relatively balanced. While we continue to expect first half revenue to be primarily driven by domestic strength, compared to our prior outlook, second quarter US performance is now expected to be somewhat tempered by shipments continuing to lag POS, while China is recovering faster than previously expected. This will result in Q2 domestic revenue more modest versus prior expectations, while China will be stronger relative to previous assumptions.

As Scott discussed, retailers continue to work towards equilibrium with their open to buy and inventory levels, which will have near term impacts. However, based on current visibility, the strong POS momentum and share gains we are seeing in the US combined with growth in our own D2C channels gives us confidence in our full year guidance.

Gross margin is still expected to be in the range of 43.5 to 44% compared to 43.1% in 2022. A few dynamics to consider as you think about the rest of the year. First, we are increasing proactive actions in managing internal production including downtime in the second quarter. This will help support inventory normalization by the end of Q3, as I previously discussed. As you would expect, this will adversely impact the near term, resulting in greatest year over year gross margin pressure in Q2, but drives reduced actions and greater efficiencies in the back half of the year.

Second, we expect to see peak inflation flowing through the P&L in the second quarter. Similar to production actions, this is expected to be a near term headwind, but will ease significantly in Q3 before inflecting to a tailwind in the fourth quarter.

And finally, as mentioned, China is recovering a bit faster than anticipated. Based on current visibility, we expect favorable geographic mix to support second half margin rates to a greater degree than previously planned. When combined with the expected reduction of production actions and easing inflation, we anticipate the greatest year over year gross margin gains in the fourth quarter.

SG&A is still expected to increase at a mid-single digit rate compared to adjusted SG&A in 2022. As Scott discussed, we will continue to invest in our brands and capabilities in support of longer term profitable revenue growth. This will include demand creation, D2C, and international expansion. Compared to our prior outlook SG&A growth is now expected to be more relatively balanced between the first and second halves with amplified investments in demand creation during the second quarter in support of many of the programs Scott discussed.

This will be offset by greater second half benefits from reductions in non-strategic spend and tight cost controls. EPS is still expected to be in the range of $4.55 to $4.75, consistent with the prior outlook. We continue to anticipate EPS on $1 basis to be more weighted to the second half of the year, due primarily to gross margin.

Furthermore, we expect a one-time tax charge in the second quarter of approximately $0.10 related to the remeasurement of deferred tax assets associated with the relocation of our European headquarters. As Scott mentioned, we are clearly operating in an uneven market. But the strength we are seeing and POS share gains for both Wrangler and Lee and D2C momentum are great proof points in the resiliency of our brands.

Further, the ability to leverage owned manufacturing is a structural advantage in an uncertain backdrop. While proactive actions in managing internal production will have near term impacts, the visibility we have on inflationary relief starting in the second half, momentum in owned retail channels and better than expected China recovery all gives us confidence to reaffirm our full year guidance.

Even with that, we are not resting and remain highly focused on driving further efficiency gains across the entire business. Taking a proactive and measured long term view combined with disciplined expense controls is foundational to our operating playbook. These actions also support significant improvements in working capital and cash generation in the second half of the year, which will fuel future optionality and reinvestment in strategic initiatives that support superior TSR for all our stakeholders.

To close, I also want to thank our teams around the world. While the macro environment remains dynamic, I am confident in our team's ability to deliver another year of strong results while continuing to build towards the future. 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 "*" "1" on your telephone keypad. A confirmation phone will indicate your line is in the question queue. You may press "*" "2" to remove yourself from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the "*" keys. One moment, please, while we pull for your questions. Our first questions come to the line of Mauricio Serna with UBS. Please proceed with your questions.

**Mauricio Serna**
Hi, good morning. Thanks for taking our questions. Yeah, just first I would like to know about, you know, the first quarter, you know, it seems it came consistent with your expectations, maybe you could discuss the gross margin piece a little bit more. As I know, like, maybe there were some expectations there that were not accurately capturing, you know, what you were discussing about the pressure in the first quarter.

