



## Kontoor Brands' Second Quarter 2020 Earnings Conference Call Transcript

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### Corporate Participants:

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### Eric Tracy

Good morning, everyone, and welcome to Kontoor Brands' Second Quarter 2020 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 read our risk factors, cautionary language, and other disclosures contained in those reports.

Amounts referred to on today's call will also be on an adjusted dollar basis, which we clearly define in the news release that was issued earlier this morning. Adjusted amounts exclude the impact of restructuring and separation costs, changes in our business model, and other adjustments. Reconciliations of GAAP measures to adjusted amounts can be found in the supplemental financial tables included in today's news release, which is available on our website at [kontoorbrands.com](http://kontoorbrands.com). These tables identify and quantify excluded items, and provide management's view of why this information is useful to investors.

Unless otherwise noted, amounts referred to on this call will be in constant currency, which exclude the translation impacts of changes in foreign currency exchange rates. Constant currency amounts are intended to help investors better understand the underlying operational performance of our business, excluding the impacts of shifts in currency exchange rates over the period. Joining me on today's call are Kontoor Brands' President and Chief Executive Officer, Scott Baxter, and Chief Financial Officer Rustin Welton. Following our prepared remarks, we will open the call for questions. We anticipate the call will last about an hour. With that, I turn it over to CEO Scott Baxter.

### Scott Baxter

Thank you, Eric. Good morning, everyone. Thanks for joining us. We will go through our second quarter results in a bit, but before that, I'd like to share my thoughts on a few key areas. First, I'd like to provide context around the current environment and how we continue to navigate through the COVID-19 pandemic. Next, I'll talk to how the strategies implemented at the spin are driving the decisive actions we've taken and are supporting improvements across our business, despite the impacts of COVID.

The investments we are making in key growth enablers, quality of sales, digital transformation, international expansion with a focus on China, new business development, innovation and sustainability, and ROI demand creation are helping to strengthen our core and support enhanced growth in the future. And finally, I'll share insights as to why we believe our model is well-positioned to win the marketplace even as we expect an uncertain operating environment to continue.

But before I begin, I want to thank our employees around the world for their extraordinary efforts. I am extremely proud of the resilience and perseverance they have demonstrated through this challenging time. Our priority remains the health and safety of our colleagues. While most of all our retail stores are now open across the globe, we continue to employ social distancing and work remote protocols where appropriate across our offices, facilities, and distribution centers.

So let me start by providing some thoughts on how the COVID pandemic has impacted our business. As we expected, the impacts from COVID weighed on our second quarter results, as stay-at-home orders and retail door closures across the world pressured consumer demand. We said in our first quarter call that we were seeing signs of improvement, principally in China and the US in late April and early May. We were encouraged to see these trends accelerate as we moved through the second quarter, with easing of restrictions and door openings supportive of improving traffic and sell-through.

In Asia, at the peak of the crisis, approximately 90% of our owned and partner stores were closed. Currently, the China recovery continues to gradually build momentum led by the digital channel, and all brick-and-mortar stores are open. We are encouraged by the momentum we have seen broadly in China, especially in our digital business, increasing 24% in the quarter. In Europe, significant demand declines weighed most heavily on this region during the second quarter. Our distribution network remains operational for digital and wholesale orders, and while stores in the region have started to reopen, traffic remains inconsistent. In North America, early signs of improving consumer demand began in late April and early May, and strengthened as the second quarter progressed, with a combination of additional retailer door openings and improving traffic, as POS significantly outpaced shipments during the quarter.

While no one at Kontoor is satisfied with our second quarter results, given the unprecedented environment, I am extremely pleased with our level of execution of the strategies we put in place 15 months ago at the spin. These actions were further amplified during the second quarter, and we anticipate will lead to sequential improvement through the second half of 2020.

Over the last year and a half, we've talked about how investing and nurturing these two iconic brands would take time, and how sequencing matters. Investments in people, culture, processes, and globalizing our organization; the benefits will manifest over time. But as you've

seen over the last few quarters, despite the challenging landscape, these strategic investments are beginning to drive green shoots of operational improvement as we seek to evolve our model. When you consider we began on the starting line as a new company, I could not be more proud of the organization and the progress we have made. And while I am really encouraged by these early successes, I am even more excited about what the future holds for Kontoor, as we are just in the beginning stages of this journey.

So let me discuss where we are focusing our efforts to accelerate fundamental performance and unlock value creation for all stakeholders. We've talked about Horizon One, were the first 12 to 18 months' post-spin. Being a period of optimization as we set the foundation for long-term success, we told you our focus would be on quality of sales, enhancing gross margin, and using our strong cash flow generation to aggressively de-lever our balance sheet, all through our TSR lens.

Despite one of the most difficult consumer environments in history, we've made tremendous progress on many of these strategic efforts. Rustin will provide more insight with respect to margins and capital allocation, but I'd like to share my thoughts with respect to the top line, including solid proof points of how our strategies are paying off, as well as how we expect to accelerate more profitable and sustainable revenue growth in the future.

As a reminder, our focus has been centered on four key growth areas. First, strengthening our core by winning with winning retailers and optimizing distribution, investing in quality sales, innovation, sustainability, and demand creation, and leveraging our world-class integrated supply chain. Second, restoring growth to D2C and becoming a digital first consumer-led organization. Third, expanding internationally with a laser focus on China. And fourth, broadening categories beyond denim, capturing meaningful opportunities across outdoor and t-shirts.

