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VF Corp. (VFC)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the VF Corp, First Quarter Fiscal 2022 Conference Call and Webcast. At this time, all participants are in a listen-only mode. [Operator Instructions] A question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It's now my pleasure to turn the call over to John Kelley, Senior Director of Corporate Development and Investor Relations. Mr. Kelley, please go ahead.

John Kelley

Senior Director, Corporate Development & Investor Relations, VF Corp.

Good morning, and welcome to VF Corporation's first quarter fiscal 2022 conference call. Participants on today's call will make forward-looking statements. These statements are based on current expectations and are subject to uncertainties that could cause actual results to differ materially. These uncertainties are detailed in documents filed regularly with the SEC.

Unless otherwise noted, amounts referred to on today's call will be on an adjusted constant dollar basis, which we defined in the press release that was issued this morning. We use adjusted constant dollar amounts as lead numbers in our discussion because we believe they more accurately represent the true operational performance and underlying results of our business. You may also hear us refer to reported amounts which are in accordance with US GAAP. Reconciliations of GAAP measures to adjusted amounts can be found in the supplemental financial tables included in the press release, which identify and quantify all excluded items and provide management's view of why this information is useful to investors.

Due to the significant impact of the coronavirus pandemic on our prior year figures, today's call will also contain certain comparisons to the same period in fiscal 2020 for additional context. These comparisons are all on a reported dollar basis. On June 28, 2021, the company completed the sale of its Occupational Workwear business. Accordingly, the company has reported the related held-for-sale assets and liabilities of this business as assets and liabilities of discontinued operations and included the operating results and cash flows of this business in disc ops for all periods through the date of sale. Unless otherwise noted, the results presented on today's call are based on continuing operations.

Joining me on the call will be VF's Chairman, President and CEO, Steve Rendle; and EVP and CFO, Matt Puckett. Following our prepared remarks, we'll open the line for your questions. Steve?

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

Thank you, John, and good morning, everyone. Welcome to our first quarter call. We are encouraged by the strong start to our fiscal 2022 year. Our teams delivered an outstanding first quarter, powering VF back to pre-pandemic revenue levels, while driving an earnings recovery well ahead of our initial expectations. We continued to see broad-based momentum across the portfolio, which furthers my confidence in our ability to accelerate growth through fiscal 2022 and beyond.

While the near-term environment remains somewhat clouded by virus surges in Southeast Asia, uncertainties in other regions brought on by the impact of new variants and further pressures on the global supply chain, our teams are executing. We remain focused on the things that we can control and winning in the parts of our business where the consumer is coming back strong. And we remain confident in our ability to continue driving this sharp recovery across our business. Matt will walk you through our results in detail, but I'll start this off with some Q1 highlights.

VF revenue has surpassed pre-pandemic levels, growing 96% or 83% organically to $2.2 billion, with momentum across brands, regions and channels. Our global DTC business delivered high single-digit growth relative to prior peak levels, driven by a strong acceleration from our brick-and-mortar stores in the US and continued strength in our Digital. Our organic DTC Digital business is now 72% above fiscal 2020 levels, including the growing benefit of our omni-channel capabilities as we serve our consumers seamlessly across their choice of channel. We've seen a sharp recovery in our wholesale business, which grew over 100% organically in Q1, approaching prior peak fiscal 2020 levels.

Strong sell-through trends and clean channel inventory levels from the past year are now translating into stronger fall 2021 and spring 2022 order books, supporting an improving outlook for our wholesale business for this year and beyond. We've seen a strong recovery in our gross margin, which grew 260 basis points to 56.7% in Q1. This represents organic gross margin expansion relative to prior peak fiscal 2020 levels despite a 30-basis-point headwind from a more challenging logistics and freight environment. VF drove organic earnings growth of 133%, delivering $0.27 in Q1, essentially doubling our plan. We're pleased to see our top line momentum and strong gross margin expansion translate into better-than-anticipated SG&A leverage and earnings flow-through, an indication of the upside potential of our model as our recovery accelerates.

Now turning to our brand highlights from the quarter. The Vans brand has returned to pre-pandemic revenue levels, growing 102% in Q1. The recovery has been led by global DTC business, which drove double-digit growth relative to fiscal 2020, led by 73% growth in Digital. This DTC strength has been broad-based, with each region recording positive DTC growth relative to pre-pandemic levels. More Vans consumers have returned to in-person shopping experiences earlier than expected, and we see encouraging trends in our DTC KPIs with consumers buying more frequently and spending more per purchase relative to historic levels. In EMEA, despite the continued impact of lockdowns and supply chain disruptions, the Vans business grew 125% this quarter, representing 30% growth relative to fiscal 2020, with strength across all major markets as stores reopened throughout the region.