Maybe, Scott, for you, it looks like the brands remain quite healthy in the market, you know, given the strong share gains and D2C growth, maybe could you elaborate more on these dynamics? And--and then on inventory, looks like you guys are choosing to be a bit more aggressive with internal production to manage it down and be clean by Q3. Is that the correct way to think about it? And then, if that means that most of the gross margin pressure will be, you know, concentrated in Q2, it seems like there is like a lot of headwinds in the second half supporting that full year gross margin expansion. Thanks.

**Rustin Welton**
Great, thanks, Mauricio. It's Rustin. Good morning. I'll go ahead and start with the question around our first quarter results. You know, on our fourth quarter call, we--we said we expected revs to be flat to down low single-digits, and we finished down one in constant currency, you know, as anticipated. You--you mentioned a little bit about gross margin, you know, on gross margin, on that call, we indicated that Q1 would be significantly pressured by higher input costs, geographic mix due to China, and--and production actions including downtime, which were all consistent with our expectations and what we saw in the quarter.

You know, I know there were perhaps a few analysts didn't fully capture this commentary in their Q1 gross margin and, subsequently, the EPS estimates, which is why we tried to be even more prescriptive in today's prepared remarks and kind of shaping the remaining quarters with particular emphasis to the fact that Q2 would be the most pressured year-on-year due to the production actions in peak inflation that we're seeing.

And then, we expect, you know, gross margins to inflect positive in the second half, Mauricio, with Q4 having the greatest gross margin gains. And that's really due to lower input costs, the favorable geographic mix as China continues to--to recover, the higher production efficiencies, and ongoing structurally accretive shifts to D2C. So the EPS in the--in the first quarter was in line with our expectations as well.

So in summary, yes, we were in line with what we were expecting in the first quarter. And hopefully the additional color on the out quarters helps shape gross margin expectations as we kind of go forward. Scott, you want to take the second one?

**Scott Baxter**
I've got it. So hi, Mauricio. Thanks for the question. And you know, Mauricio, for us it's incredibly important because it's our scoreboard. So every day we come in, we look at the scoreboard and we say, hey, share gains are the thing that makes it work here. It's why we do this. It's why we have a lot of fun running this business.

And I'll tell you, the other thing that's really important here is it's the consumer who is making the choice, and that is the single most important equation that we're talking about here. When they walk into one of our big customers, they've got a choice across the board. But at the end of the day for the last couple of years, that choice has been Wrangler and that choice has been Lee, and it's been significant.

And here is the key: it's been in male, it's been in female, and it's been globally, which is really, really important and an incredibly important part of our strategy. I know we dimensionalize a little bit more today in--which I thought was really important that we do so that everyone could understand how and why our brands are winning.

And it's like a virtuous circle of success, right? So we think about the brand and our people in the middle and then all the things that we're doing around it to expand that distribution. You think about the elevated design that we have right now, the category extensions that are naturally fitting in with our company and our people and the culture that we're building, and then we're bringing new consumers into these franchises like we never had before.

And we're doing it with a really purposeful sense from a demand creation efforts. It's holistic like it's never been before. You think about Lee, you think about our cultural influencers, Disney and 7up from a global standpoint, international Bearbrick and Whalebone. And then, you think about Wrangler, you think about what we just did with Lainey Wilson, that is a monumental step for our company like we have never taken before. She is the hottest artist, I would say, in the globe right now, period. Whether it's on TV with Yellowstone, whether it's her recording and her albums and her songs and how much she is on the radio right now, but you think about things that we've done with Lucchese and Buffalo Trace and Fender and those folks, too.

So I really like the approach that we've taken as a company. And then, you couple that with the fact that it's early on. You remember, Mauricio, you've been with the story, a long time. We talked a lot about digital was going to be how we've led this from a D2C standpoint and we captured that and done that. We've built an infrastructure around that with both, you know, tech and also people. And we're having great success globally. Well, the natural next thing has been our brick and mortar development, which we're now really evolving.