So let me start with the core. While the COVID pandemic has had significant impacts on both the Wrangler and Lee US wholesale businesses, we were encouraged by how each experienced strengthening sell-through as the second quarter progressed. Additionally, beyond the impacts of COVID, we also experienced a timing shift that had a negative impact on Q2 Wrangler revenue that will benefit the third quarter. Our continued optimization within the wholesale channel is a major distinction from many of our competitors, with three of our four largest retail partners: Walmart, Target, and Amazon remaining open throughout the pandemic, while Kohl's reopened doors during the quarter.

We have made tremendous strides in our quality of sales efforts domestically, and our exposure to challenged retailers in channels is very limited. Given our assumption that the US will experience a prolonged COVID operating environment, we are really well-positioned with these key, best-in-class retailers. And how do we expect to not only strengthen this core position, but grow it? By continuing to invest in key enablers such as innovation, sustainability, and demand creation. From an innovation perspective, during the second quarter, we

continued to scale technology platforms like never before, with Body Optics and MVP for Lee, and ATG and Rooted for Wrangler, we are scaling innovation both vertically, up and down the pricing spectrum, and horizontally, across various product categories, to more effectively capture consumer mind and wallet share.

And I want to take a moment to highlight our work on sustainability. Similar to our innovation pipeline, Kontoor's efforts around sustainability is a key pillar to becoming a consumer-led organization, and we intend to be more active from a sustainability perspective going forward. Our Indigoood and Rooted collections already provide solid proof points, and we will be accelerating investments across key wastewater dyeing processes, materials, energy, and climate initiatives to further scale our sustainability platform in the years to come. And we were excited to announce today that we will be publishing Kontoor's Sustainability Goals Report during the third quarter, and we look forward to sharing more detail with you at that time.

Beyond innovation and sustainability, we are also investing in demand creation efforts to strengthen our core. We will be a consumer-led organization, and staying engaged with our consumer during the COVID pandemic has been critical as we focus our efforts on high ROI marketing areas. During the second quarter, our teams did an amazing job of creating tone-right campaigns that connected with our consumer in empathetic yet powerful ways. For Wrangler, we continued our successful long-lived Cowboys campaign and Can't Stop Music Country series, driving enhanced consumer connection during the COVID crisis.

We also introduced new collaborations with musical artists such as Diplo, partnering for the release of his highly-anticipated country album. And in honor of what we have been--in honor of what would have been Bob Marley's 75th birthday, we recently announced a partnership with the Marley family to launch a limited edition collection with heavy reggae influences and revival of Marley's favorite Wrangler styles. These are just a few of the initiatives that are allowing the Wrangler brand to reach younger and more diverse consumers.

The demand creation investments in digital and social are fueling the strong growth we saw in US wrangler.com during the quarter, and enhance our core positioning with key retailers. These initiatives also support new distribution opportunities, including our Wrangler by Fred Segal collaboration that we will be launching at Nordstrom's this fall, both in store and on digital platforms.

And with Lee, we drove incremental demand creation spend in the second quarter in support of our upcoming launch in over 2,000 doors with Walmart this fall. In China, we leveraged live streaming events with two premier online influencers in the region: Vaya (SP) and Austin. With our event with Vaya, we sold 4,000 women's shorts in 25 seconds. And with our event with Austin, we sold 8,000 pairs of jeans in 30 minutes. We remain excited about the direction the brand is headed in the second half of 2020 and beyond.

And last, with respect to strengthening our core, we continued to leverage our own manufacturing here in the Western hemisphere to service our large customers with scale and speed, further driving competitive separation within the market. Our advanced manufacturing capabilities allowed us to aggressively align production with demand. And with inventory levels down 20% in the quarter, we are well-positioned for the second half of 2020, and even more importantly, for 2021. We believe this has been and will continue to be a distinct advantage relative to much of our competition in the marketplace.

Beyond strengthening our core, we continue to embark on the company's digital transformation. With new leadership now in place, we are enhancing our total digital ecosystem from owned dot com to digital wholesale, to retailer dot com. And while still in the early stages, the second quarter provides solid evidence that our investments are paying off. During the second quarter, US-owned dot com grew 48%, with wrangler.com increasing 62%, and lee.com increasing 22%, while digital wholesale grew 36%.

We also went live with our US and European digital platforms during the quarter. Consumer behavior was already rapidly migrating to digital, and we believe this adoption has only accelerated during the COVID pandemic, as new users become increasingly comfortable with buying online. And our categories, in particular, are ideally suited to this new environment. This is creating massive new opportunities to evolve our digital capabilities, from interactive livestream platforms, to growing social channels. In developing this new digital ecosystem, the consumer must be at the center of everything we do.

Benefits will accelerate over time, but we will leverage our growing data analytics capabilities, and unlock value from our new global ERP infrastructure to ensure Kontoor is a consumer-led, digital-first organization. While we are under-indexed with digital currently, we are aggressively investing in support of this accretive growth opportunity, and we intend to leverage improved systems, processes, and capabilities to drive significantly greater digital penetration over time. From a geographic perspective, we continue to augment our core US business by accelerating international growth, with a sharp focus on China.

As I stated earlier, the recovery in the China region continues to gradually stabilize. While China declined in the second quarter, it's sequentially improved from the first quarter and by month in Q2. But beyond the near-term quarterly results, our distorted investments in China are creating significant opportunities for both of our brands. We are confident that we will extend our leadership position with the Lee brand, utilizing key regional influencers that we discussed earlier, and new collaborations such as our recent partnership with Coca-Cola to drive further brand heat in the region.