Vans APAC business grew 19% in Q1, led by 22% growth in China. June marked a milestone for the brand in China with the soft launch of the Vans Family program. While the official launch will be celebrated with the Super Brand Day on Tmall tomorrow, we have already registered over 1 million new loyalty members following the initial launch, bringing global Vans Family membership to nearly 17 million consumers. Vans kicked off its 52-week drop calendar this quarter, seeking to create a consistent, predictable, globally aligned and focused approach to drive brand energy and consumer engagement. Seven weeks into the program, we are encouraged by the initial consumer reads and the instant sellout of several early drops.

Internally, the Vans team has increased its focus, energy and resources around driving newness and compelling storytelling, which we believe will unlock further long-term value for the brand. The team is on track to more formally market the Vans drop list in fiscal Q3, ahead of the fall holiday season. We remain bullish on the setup for Vans moving through fiscal 2022 and are encouraged by the early reads from the back-to-school season underway. We are raising our full year outlook to growth of 28% to 29%, representing growth of 9% to 10% relative to fiscal 2020.

Moving on to The North Face, global brand revenues increased 83%, representing 6% growth above pre-pandemic levels. All regions rebounded sharply in Q1, highlighted by continued exceptional performance in EMEA, which grew 142% versus the prior year and 58% relative to fiscal 2020, despite the impact of door closures over the period. The APAC business grew 22% in Q1, highlighted by 80% growth in Digital relative to fiscal 2020 levels.

The North Face's spring sell-through rates were some of the highest in years, reflecting strong progress on the brand's ability to drive 365-day relevancy. TNF continues to drive energy in on-mountain categories with the FUTURELIGHT franchise as well as the new VECTIV footwear rollout, further establishing its legitimacy in outdoor footwear.

We also see outsized growth from the casual categories such as logo wear, which grew over 100% in Q1, as consumers show strong engagement with the brand off-mountain. TNF's loyalty program, the XPLR Pass, has grown to over 7 million consumers, adding nearly 300,000 new members in Q1, driven by exclusive member experiences enriching the consumer journey. We continue to be encouraged by the broad-based global momentum at The North Face, and now expect the brand to deliver 26% to 27% growth this year, representing 15% to 17% growth relative to fiscal 2020. Alongside the significant top line recovery, we're seeing strong improvements in profitability, and continue to expect mid-teen profitability for TNF in fiscal 2022.

The Timberland brand delivered a 63% growth in Q1, tracking ahead of plan. We are encouraged by high-teens growth in the Americas and 87% growth in digital relative to fiscal 2020 levels. We continued to see outsized growth from outdoor, apparel and Timberland PRO, each growing over 75% in the quarter. Momentum behind core iconic product also continues, with heritage styles seeing strong demand despite historically low inventories.

Our Timberland team remains committed to its purpose-led vision, highlighted by the recently announced global product take-back program in partnership with ReCircled. Beginning this fall, US consumers will be able to return any Timberland product to a brand store to either be refurbished for resale or recycled into future products. This program supports the brand's bold vision announced last fall for products to have a net positive impact on nature by 2030. We're encouraged by Timberland's strong start to the year, and, as a result, we now expect the brand to deliver modest growth relative to fiscal 2020, surpassing pre-pandemic revenues beginning in Q2.

Dickies delivered another exceptional quarter, growing 58% in Q1, well ahead of our plan. As the brand has kicked off several new campaigns and inventories become more available, we've been pleasantly surprised by the intensity of sell-through performance across all wholesale partners in the US. This acceleration continues to be driven by both work-inspired lifestyle products, which reported strong growth across all three regions, as well as core work items. Work-inspired lifestyle now represents about 40% of global brand revenue.

Importantly, the Dickies brand has begun to deliver meaningful profitability improvements, driven by both gross margin expansion and SG&A efficiencies. Q1 represented a strong start to our goal of returning to double-digit profit margins in the Work segment in fiscal 2022. Following a strong Q1 performance and accelerating demand signals across channels, we are confident raising the full year outlook for the Dickies brand to mid-teen growth in fiscal 2022, representing over 25% growth relative to fiscal 2020 levels.

A quick update on Supreme. We continue to be happy with the integration process. The VF supply chain organization continues to advance engagement with the Supreme teams, with particular leverage opportunities and logistics capabilities, scale and relationships, which couldn't come in a more opportune time. One quarter into our fiscal year, we remain confident in our outlook of $600 million and $0.25 from the brand.

Before I turn the call over to Matt, I want to thank our associates from around the world, across our brands and enterprise functions, with a particular call out to our supply chain teams, who have been working tirelessly over the past 18 months to minimize disruption against the backdrop of unprecedented volatility.

Our strong results are a reflection of the consistent execution, hard work and inspiring dedication of our teams around the world. This continued passion and energy, alongside the broad-based nature of VF's acceleration, give me great confidence in our ability to continue driving the strong recovery underway. While the first quarter represents a small portion of our total year, we're starting off fiscal 2022, building off the great momentum, which began in February of this year.