One of the things I really like about this is the fact that we've only been doing this for four years is the fact that we haven't got a big infrastructure yet. But that's the key, because we're early in our consumers are demanding it from us. And now, you know, you think about some of the things we're doing. We're building these beautiful Lee and Wrangler doors, which I'd like everyone to go see in Europe when you get there and we will send you where they are, you know, specifically in the European continent. They're premium. They're rolling across Europe. We're really excited about that.

And then, you think about APAC opening back up, which is a really big deal for us. I think everybody knows that. Now, those are mostly partner doors and our inventories are getting in much better shape. But here's the thing that's really interesting since those doors in that continent has started opening up for us, we have seen the consumer bounce back really quickly and engage with our brand and a very significant way.

And I think we're going to talk about that hopefully a little bit later today, so really, really excited about what we've done. Thank you very much for the question. And I'm going to flip it back to Rustin from an inventory standpoint.

**Rustin Welton**
Yeah. Yeah, so I'll close out the questions, Mauricio, and talk a little bit about inventory. As you saw in our prepared remarks, you know, inventory finished up 52% in the quarter versus last year, which was sequential improvement, as we had expected from the Q4 results.

You know, just a few comments kind of shaping it and then talk a little bit about your question about gross margins and the actions we're taking first. First--first off, I would say that, you know, the quality is good with approximately 90% in core styles. We really feel good about the quality of the inventory. The majority of that inventory is in North America, as you would expect, with our business. And that's where we're seeing the strongest brand heat and the POS strength that Scott talked about in his--his prepared remarks.

So what are we doing to address the inventory? You know, a couple of things. First, we're flexing our internal manufacturing and adjusting receipts on sourced goods to right-size the inventory. And what I would say, Mauricio, is a prudent and profitable manner as we move through the year. These actions, certainly, particularly around the production actions are going to weigh on the near-term gross margin, but--but taking downtime in the facilities reduces markdown in brand equity risks and relative to liquidation in off-price channels. And I think that's a really important point.

You know, we're working this down in a way that is right for the brands and it is relatively confined to the second quarter with the actions that we're taking. We do not have any downtime planned in the second half. So we are going to aggressively get after this in the second quarter and we're going to do it in a way that needs to continue to balance. Servicing the domestic growth that we're seeing in the business, while also driving the inventory reduction.

So in closing, you know, we expect the inventory growth to be in line with the revenue growth by the end of Q3, '23 and certainly see, you know, significant inventory improvement in the back half of the year. So hopefully that--that answers your question, Mauricio. Thanks for the--thanks for the time this morning.

**Mauricio Serna**
Yes. Very helpful. And if I may just follow-up very quickly with another question, could--could you come--provide some commentary of--on, you know, on your wholesale partners? I know, like, there has been some concerns about, you know, why are maybe, like, Wrangler and Lee Jeans no longer available at, you know, customer, like, Target. Maybe if you could provide some commentary around that. Thanks.

**Scott Baxter**
Sure. So Mauricio, let me go ahead and talk about Target, because that's been a question that's come up before. So we want to go ahead and address that today. And you know, in the past, we've indicated that we don't typically like to talk about our specific customers, unless it's, you know, financially immaterial. But since that question has come couple of times, we'll go ahead and talk about it.

Target's been a long-standing retailer of Kontoor for decades. And as you know, there's an ebb and flow. And if you just go back 10 years ago, so let's just dial back to the mid-teens 2000, we were well above 90% a denim supplier to Target only. And then, as Target has evolved and as the consumer has evolved, we've evolved with them. So our offering has evolved greatly with them.

So as you think about back in 2017, we went ahead and rolled out our outdoor initiative and Target was one of the first customers that got very excited about that and has been behind that in a pretty significant way since then. It's a great example of our category diversification and how we can continue to work with our big partners in a different way and how we can go ahead and capture more consumers as they come in the door because, obviously, the consumers are looking for different things, too.

And if you think from 2019, and I'm going to dimensionalize this for you in a pretty specific way, since 2019, our non-denim assortment in Target has grown nearly 25% annually. And in 2022, it started to represent the overwhelming part and the majority of our business. Now, I'm not going to comment on the specific strategies, but I'm going to share a, not a data point, but a specific point with you that I think is really relevant to how we're discussing and how we're thinking about the future consumer and how we work with our wholesale partners.