We have more than 25 years in the market, but the Lee brand is just getting started, with deeper penetration in existing markets and significant runway in extending its reach to tier three and four cities. And we will leverage this tremendous experience for the region to launch the Wrangler brand in China. While we chose to delay the launch in light of COVID, we are

ready to go, and we will be executing a soft launch this fall, and a more robust, full launch planned for spring '21 to most effectively optimize the consumer environment. We expect the business will take time to scale, but the long-term white space opportunity remains tremendous.

And last but certainly not least, our ability to extend these brands in traditional categories beyond core denim is enormous. We see two primary areas of focus: outdoor and t-shirts. Within outdoor, our Wrangler All-Terrain Gear line, or ATG, has had incredible early success, a natural extension for the Wrangler brand. ATG affords the customer high quality performance product at an exceptional value. The nearly \$30-billion-dollar global outdoor market is poised to accelerate in a post-COVID world, and we intend to leverage this brand right opportunity.

During the first half of 2020, ATG experienced up to triple-digit year-over-year growth with our key retail partners, a great proof point for the early traction the line has garnered. And with key new international distributions set for the second half of 2020, including presence in over 400 Dressmann stores in the fall, and opportunities in the outdoor specialty and sporting good channels. The future is bright for ATG and Kontoor's evolving outdoor platform.

With respect to t-shirts, as we have previously discussed, the addressable market for Kontoor is significant, and we intend to increase investments to capture share. For the first time, we recently hired a category leader to focus on this important opportunity. We are adding design and marketing talent, and defining our go-to-market strategies. From logo, to lifestyle, to license, these afford us the ideal organic extension for our brands. Expect to hear more on this opportunity in the coming quarters.

But how did these strategies come together in support of our rapidly evolving model? Investments in new business development, innovation, sustainability, and demand creation active enablers to not only strengthen our core positioning, but accelerate growth across category, channels, and geographies. And while we continue to expect a prolonged COVID operating environment, these strategic decisions, looked at through our TSR lens, will position us for more sustainable and profitable growth. Combined with our underlying structural margin expansion and robust cash flow generation that fuels optimizing our capital structure, we as a leadership team remain as excited as ever about the incredible opportunities ahead. With that, I turn it over to Rustin.

### **Rustin Welton**

Thank you, Scott, and good morning, everyone. I will discuss our second quarter results in a moment, but I'd like to begin by addressing a few key topics I know are on your minds. Specifically, I will provide an update on Q2 trends and the current operating environment, our balance sheet, strong cash flow, and debt repayment, and finally, how our key strategic initiatives are driving improved fundamentals even given the challenging landscape.



On our Q1 earnings call, we shared that we had begun to see early signs in late April and early May of strengthening wholesale order patterns and digital trends. As we moved through the second quarter, we saw a sequential monthly improvement in our global business. Our strategy of winning with winners and accelerating digital as levers to differentiate performance we evident in the quarter, led by the 48% growth in US owned dot com.

Next, we were able to strengthen our balance sheet during the quarter by driving improved working capital performance. Cash generation is the cornerstone of our operating model and capital allocation strategy for Kontoor. Accordingly, as the primary lever to influence cash generation, inventory has been and remains a critical component of our working capital focus.

Post-spin, we began a journey utilizing a TSR-driven approach to driven improvement by focusing on quality of sales initiatives, business model changes, and exiting select, non-strategic lines of business and points of distribution. In the back half of 2019, our net inventory decreased \$80 million, or 15%. In 2020, our plans focused on continuing to drive incremental inventory improvement. As liquidity became paramount for all companies with the acceleration of COVID, our vertically-integrated manufacturing allowed us to right size production in light of decreased demand, avoid creation of excess inventory, and minimize cash flow impacts.

Accordingly, our first half 2020 inventory levels decreased \$25 million, or an additional five percent, and are exiting the second quarter at the lowest levels since 2015. So, in light of our progress to date and volatile operating environment, how are we thinking about inventory and service in the back half of 2020? We want to be thoughtful and prudent regarding inventory by ensuring close alignment with our trade partners on expected demand. Our owned manufacturing provides a distinct competitive advantage. As conditions warrant and government restrictions and capacity permit, we were able to respond to changing demand to scale production and minimize service issues for our partners.

While we are actively managing to optimize the supply/demand balance and are pleased with our performance to date, we believe there are additional opportunities to reduce inventory levels, all while supporting the marketplace and new program wins. And as a result of these inventory and other working capital actions, I am pleased to say we made an additional discretionary payment of 75 million on the revolver in the quarter due to our strengthening cash generation and liquidity.

This payment was in addition to paying down 175 million on our revolver in May in connection with the closing of our amended credit facility. As we have also discussed, our model is differentiated, among other things, by its durable and consistent cash flow generation. This consistency was clearly demonstrated in the second quarter as we drove positive free cash flow, positive operating cash flow, and improved liquidity despite the challenging macro headwinds.

And finally, I will spend a few moments discussing the progress we have made transforming our business for future profitable growth, amplifying cost saves, and supporting our global ERP initiative, and other key growth platforms such as digital. Let me share a few examples. As we discussed last quarter, we have both engaged associates around the world to rethink business processes, while also challenging all operating expenses, from travel to outside services. These proactive measures drove a significant reduction in SG&A expense in the quarter, something I will touch on momentarily. Furthermore, we are continuously evaluating areas of the business to better align with our TSR-driven approach, including the VFO platform, for example. With the move of the headquarters we previously announced, we will seek to optimize the business near-term through select rationalization and reformatting of underperforming doors.