And now, I'll turn it over to Matt.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

Thanks, Steve. Good morning, everyone. I'm really happy to update you on our strong Q1 results and revised outlook for the year. We're encouraged by the continued broad-based momentum across our business, and the setup for each of our big brands heading into the heart of our fiscal year. Despite additional pressures throughout the global supply chain, I remain confident in our team's ability to execute, and to build on the strong earnings recovery delivered in Q1.

Let me start with an overview of the operating environment across geographic regions, In the Americas, less than 5% of our stores were closed at the beginning of the quarter and all stores are currently operational. A strong US consumer, easing US restrictions and increased vaccination rates have encouraged a gradual recovery in foot traffic, alongside continued strength in conversion.

Our Americas DTC business grew 84% organically in Q1, surpassing pre-pandemic levels, led by a sharper than expected recovery in our brick-and-mortar business. Consumer appetite for athletic, athleisure and outdoor categories remained strong, benefiting our direct business as well as the performance of our key accounts. Low inventories and strong sell-through trends continued to drive down promotional activity and improve quality of sales across the marketplace, which is resulting in stronger-than-expected order books for the upcoming fall and spring season.

Moving on to the EMEA region, while lockdown measures continued to affect economic activity, our business has remained resilient, growing 97% organically in Q1, representing 13% growth relative to fiscal 2020. Both wholesale and D2C channels returned to growth relative to 2020, as continued strength from both our direct digital channel and from Digital Titan partners helped more than offset the impact of brick-and-mortar store closures. About 60% of our EMEA stores were closed to start the first quarter. As we sit here today, all of those doors have now reopened. The consumer confidence is improving as restrictions ease. And we've seen strong performance from our brick-and-mortar fleet following reopening. For example, our UK business delivered triple-digit growth from open doors following three months of lockdowns, representing growth of nearly 30% relative to fiscal 2020.

Finally, our APAC region continues to deliver double-digit growth despite sporadic resurgence of the virus across many markets. Our China business grew 12% in Q1, which was impacted by a wholesale timing shift of revenues from Q1 into Q2. Excluding this impact, China would have delivered mid-teen growth this quarter. We continue to see digitally led growth in the region, particularly with our Titan partners, and remain confident in our ability to deliver greater than 20% growth in China in fiscal 2022.

While we remain pleased with our APAC performance to-date, we are observing most Southeast Asian markets facing various degrees of lockdowns and travel restrictions. While only about 5% of our stores are currently closed, commercial activity has been impacted across most APAC markets outside of China and Hong Kong. This latest rates also presents additional near-term uncertainty for our global supply chain. In recent weeks, more widespread virus outbreaks in key sourcing countries with lower levels of vaccination have resulted in temporary factory lockdowns and manufacturing capacity constraints.

Our supply chain also continues to be impacted by port delays, equipment availability and other logistics challenges. Essentially, every link in the supply chain has been impacted to varying degrees over the last 18 months. And while we're not immune to this, we believe we've managed these challenges relatively better than most. Our teams remain focused on delivering the products to satisfy increasing demand signals in the most cost-effective and efficient way. Some of the actions include using air freight, other means of expedited shipping and dual sourcing where appropriate.

While we remain confident in our ability to service our strong growth plan, there is a financial implication to these actions. For example, we expect to spend more than $35 million in incremental expedited freight charges relative to fiscal 2020. We view our supply chain as a key competitive advantage at VF, and our teams are proving this now more than ever. I want to echo Steve's appreciation for the supply chain team's incredible execution over the past 18 months. As a result of their tireless and tremendous efforts, I remain confident in our ability to continue navigating this dynamic environment.

Now, moving into our Q1 financial results. Total VF revenue increased 96% or 83% organically to $2.2 billion, reaching pre-pandemic levels one quarter ahead of our initial expectations. Our Q1 Digital business is 72% above fiscal 2020 levels organically, representing a 31% two-year CAGR. We also continued to see strength from key digital partners globally, with pure-play digital wholesale growth of over 70% relative to fiscal 2020.

VF's total digital penetration was roughly a quarter of our Q1 revenues, which represents about 2X our penetration from the first quarter of 2020. Gross margin expanded 260 basis points to 56.7%, representing organic expansion from Q1 peak gross margin levels in fiscal 2020. Relative to last year, this strong expansion was driven by greater full-price selling, partially offset by the expedited freight costs and business mix as our wholesale business rebounded sharply in the quarter. When compared to fiscal 2020 gross margin, we generated a strong mix benefit, partially offset by the incremental air freight costs and FX.