Our real estate, so the amount of real estate that we have on the pad at Target, we will not change in '23 compared to what it was in '22, but it will look different relative to the assortment and the offering. But I'm going to say that again and make it real clear. It will not change what we have on the pad from '22 to '23. Rustin, anything you'd like to add?

**Rustin Welton**
No, I think that--I think that was great. And I know there was a question, too, about kind of the wholesale partners a little bit, and I think we talked about that, Mauricio. You know, certainly in our prepared remarks, you saw that that wholesale, whether it's domestic wholesale or--or the international wholesale certainly is the more challenged portion of the business.

But--but again, I would go back to sort of Scott's remarks. Our--our brands are resonating. I think that the POS and the share gains in the example Scott shared in the prepared remarks really talks about the strength of the brands. And over time, the--the supply and demand will find equilibrium as we move forward. So again, we focus on sell-out as opposed to sell-in and, certainly, our offering is resonating with--with consumers in a way that we would like it to. So thanks, Mauricio, for the questions.

**Operator**
Thank you. Our next questions come from the line of Will Gardner with Wells Fargo. Please proceed with your questions.

**Will Gardner**
Hey, guys. Thanks for--thanks for taking my question. Just a--just a couple here. So for Scott, you know, great to get your thoughts around the health of the U.S. consumer. I mean, you're baking--you're baking into guidance consumer demand worsening into--into the second half, but you know, you're gaining share and D2C seems to, you know, reflect some resiliency in the--in the business. So I just wanted to square those two competing factors. What's your confidence in reaffirming the top-line for the year?

And then--and then on China, it sounds like the recovery is happening faster than--than you expected. Maybe just talk about what you're seeing differently in the region. You know, how are you--how you're seeing 2Q shape out quarter-to-date and--and implications for--for gross margin going forward? Thanks.

**Scott Baxter**

Well, let me go ahead and I'll start with the consumer question first. I think the thing, if you just think about our business, and we've talked about this, we probably haven't talked about it for a few quarters ago, but I always think about our brands and our company as being a company that offers incredible value at an incredible price and the product is fantastic, right? So, you think about these great brands that we really amplified over the last few years. Consumers really come back to them in a significant way.

But they're really at a great price, and--and they are available and a lot of different places. So for the consumer that's under pressure, and I think we all can agree that the consumer with the record setting inflation that we've had is under more pressure than they've been before. They're going to go ahead and they're going to migrate to a brand that they trust and know, a brand that's been resilient for them before, and a brand that they can afford, and we fit all those categories.

But there is something much different about this company that hasn't been here for years. We are creating excitement around this company and these brands with our demand creation platforms that I've shared before, the things that we're doing now that we've just never done before. And if you think about it from the time that we spun, all the difference that we've made from a demand creation standpoint for both brands and how we still kept our brands forefront with that key consumer that we worked with through the years in addition to the fact that we now have a really strong digital platform but now we're going ahead and offering that same brand in our own D2C formats around the globe, too.

So we're not immune to the macro challenges and we understand what's going to happen through '23 and we've prudently accounted for that in our guide. So for us, we're working really hard to make sure that we continue to bring that value to the consumer, but just as importantly to continue to tell that story that we've been telling in resonating. And I would say the best phrase that I could use for what I'm thinking on how I'm thinking about the company is that we're breaking through to the consumer like we never had before. So it's those drivers in the marketplace, right, relative to our history and how we've changed and how we're outpacing, I think, all of the competition.

So let's--let's go ahead and flip over to China. Let us talk--and--and Rustin will go ahead and dimensionalize a little bit of China, but let me start with opening up China. You know, China has been closed for a while, as everybody knows. And as everybody knows, it's been a very good marketplace for us for a very long time and we have exceptional team in China.

You know, we are in a situation right now where the marketplace is opening. Its opening rather quickly. We're in a really good spot relative to the fact that the brand is still resonating. And what we're finding is that the consumer is seeking the brand out immediately as they restock and rethink about their closets because they've been kind of, you know, tied down here for a little bit relative to--they have been able to go out and do some shopping and what have you. So they're really thinking about the brands that they want to go ahead and pull in first, and we are top of mind with the consumer, which I think is really, really important.