We also continue to invest in our global information technology initiatives. During the quarter, we launched our new ecomm platform in both Europe and the US, which were key contributors to the strong digital growth Scott discussed earlier. In addition, we are pleased to report that the first phase of our new ERP platform and infrastructure recently went live in Asia, marking our first region to be implemented. We are excited for the unlocks these investments will afford, and are eager to share additional gains and efficiency improvements in 2021 and beyond.

Finally, during the quarter, we moved all of our European distribution to a 3PL, consistent with our plans since the spin, under our transition service agreement. We continue to make progress against our key strategic pillars, which are providing solid proof points that we are executing against the right priorities, as evidenced by our second quarter results.

So let's get to our second quarter review. Global revenue decreased 42% on a reported and constant currency basis in the second quarter, compared with attested revenues for the same quarter in 2019. Revenue declines during the quarter were primarily the result of widespread impacts of COVID. Retail and owned door closures and stay-at-home orders, as well as a timing shift of shipments from the second to the third quarter within the Wrangler business, which I will touch on in a bit. On our last few calls, we have talked about our ongoing quality of sales actions that began in 2019, as well as planned declines in select dilutive lines of business. While this continues to negatively impact near-term revenue, these actions will continue to drive transformational change to improve operational performance and position us for long-term profitable growth.

On a regional basis for the quarter, US revenues were down 40%, compared with adjusted revenues for the same quarter in 2019. Declines were primarily the result of COVID impacts partially offset by digital wholesale increasing 36%. The US represented 83% of our revenue in the quarter. Outside of the US, international revenues declined 47% in constant currency, compared with adjusted revenues for the same quarter in 2019. Beyond COVID impacts, the second quarter international decline was affected by planned exits and business model changes, quality of sales actions, and foreign currency, which combined pressured international revenue by mid-single-digits.



Turning to our channels. Our reported revenue in our US wholesale channel, which represented 72% of our revenue, was down 39%, compared with adjusted revenues for the same quarter in 2019. Declines were driven primarily by the impacts of COVID. Our non-US wholesale channel, which represented 13% of our revenue, decreased 52% compared with adjusted revenues for the same quarter in 2019. Our branded direct-to-consumer channel, which represented 12% of our revenues declined 31%, due in large part to owned brick-and-mortar door closures. Our owned digital business increased 36%, driven by 48% growth in the US, and 24% growth in China. We are encouraged by the positive results from our recent investment in our digital platform. Given the accretive, under-indexed nature of this channel, we will continue to distort investments to grow in this area.

Finally, let's turn to our brands. Global revenue of our Wrangler brand declined 30% on a reported and constant currency basis, compared with adjusted revenues for the same quarter in 2019. Wrangler US revenue declined 27% in the period. Impacts from COVID, including retail and owned store closures, drove the majority of the decline. An approximately \$33-million-dollar shift in timing of all load-ins from Q2 to Q3 2020 also adversely impacted the quarter. These declines were mitigated in part by strong growth in both owned and wholesale digital.

Wrangler International revenue was down 54%, compared with adjusted revenue in the same period last year, driven by COVID impacts, the actions taken in India, and business model changes in Europe. Lee brand global revenue declined 57%, compared with adjusted revenues for the same quarter in 2019. Lee US revenue decreased 66% in the period. COVID-related impacts drove the majority of the decline.

Beyond COVID, we remain encouraged by the underlying progress of the Lee US business, including the upcoming significant program win set for the second half. Lee International revenue was down 45% on a reported basis, compared with adjusted revenues in the second quarter of 2019. Over one-third of the decline was driven by the EMEA region, as many countries were under lockdown during much of the quarter.

Now onto gross margin. Total adjusted gross margin decreased 160 basis points to 38.4%. The decline was primarily driven by the following factors. First, the cost of downtime in our plants as we reduced production to align supply and demand, taken with inventory reserves, netted to a 450-basis-point headwind in the quarter. Next, lower international revenue also adversely impacted geographic mix by 60 basis points. These declines were mitigated by the underlying benefit of accretive mix shifts and proactive measures we have discussed as an important part of our business model and TSR drivers.

During the second quarter, the favorable impact of channel mix, quality of sales initiatives, pricing, and product cost improvements positively impacted gross margin by 350 basis points. Adjusted SG&A decreased \$38 million on a year-over-year basis to 129 million, or 36.8% of revenue. Fixed cost deleverage due to revenue declines and credit losses due to COVID were

partially offset by tight expense controls mentioned previously, and restructuring benefits. We delivered an adjusted loss per share of 22 cents in the second quarter.

Now turning to our balance sheet and cash flow. As we've discussed since the spin, the compelling, durable, and consistent free cash flow strength is foundational to our operating model. Despite an operating loss driven by COVID impacts and continued investment in our strategic ERP and IT infrastructure, cash from operations and free cash flow were both positive in the quarter. Working capital improvements were driven by inventory, which declined 56 million or 11% from Q1, and 105 million or 20% versus the prior year. We finished Q1 with 479 million in cash, and debt of just under 1.4 billion. At the closing of the amended credit facility in May, we repaid \$175 million of our revolving credit facility balances to comply with the available cash limitation.

In June, we made an additional discretionary repayment of 75 million on our revolver due to our positive cash flows and improved liquidity position. At the end of Q2, we finished with 256 million in cash, and debt of just over 1.1 billion. There are no material debt repayments required over the next 12 months. Our overall liquidity improved in the quarter, and our leverage ratio, per the credit facility calculation for the quarter, was three and a half times, compared to our original limit of four times, and the amended limit of five and a half times.