I think the other thing that's important is that our big retailers there, as you know it's a big partner market for us, they are working down their inventories, which is really important for us. So we're really optimistic about the re-openings. And we're going to continue to monitor the geopolitical conditions, but we--we believe, like we always have here since we've spun off, about how important in that marketplace for us is. We have incredible talent in that marketplace. Our brand is resonating. Its opening back up. I'm feeling really good about it. Rustin, anything there?

**Rustin Welton**
Yeah. Thanks, Scott. Good morning, Will. I'd just add a couple of points. I think Scott summarized it well. You know, on the Q4 call, Will, we--we spoke a little bit about with the reopening retailer inventory levels were--were elevated. And we talked about expecting the first quarter in China to be a little tougher than what we saw in the fourth quarter, and that certainly came through. You know, when you look at wholesale, or when you look at the business in China, it decreased 31% in constant currency in the quarter, certainly in line with the expectations we've laid out.

I think a couple of data points that are really relevant, you know, as you think about the go-forward here, first, we were super encouraged with the direct to consumer business increasing 11% in the quarter in constant currency because we really believe that provides an important proof point as conditions continue to normalize over the next few quarters about how the brands are resonating with consumers, as Scott talked a little bit about. We have seen that recovery happen a bit faster than originally expected, as you've heard us comment, but I would also sort of say that we expect that the reopening will not necessarily be linear by quarter and/or uniform across the country. And you've heard us talk a little bit about that, Will.

We are certainly cautiously optimistic, but we will continue to play the long game with our brands in the region, as we've always done. So again feel--feel real optimistic about kind of how things are opening up at this point and the long-term potential in the market. So thanks for the question, Will.

**Operator**
Thank you. Our next question comes from the line of Bob Drbul with Guggenheim. Please proceed with your questions.

**Bob Drbul**
Hi. Good morning. I just have a couple of questions as well. The first one, Scott, you know, you talked a lot about the demand creation pipeline. I think you call it robust. It does look really strong, you know, between Lainey Wilson and, you know, the collabs that you talked about. Can you just talk a little bit more just how you see this feeding the business? And then, Rustin, can you talk about the cadence, you know, of the impact of all this SG&A throughout the year?

And then, the second question that I have is around the, you know, the inventory rationalization normalization, I think, Rustin, you talked a little bit about optionality. Can you just expand a bit more in terms of, you know, how you're thinking about it as you do free up a lot of this cash for the rest of the year? And then, my third question is around, you know, you talked a lot about sell-in versus sell-through. Can you quantify U.S., North American wholesale POS? Like, what--what did you see really at retail this quarter? I think that'll be very helpful. Thank you.

**Scott Baxter**
Hey, Bob. How are you? Scott. I'll go ahead and talk about creation.

**Bob Drbul**
Good, Scott. Thank you.

**Scott Baxter**
Nice to hear your voice. I often think back about what we did before. And--and not to spend too much time and dwell in the past, but if you think about when we spun-off, we--we did two or three things only and our demand creation platforms and--and didn't have big teams doing it either. But you know, we had George Strait as a spokesperson for a long time, and that was successful. And then, we had, you know, some football, right? We advertised in football and those are really the only two things that we did with, you know, really big significance.

And then, Lee was kind of spotty. It was on TV, off TV one year, so it didn't have, you know, traction and gain traction like that. So I always thought about it from a consistency standpoint. So from a consumer standpoint, one, you're touching a really small audience, you know, with just Country music and football and, you know, you're not touching enough from a female standpoint. And then, with Lee, you're not touching everybody on a consistent basis.

I think the thing that I'm most impressed with, with our organization right now is if you think about this as I do from a holistic standpoint. So you think about the fact that we now have brand investors and we've talked a lot about those brand investors in the past. You know, we've now added Lainey Wilson, you know, of--of and I mentioned it in my prepared remarks, of Yellowstone and also her recordings, and then we have strategic partnerships. So--and I didn't talk about this that much, but you know, with Whalebone with Lee and with Yellowstone, you know, the TV show with Wrangler. And then, we've talked a lot about the collaborations. They're another component of this.