And now, onto our outlook. As we previously announced, and as a result of the uncertainty and significant business impacts caused by COVID, we withdrew our 2020 guidance provided on our Fourth Quarter Call in March, and we have not provided an updated outlook at this time. While we're not providing formal guidance, additional perspective and assumptions related to our second half are as follows. First, we continue to take the necessary proactive steps to accommodate a prolonged COVID operating environment.

Second, revenue in the second half of 2020 should experience sequential year-over-year improvement, and is expected to benefit from new programs and distribution gains as well as the timing shift of shipments. Third, we anticipate structural gross margin gains from restructuring and quality of sales actions to continue in the second half of 2020, in spite of more difficult year-over-year comparisons on realized gains during the similar period in 2019.

And finally, inventory remains a critical component of our working capital focus, and we expect levels to continue to improve in the second half of the year. Inventory is expected to be well-positioned to support new program wins and demand in the marketplace. In closing, I want to reinforce our confidence in the proactive actions we have taken to improve our long-term operating performance that began in 2019.

Despite the challenges of the current operating environment, we generated positive free cash flow, further de-leveraged the balance sheet, managed down inventory, all while investing behind key strategic initiatives. These strategies are clearly proving the right actions in this

current environment, and will best position Kontoor for continued success. This concludes our prepared remarks, and I will now turn the call back to our operator. Operator?

## **Question and Answer Session**

### **Erinn Murphy**

Great, thanks. Good morning, and thank you for taking my question. I guess my first question is for Scott, but maybe Rustin, you can weigh in. You know, you talked about strengthening trends throughout the quarter, with POS now outpacing shipments. Are you in a position that you're chasing this demand now? And then just curious, maybe for Rustin, how is this fitting into your commentary when you reference the sequential year-on-year improvement in the back half? And then I have a follow-up.

### **Scott Baxter**

Sure. So Erinn, this is Scott. Good morning, thanks for joining today, and I'll start. You know, we did see really nice improvement, as we mentioned, both Rustin and I, in the second quarter, so we were pleased with that. And one of the things that we've talked a lot about, and you've heard me talk about it, is that we're under distributed here in the United States specially, from a brand standpoint, both brands. And these big wins that we've had that we shared last time, and we actually added a little bit more color, you know, over 2,000 doors with Lee, both male and female, which is the key component, both men's and women's--denim in men's and women's casuals for the fall.

And then in addition to that, we have some additional programs next year in spring of '21 with those two programs. And then the Dressmann's program with ATG, really bringing ATG to Europe in a pretty big way. We think with that--and you know, also, the fact that we've really done a nice job as far as our strategy about winning with the winners and who we do business with. And then we talked a lot about at the beginning how we've cleaned up this quality of sales initiative. You couple those things together, and we feel like, you know, there's going to be sequential improvement going into the second half of the year. Rustin, anything to add to that?

### **Rustin Welton**

No, I think the only the other thing I would add is sort of the timing shift, Erinn, that certainly is material. You saw that it was 33 million in the quarter, that is in the Wrangler US business, so just a little bit of context and perspective there. Wrangler US in the quarter was down 27%, so, had those timing shifts, you know, occurred as originally--or has historically taken place, you know, the Wrangler business would've been down about 16% in the US. So, a pretty material impact, and obviously that will move to the third quarter. And you may recall, Erinn, we talked about that on our fourth quarter call as a timing shift that we were expecting moving from Q2 to Q3, and so that's what we were referencing.

**Erinn Murphy**

Okay. Thank you. And you kind of answered part of my second question, so maybe if I could just ask, on the US landscape broadly in the second half, can you just speak a little bit more about what you're seeing in the channel, and how you're seeing promotions? Like from our perspective it does seem like there's very lean inventory in mass channel for some of your brands and even some of your peers. So just curious on your expectations broadly for the landscape. Thank you so much.

**Scott Baxter**

Yeah. So Erinn, I'll go ahead and start, this is Scott. We feel pretty good about the second half, like we've said, from a sequential improvement standpoint. Our inventories are in tremendous shape. You know, we're really clean, specifically in the mass channel also, so we feel really good about that. We're probably going to chase a little bit in back to school, and we actually think that's a good place to be.

But I'll tell you why we think that's a really good place to be, is--and we've talked about this a lot, and it's a real strategic advantage that really got to flex its muscle during this time, and that's owning our own distribution, about a third of our own manufacturing facilities. We're going to really go ahead and manage that here, the rest of the year, owning those, and relative to what the supply and demand is. So we feel like we're in a real enviable position, having that right here, in the North American market. Rustin?

**Rustin Welton**

Yeah, I would just say from our inventory position, Erinn, you talked a little bit about that. You know, I would say that this journey really started at the time of the spin. And you know, we really started focusing on quality of sales and the business model changes, and really exiting some of the non-strategic lines of the business, all through a TSR lens. And so in the back half of last year, we drove an \$80-million-dollar improvement, or about 15%.

You know, as we came into this year, inventory remained a really important focus for us. And in the first half of the year, we drove about a \$25-million-dollar improvement, or an additional five percent. Just for perspective, in 2019 our first-half inventory actually increased \$50 million. So, we are certainly focused on inventory, aligning the supply and demand signals that we're getting from our retail partners, as Scott mentioned, and making sure that we can service the market. And so we feel good about where we're positioned from an inventory perspective, and our ability to service those new program wins, and the marketplace demand in the back half.

**Erinn Murphy**

Great, thank you.

**Scott Baxter**

Thanks, Erinn.

**Operator**

The next question comes from the line of Bob Drbul with Guggenheim. Please proceed with your question.

**Bob Drbul**

Hi guys, good morning.

**Scott Baxter**

Good morning, Bob.

**Rustin Welton**

Good morning.

**Bob Drbul**

A couple questions, actually. I think the first one, can you elaborate a little bit more in terms of where you are--like, you know, you mentioned the ERP implementation, but just sort of, you know, what are the milestones, and sort of, you know, where you are and what we should be looking for? And the second question is, you know, you talked about minimal exposure to challenged retailers, can you just talk a little bit about like doors that you were selling last year, just sort of, you know, that are closed? How many doors like that are closed, and sort of, do you see any risk in the doors that you're continuing on the challenged retail side? Thank you.

**Rustin Welton**

Yep. Thanks, Bob. I'll go ahead and start on the ERP implementation. You know, certainly it was--it's been a big series of activities for us over the past hundred days or so as it relates to the implementation. Certainly, as you know, we began the ERP project at about the time of the spin, and there's been significant work ongoing on that. Obviously as we moved into 2020, with the advent of COVID and working remotely, some additional challenges, you know, certainly as we prepared for the second quarter activity. But couldn't be more proud of the team and how they have worked together, you know, heavily relying upon collaboration tools. You know, during the quarter we did have some significant milestones that were out there from an ERP perspective.

And so, you know, Scott talked a little bit about in his prepared remarks going live on both a new ecomm platform for EMEA and the US in the second quarter. We also shifted over our production--our distribution, I should say, in Europe to a 3PL. And then just recently went live with our first region on the new ERP and infrastructure platform in Asia. And so, in terms of the timeline, you talked a little bit about that. We still have--are making great progress and we still have the US and Europe in front of us. And--but that's the last region--Asia's the last region we have planned for this year. So, hopefully that gives you a little bit of color--more color on the ERP side. Scott, you want to weigh in on the exposure to challenged retailers?

**Scott Baxter**

Yeah, so Bob, when we think about it, we really think about going back to our Horizon One and our strategy, and how we thought about how we wanted to set this business up for success. And we took a hard look at the marketplace globally and said, where do we want to align, and who do we want to align with? And we chose some certain folks to make big investments with, and they are really paying off now.

So, one of the things that we've talked a lot about is that our four largest customers represent about 50% of our business. So if you think about Walmart, Target, Amazon, and Kohl's, we feel really good about how we think about that from a win with winners, and are positioned really well going forward. And then if you think about, you know, department stores, and we've talked about this, we've just always had very limited distribution there, and now we have even more limited distribution there unlike our competition. So for us, that puts us in a really good--you know, a really good position as far as going forward.

And I think the other thing is, from the very beginning, we've talked a lot about the fact that we were going to amplify our digital. And we have spent an incredible amount of time and energy and investment on doing that and it's starting to show. You know, both Rustin and I talked a lot about how that's kind of started to really pay its benefits back to the organization, but we think there's a long way to go. And we've hired a new leader that's doing a terrific job, and we're making investments in that business. So, a combination of those things, we think, puts us in a really good spot, and--as far as going forward.

**Bob Drbul**

Great. Thanks, guys.

**Scott Baxter**

Thanks, Bob.

**Rustin Welton**

Thanks, Bob.

**Operator**

The next question comes from the line of Alexandra Walvis with Goldman Sachs. Please proceed with your question.

**Alexandra Walvis**

Good morning, everyone. Thanks so much for taking the question; I've got two questions. The first question is, I'm wondering if you could share any thoughts on the structural changes, which could result from the COVID pandemic as it relates to your business and as it moves to the broader market. You know, I'm particularly interested in how the wholesale model evolves, and how wholesale partners will approach holding inventory and saving receipts in the future, and how you're positioned for that? And then I've got a follow-up question.

**Rustin Welton**

Okay. Thanks, Alex. Good morning, it's Rustin. I'll start with the first piece about some of the structural changes that we're seeing a little bit internally, and then ask Scott to weigh in about-- a little bit more on the wholesale market dynamics that we're seeing. But certainly I think, as we think about structural changes with COVID, we've talked a little bit about, you know, we've taken a step back and really examined all of our expenditures in the business, and you know, how we work together. So last quarter we talked a little bit more, you know, just even about doing kind of virtual design work, and certainly virtual sales meetings. So, we're seeing some changes from a structural side that we're certainly looking at. We did take a number of temporary actions to--you know, furloughs and salary reductions, to manage through this year.

But certainly we're looking at, you know, how we would spend those dollars moving forward. Scott's mentioned quite a bit about the focus on digital, you know, and many of the investments in those strategies we really had in place at the time of the spin. You know, certainly we're trying to distort and amplify now. We're early in that journey, but it is--we are taking fresh looks as result of COVID about how much we're spending and where we're spending our dollars to make sure that we're prudent there. So, Scott, maybe you want to weigh in on the market side?

**Scott Baxter**

Yeah. You know, from a strategic standpoint, Alex, I think this is one of the areas where we have really benefited. And we had a vantage point from the very beginning, taking a business that was kind of disparate all over the world, doing their own separate things, making their own product, having their own offices and all that. And we brought it all together. And we're in the process right now, and it's happening very quickly, of globalizing this company, and doing that in many different ways.

So whether it's Rustin speaking about the ERP, or Tom and Chris and how they're bringing the global product teams together across the world, but that structurally is really important to us going forward. And then as you compliment that with how we think about digital, and how we're thinking about, you know, a headquarter office where we brought Lee here, and we've brought the team together, and we've talked a lot about that. You know, I can't say enough about how much that's benefitted us as an organization. Actually, we were way down that path, and only now we just continue to accelerate. So for us, it's actually been a real push and a good one.