But we also have the event sponsorships that we've never done before. So the American Academy of Music Awards that we're sponsoring now, Live Nation that we've been a sponsor over the last couple of years, Rock the Bells. So I think about the fact that, like never before, we're touching all those aspects and they're all coming together and we're seeing a different consumer, we're seeing a stronger, better consumer, one that wants to engage with the brands. It's showing up differently everywhere. And just--I just love the way the team is doing it, and I would leave you with this. I'm always impressed every time I talk to the team because they are bringing newness and ideas to the table that we've never seen before as a company.

**Rustin Welton**
Yeah. And on--on your follow-up question, Bob, dovetailing off of that, just the cadence of the impacts of SG&A, you know, as Scott said we're going to continue to invest in demand creation, D2C, geographic expansion, as you've heard us talk about for--for many quarters, Bob. You know, keeping the brands really strong is--is incredibly important component of our success. You know, as you think about SG&A kind of flowing through the year now, we--we expect it to be more relatively balanced, I'll say, between H1 and H2 with some of that amplified demand creation in Q2 that we talked about in the prepared remarks.

In the back half, you know, we expect greater second half benefits from reductions in--in nonstrategic spend and tight cost controls. You know that's an area of focus for us, Bob, it always will be and certainly frees up opportunities to either, you know, continue to improve the bottom line or invest back into the business to--to drive that top line growth.

Maybe I'll shift over to a couple of your other questions. You know, you talked a little bit about inventory and--and optionality, so--so let me hit that one, Bob, and--and then maybe I'll close with a data point about sell-in versus sell-through that--that might help kind of resonate there.

So you know, as we think about sort of capital allocation, you--you've heard us talk a lot, Bob, over time about optionality, and we really think that's critical, particularly in an uncertain operating environment like we're in at--at the moment.

You know, our near-term priority is going to remain on cash generation and conversion, you know, as we worked down the inventory levels and enhance our operating cash flow. You know, as I said a few minutes ago, we--we do expect, you know, significant improvement in the inventory levels as we get through the back half of the year. And certainly, that increases the cash flow and gives you that optionality.

You know, we’ve--we've talked about share repurchase in the past. We did not repurchase any shares in the first quarter. You know, Bob, we repurchased about $62 million last year and--and returned $166 million to shareholders in--in '22 with a combination of share repo and--and dividends. Certainly, share repurchase remains an important option in our capital allocation model and--and we've got $62 million remaining under the share repurchase authorization.

So you know, we intend to use our share repurchase to offset dilution opportunistically while buying shares. But--but certainly, you know, looking at excess cash flows and market conditions, as well. Obviously, our priority is always going to be, as we think about capital allocation, first and foremost, opportunities to organically invest back into the brands, to continue to strengthen those and make sure that were driving that top-line growth.

So hopefully that gives you a little bit of a sense, Bob, about where some of that cash, potentially, can be deployed, you know, as we go forward. We also have, you know, options around debt repayment. Certainly, the dividend is a--is an important element of that capital allocation as well.

You know, your last question about sell-in versus sell-through, maybe I'll give you a data point that I think, you know, kind of helps dimensionalize it a little bit. And I'll talk about men's jeans, which clearly is our largest category, Bob. So when you look at NPD over the last three months for the total measured market around men's jeans, the market was down low-single digits. As you saw, you know, our U.S. wholesale business was--was up low-single digits.

But I'll talk a little bit about Wrangler specifically in that category because I think it's important. You know, the Wrangler POS, again, NPD data total measured market for men's jeans over the last three months, was up 19%. So that gives you a little bit of a data point about the strength of--of the brands and hopefully dimensionalizes a little bit about how POS is--is outpacing ships and--and outpacing the overall market as we continue to gain share. So hopefully that helps a little bit, Bob. Thanks for the questions. Appreciate it.