**Alexandra Walvis**

Awesome. And then my second question is on cash generation. So I'm wondering if you can share any color on the way you're forecasting cash generation for the year? It exceeded expectations in this quarter, and used that to make an incremental discretionary debt pay down. Can you talk about, you know, how--you know, where you're forecasting for the year, and how you're thinking about paying--the pace of debt pay down?

**Rustin Welton**

Yeah. Thanks, Alex. It's Rustin, I'll take that. So, you know, as we've talked many times since the spin, you know, cash generation is of paramount importance to our investment thesis. And just really, frankly, our operating model. So, we've maintained focus upon cash generation since the spin. And as I talked a little bit earlier about some of the inventory trends that we saw late last year with the \$80-million-dollar improvement in the back half, you know, continuing to accelerate that, certainly in light of COVID and liquidity as we moved into Q2.

So, you know, as we think about the back half of the year, certainly I'm not going to guide specifically on cash generation, but we did call out that we do have line of sight to continue inventory improvement that is out there in the back half, so we do see additional improvement. We're pleased with the progress we've made so far, but that is the single largest lever from a working capital perspective we can pull, in terms of cash generation. So, it continues to be a focal point for us, and we see additional opportunities to continue to improve in the back half.

**Alexandra Walvis**

Fantastic. Thanks so much for all the color.

**Rustin Welton**

Thanks, Alex.

**Operator**

The next question comes from the line of Sam Poser with Susquehanna. Please proceed with your question.

**Sam Poser**

Thank you for taking my question. Hope everyone's well, and I've got a handful. Let's start with--I'm just going to ask them, and then we can deal with them. The dividend--what is the status of your plans for the dividend? And I'll follow-up on that if I need to. What are--is there--are you expecting the sales to be positive in the third quarter given the Wrangler--that trip to the 33 million plus the Walmart Lee order? And can you give us some ideas of size of that Walmart order?

And the same things too on the gross margin, given that things are starting to get cleaned up. So, like sort of on a non--like on a comp basis without those new businesses, I assume. you're expecting some improvement in the trends. And then you add those new businesses in, you know, where does that leave you? I know you don't want to give specific guidance, but these are two, you know, large orders, I would guess.

**Scott Baxter**

Okay. Well Sam, why don't I go ahead and start with the dividend, and then Rustin will go ahead and take it from there, for the next two. So, as we stated in the release, we want to reinstate the dividend as soon as appropriate. Obviously we here as a team, it's been part of our



investment thesis; we absolutely understand how important it is. Just to remind everybody, we suspended for the second and third quarter of '20. And we can make, you know, payments as long as certain criteria is met after the third quarter, and we know how important it is to the story.

And I hope everybody here knows how important it is to our board and to all of our shareholders, so we take it very serious. There are a lot of things that go into that decision, as we work with our board to go ahead and reinstate. We're going to go ahead and comment on that in the next quarter, of course, and bring everybody up to speed. We're not going to go into any specifics at this time, but again, we know absolutely how important it is, we will go ahead and comment in the next quarter on it, and bring everybody up to speed. Rustin, you want to go ahead and talk about the sales?

**Rustin Welton**

Morning, Sam. I'll go ahead and take your next two questions. Obviously as we stated, we're not going to guide on the back half, but we did talk on the revenue side about seeing sequential improvement in the second half. And that's certainly, you know, the timing shift of the \$33 million that we talked about and the new distribution gains, specifically the Walmart program with Lee, which we won't dimensionalized, but you do know it's over 2,000 doors, you know, just to give you a little bit of perspective, will help. You know, and that's where we're seeing some of that sequential improvement.

But, I will stress, Sam, that we continue to assume a prolonged operating environment, and we stated that last quarter. We continue to believe it's prudent to assume a level of uncertainty from a macro perspective. So, that's how we're envisioning the sales in the back half, again, sequential improvement. From a gross margin perspective, you know, we talked a little bit about, you know, tougher comps, certainly in the back half of 2019 as we started to see some of that improvement from our quality of sales initiatives and the restructuring.

We started to inflect a little bit in the back half of '19, so we will be up against tougher comps. Channel mix will shift a little bit as well, certainly not a lot of distressed goods necessarily being sold in the front half, that there'd be a little bit more distressed, and again, that timing shift from Q2 to Q3. So, we do anticipate we'll likely have some continued downtime in inventory reserves, but we anticipate those'll moderate, Sam, as we go into the back half. And so that's a little bit more sort of context, again, on the gross margin. But we won't guide specifically on the margin piece, so.

**Operator**

--The next question comes from the line of Adrienne Yi with Barclays. Please proceed with your question.

**Adrienne Yi**

Yes, good morning. Scott, I wanted to talk about two of the strategic initiatives. I guess, you know, your own brand digital, so can you give us the penetration that it is, you know, pre-COVID in the US versus Lee in China. And then, what has COVID done in terms of those targets? Either on a next year basis or a three-year-long range plan basis, how has that accelerated that? And then on category expansion, a little bit more on All Terrain Gear. You know, the notion of moving from jeans wear inclusive of outdoor and then tees, how much bigger is the total addressable market?

You gave a number in your prepared remarks, but who's buying it? Is it a new customer to the business, to Wrangler? And so just wondering how much bigger that footprint looks like. And then for Rustin, I think you said you're not talking about margin, but I'm going to ask again anyway. Given your inventory discipline and its additional sales in the third quarter, should we expect a positive gross margin inflection from the third quarter? Thank you so much.