**Operator**
Thank you. Our next question comes from the line of Jim Duffy with Stifel. Please proceed with your questions.

**Peter McGoldrick**
Hi, good morning, this is Peter McGoldrick on for Jim. Thanks for taking our question. I--I was curious about the inventory at domestic wholesale. As--as you looking at the channel, the inventory, what visibility do you have to the inventory they have on hand? And given the higher rate of sell through, can you anticipate a return to strength in--in the U.S. market?

**Scott Baxter**
Yeah, I'll go ahead and--and take that one, Peter. So you know, as we think about retailer inventories, certainly in the back half of last year, I think pretty well chronicled, you know, about the rebalancing efforts that--that took place in the back half of last year, you know, as we think about the wholesale channel. Certainly, it's in a much healthier spot, I would say, than--than where it was middle part of last year. But with that being said, I think, you know, certain--certainly retailers are being cautious as they think about the outlook moving forward, and the open to buy dollars, you know, remain restricted.

So again, I think the inventory levels are and healthier spots, and that's why we focus a little bit more on the POS and how our--our brands are doing in terms of sell through, because certainly, over time, that supply and demand will find equilibrium, you know, as we move forward in the markets. So again, I think continuing to improve, but--but still a tight environment out there. So hopefully that answers your question, Peter. Thank you.

**Operator**

Thank you. Our next question comes from the line of Brooke Roach with Goldman Sachs. Please proceed with your question.

**Brooke Roach**
Good after--good morning, and thank you so much for taking our question. Scott, I was hoping that you could help us quantify the level of demand creation that you guys are embedding in your outlook as you lean into brand investments and marketing. And then, for Rustin, I was hoping that you could help us understand how the conversations that you're having with wholesale partners now versus a few months ago and--and what's really changed. And perhaps as you think about the second half, how are you thinking about your units versus price opportunity in the U.S. market? Thank you.

**Scott Baxter**
Brooke, I'll go ahead and start and then hand it over to Rustin. What we've done here is that, after having several years of experience and also bringing in, you know, Brigid and Holly, some true professionals that know how to run these categories in this business, we're actually spending a lot of time on the ROI. And what we've done is, in addition to what we have from a core standpoint, we're reallocating dollars to the higher opportunities from an ROI standpoint.

And having that data available to us now and looking at it differently, but also, in addition to that, just having different programs and doing different things that we can evaluate and look at and see how sticky it is and how the consumer is, you know, just answering our questions that we're asking and how they're carrying on a conversation with us. So for us it's really about an allocation to higher ROI and the things that bring the consumers in.

Rustin?

**Rustin Welton**
Yeah. And Brooke, good morning. Thanks for the question. You know, in terms of the wholesale partner conversations, you know, I would say that, you know, similar to the--our comments on the call here, you know, we certainly, in conversations with our partners, focused on the fact that the brands are resonating with consumers, that sell-through is--is really strong and the brands are gaining momentum and gaining share.

Certainly, I, you know, just mentioned that I think many wholesale partners are--are cautious about the back half outlook. And you've heard that--heard us reflect that as well in--in, you know, our outlook taking that into consideration in the back half with the US and--and certainly, you know, continuing to sort of work through that. But you know, I won't get into dimensionalizing units versus price assumptions, but again, keeping the brand strong, making sure that they resonate and offering a compelling value to consumers when they come on the floor, really important for us. Key--key piece of our strategy and we're going to continue to do that in the back half and make sure that the brands are strong by investing in demand creation. So thanks for the questions, Brooke

**Operator**
Thank you. Our next question comes from the line of Sam Poser with Williams Trading. Please proceed with your question.

**Sam Poser**
Good morning. Thank you for taking my questions. I have handful. Number one, could, you know, since there was some misunderstanding about how the gross margin was going to fall in the--in the first quarter, and could you give us a better direction for what's happening with, you know, how--how much the gross margin is going to be down? Are we looking at a 40% or--I mean, is it going to be down 200 bps in Q2? Are we looking at 600 bps in Q2? So that's number one. Just give us, and on the SG&A as well, give us some help here because there was some misunderstandings in Q1. And I hope there's not as many misunderstandings going forward.

Number two, on Target, the discussion that you had in the prior--in--in--to the prior question, was that involving Wrangler? And can you give us a status of both brands, Lee and Wrangler, at Target?

And thirdly, inventory levels in the third quarter should be in line with sales growth. So call that, you know, low to mid-single-digit sales growth in--in the quarter in Q3. That would put inventory, you know, above where it is today, even though it's not as much on a year-over-year basis. And it would mean that your four weeks of supply would be quite high. So what is the accurate, like, sort of inventory turn that you want and what should normalized inventories look like?

**Rustin Welton**
Sure. Good morning, Sam. It's Rustin I'll--I'll go ahead and start with the question on gross margin and then--and then flip over to Scott on Target and then come back on your inventory question. So you know, in Q1, our gross margin was down 180 basis points. We were down 200 basis points in the--in the fourth quarter, Sam, as you well know. And we talked about in that fourth quarter call that we expected higher inflation, geographic mix, and production downtime to be partially offset by strategic pricing and--and moderating transitory costs like air freight. So as I mentioned earlier, certainly came in line with our expectations.

You know, with shipments lagging POS, you know, the Q1 '23 inventory finished higher than expected. So--so we're really getting after taking action here in the second quarter, as we've talked a little bit about. And that includes, you know, incremental proactive actions and managing that internal production that's planned here in Q2. For, you know, based on those more elevated inventory levels, Sam, the highest cost goods are now expected to flow through the P&L in Q2. So we will be at peak inflation of what's flowing through the P&L.

You know, I'm not going to get into specific guidance around the gross margin number, but I will draw you to the fact, again, that we said we expect in Q2 that the greatest year-on-year gross margin pressure will come during the quarter because of those two factors. You know, certainly gives us confidence in holding the full year rate, though, because we're going to get greater efficiency in the back half because those production actions, as I indicated, are--are behind us. Certainly, peak inflation is easing significantly in Q3, Sam, before inflecting to a tailwind in Q4.

And then, certainly, then you layer in the geographic mix from China. That's going to further support that second half margins. With the greatest year-on-year gains, again expect gross margin gains in both Q3 and Q4, but the greatest year-on-year gross margin gains in that fourth quarter. Scott, you want to take the Target piece?

**Scott Baxter**
Yeah. Hey, Sam. Just a quick comment on your--your question on Target. Lee has not and is not in Target. So there haven't been there. So hopefully that answers your question. Rustin from an inventory standpoint?

**Rustin Welton**
Yeah. So on--on the inventory side, and Sam you know this from this business, typically we build inventory in the first three quarters in preparation for holiday. And then, certainly, you see a big decrease in the fourth quarter as you think about kind of how the inventory flows through the year. So certainly, to your point, you know, inventory and--and building for--for that holiday season will continue out there.

As we said, we do expect at the end of--of Q3 to have that inventory growth to be in line with revenue growth. And then, certainly in that fourth quarter, as you normally would with ours--our cadence of our--our inventory, to see further reductions from there. So again, some significant opportunities to generate cash in the back half of the year, Sam, with some of the actions that we're taking here. So thanks for the question. Appreciate it, Sam.

**Operator**
Thank you. That is all the time, we have for questions today. I would now like to turn the call back over to Scott Baxter for any closing remarks.

**Scott Baxter**
So folks, just a quick couple of comments. First, I wanted to thank everyone that participated on the call today. We here at Kontoor Brands certainly appreciate all the support that you gave us each and every day. So thank you very much and we look forward to our call again in a few--few short months. But I did also want to mention that I know we ran a bit long today, so I'm sorry if we didn't get to everyone's questions, but please follow up with Eric and Rustin, as you usually do. So again, sorry, that we ran a bit long.

And then, just one quick note to--to finish today, and that is that you saw in our prepared remarks where I mentioned that we would be have an Investor Day coming up, so please watch for those details in the next few months and we'll let you know. But we'll look forward to that, too. So thanks, everyone. Thanks for your participation. Have a great rest of your day.

**Operator**

Thank you. This does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.