**Scott Baxter**

Okay. Adrienne, I will start with digital. So, you know it's a primary focus for us. We didn't put a lot of energy and effort into this in old-co. And so we've kind of started from new, about almost two years ago, in that it wasn't a priority for the business and it wasn't a priority for old-co from an investment standpoint. So what we've done is we've gone ahead and got the leadership situation right, hired an external talent, an extreme talent, we're really happy. And that person's been bringing on their team, and then we've been sequentially making investments into that business as we grow it.

So you've seen that we've had some really nice success this past quarter, obviously, with Wrangler US being up 62%. What we're really doing is turning that into an opportunity vehicle for us from the standpoint of, how do we connect with our consumers in a really positive way? It used to be for us, it was just simply a vehicle of making a transaction, and that obviously wasn't a positive thing for us going forward. So, you can see how we've transitioned. We've also built new platforms that have gone online here just recently around the globe, both in Europe and the US, for both Lee and Wrangler. So we're real pleased with how that's gone.

And then I think the other key piece is how we tie in our data and analytics capabilities relative to the work that we're doing with our ERP. So, our digital team is tied to the hip with our ERP/IT team, and they've worked really hard to make sure that we're putting in the right systems, so that when we turn this on here, it'll be a very powerful machine for us going forward. And we're going to continue to make investments in that business as we move forward.

From the standpoint of ATG, it is a natural extension. If you think about how you think about Wrangler, Wrangler's always had a very big outdoor presence; fishing, hunting, hiking, camping, so it was a natural for us from a consumer standpoint. Our consumers have been asking us to go ahead and migrate this way. I think the thing that's really important for us, is you take our Wrangler product. It's a terrific product, it's valued, it's built really well, it's got great

name/brand recognition behind it, and it's sold in really right and appropriate channels, so there's really big upside.

You heard me talk in my prepared remarks about the fact that we've had really nice success here over the last quarter with some of the comps that we've seen, and now we're gaining new distribution. And I think that going forward, the marketplace as one, it's a very big market, is going to want to see some more types of products like this, in addition to the fact that they're going to want to see it with a company that brings value and brings name/brand recognition. And we bring both of that to it, so we're really pleased.

**Adrienne Yi**

Thanks.

**Rustin Welton**

ATG, or--okay. So--

**Operator**

---The next question--sorry.

**Scott Baxter**

Oh, nope, we've got one more there with--we've just got one more to do for Adrienne.

**Rustin Welton**

Yeah, Adrienne. I'll go ahead and comment quickly on your gross margin inflection question in Q3. You know, obviously, as I said, I'm not going to guide on Q3 specifically. And whether that is positive or not, we do anticipate some of the structural benefits from the quality of sales, restructuring of product costs that we've been driving to continue. But we anticipate some of the downtime, and inventory reserves will moderate as well. And as I mentioned, we have a little bit tougher comp in the back half of '19 that we're comparing to. So, hope that helps provide a little bit of additional color. Thanks.

**Operator**

The next question comes from the line of Jay Sole with UBS. Please proceed with your question.

**Jay Sole**

Great. Thank you so much. You've given some great color on gross margin and quality of sale already, I just want to follow up a little bit. If you sort of explain maybe where you are in the journey on getting the quality of sales to where you want it to be, and if you can sort of offer any examples, specifically of like, what kind of actions you've taken to improve the company's quality of sales? Thank you.

**Rustin Welton**

Yeah, Jay, it's Rustin. Good morning. I'll go ahead and take that. So, you know, as we think about quality of sales, it really is a journey, and so the word you used there I think is really appropriate. You know, as we think about it, it continues on. We do everything here at Kontoor through a TSR lens. And so certainly as we came out of the spin, we really looked at our operations across the world, and you know, started to look at, you know, unprofitable markets or channels.

So we exited some countries, one in Europe, certainly we've exited unprofitable points of distribution. And just making sure that, as Scott said in his prepared remarks, that we're optimizing the foundation for continued growth. So, we've taken a lot of steps since the spin in quality of sales, again, it will continue. We're always going to be looking at, you know, SKU rationalization, items like that. And certainly, you know, all of this is in the context of the TSR lens, which will help us drive up our AURs and our gross margins over time, and really create that positive structural mix shift moving forward.

**Jay Sole**

Got it, thank you. And then Rustin, if you could just talk a little bit about liquidity. Do you have any other--the pandemic situation is still quite fluid, if you could just talk about what the company's liquidity position is at this point, and the kind of flexibility that you have looking ahead?

**Rustin Welton**

Sure. Yeah, Jay, if we take a step back, we kind of ended the first quarter--we had about 479 million in cash, net was about 1.4 billion. As we talked about in the prepared remarks, we did pay down 175 million on that revolver on closing of that amended credit facility in May. Again, the strong cash generation, we paid down an additional discretionary 75 million on the revolver in June.

So we ended the second quarter with 256 million in cash, about 1.1 billion in debt. You know, as we think about liquidity, we have about 225 million or so--I'm sorry--yeah, 225 million or so in the revolver that's available for us, as well as the 256 in cash. So, hopefully that gives you a little bit better sense on then liquidity side. And I will emphasize that despite all the macroeconomic challenges in the quarter, we did improve our liquidity during the second quarter. So, that's a big milestone for us as an organization.

**Jay Sole**

Got it. Thank you so much.

**Scott Baxter**

Thanks, Jay.

**Rustin Welton**

Thanks, Jay.

**Operator**

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

**Scott Baxter**

Well as a team, we just wanted to say thank you everyone for spending some time with us today, we really appreciate it. We're certainly looking forward to talking to you soon and spending some time with you again next quarter. So thanks everybody, have a great week.

**Operator**

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