Operating margin expanded meaningfully to 6.8%, driven by the strong gross margin performance and SG&A leverage relative to the prior year. We delivered EPS of $0.27 in Q1, representing 133% organic growth, driven by a stronger top line and earnings flow-through relative to our initial expectations. Following the strong broad-based performance in Q1, we are raising our full year fiscal 2022 outlook. Our outlook today assumes no significant changes to the environment, including increased disruption to our supply chain operations. VF revenue is now expected to be at least $12 billion, representing at least 30% growth from fiscal 2021 and a mid-teen increase relative to our prior peak revenue in fiscal 2020.

Excluding the Supreme business, our fiscal 2022 outlook implies organic growth of at least 25%, representing at least 9% organic growth relative to fiscal 2020. As Steve covered, the increase to our revenue guidance is broad-based across the portfolio, with stronger outlooks for each of our top four brands and sizable increases in two of our emerging brands, Altra and Smartwool. Specifically, the improved outlooks are supported by stronger-than-anticipated order books and the accelerating DTC trends we've observed over the past five months.

Moving down the P&L, we still expect gross margins to exceed 56%, despite a 20-basis-point to 30-basis-point headwind from additional airfreight that wasn't assumed in our initial outlook. We now expect the operating margin to be at least 13%, an improvement of over 20 basis points from our initial outlook, a signal to the upside potential of our model as our top line accelerates. Fiscal 2022 EPS is now expected to be at least $3.20, including a $0.25 per share contribution from the Supreme brand, representing at least 20% earnings growth relative to fiscal 2020.

We continue to expect to generate over $1 billion in operating cash flow this year, with planned capital expenditures of about $350 million, including the impact of growth investments as well as deferred capital spending from fiscal 2021. As announced on June 28, we closed the sale of the Occupational Work (sic) [Occupational Workwear] business this quarter, providing roughly $615 million of additional liquidity. These proceeds are reflected in our fiscal 2022 outlook for total liquidity to exceed $4 billion. We expect to exit this year with net leverage between 2.5 times and three times, providing us meaningful near-term optionality to deploy excess capital moving forward.

So, to conclude our prepared remarks, I'm extremely pleased with the broad-based strength we're seeing across our portfolio as we begin fiscal 2022. We took bold decisive actions last year to position our brands and the enterprise with a strong recovery currently underway. And the balanced broad-based nature of this recovery along with the continued optionality that our model provides gives me confidence in our ability to drive sustainable long-term growth moving forward.

We'll now turn the call over to the operator to take the questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Laurent Vasilescu from Exane BNP Paribas. Your line is now live.

Laurent Vasilescu
Analyst, Exane BNP Paribas

Q

Good morning, Steve. Good morning, Matt. Thanks for taking my question. I wanted to ask about Vans. It's nice to see the raised guide for the brand. It looks like Vans was up single digits on a two-year stack. This is, I think, the toughest compare that you have for the year. How should we think about the growth rates between the first and second halves on a two-year stack basis? And are you raising the annual guide based on like a certain regional performance, or is it wholesale? And then if I go into the minutia here, but it looks like DTC Americas was up, but there might have been a timing shift within wholesale Americas. Is that the case?

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Hey, Laurent, yeah, you got a lot in that. So, I think we'll make sure we try to get through it all. Good morning, and it's great to talk to you. Yeah. So, let me start with – in terms of what we saw in Q1, as you laid out there, we're really happy with the results that we saw. Certainly, sequential improvement, in particular, in our direct-to-consumer business, and also in the Americas, in particular, from a DTC perspective. So, that was really encouraging. There was some timing impact in the quarter from a wholesale shipping standpoint. So, we can – and by the way, that's all sort of caught up in terms of that in July. That was about $30 million. So, a few points of growth on a global basis impacted the results in Q1.

So, as it relates to our outlook, basically, what we're doing here is we're flowing through the Q1 beat. From a DTC perspective, again, that was primarily in the Americas. We're partially extrapolating that into Q2 based on the trends that we've seen. And by the way, July is off to a good start. And then, we're dialing in some stronger wholesale order book that we're seeing, again, most of that all in the Americas. What I would say in terms of you – so your point about first half, second half, I really just point you to the fact that our year to go outlook now implies about 12% to 13% growth versus fiscal 2020. So, hopefully that I think – did I get everything you asked there in terms of some of the details.

Laurent Vasilescu
Analyst, Exane BNP Paribas

Q

You did. Thank you. Thank you very much for that on Vans. And Matt, Steve, maybe a couple of questions on how we think about the guidance, obviously, you're giving annual guidance. But you talked about a $35 million impact from incremental freight, 20 bps to 30 bps, on the GM. Can you talk about the shape of the gross margin between the first half and second half? And I think – remind me, Matt, but I think during the Q&A last call, Camilo asked about, how do we think about first half EPS, and I think it was about $1.20. Just due to the size of the impact of – or just the magnitude of the beat, how do we think about first half EPS?

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. So, let me – first of all, we're not going to give specific Q2 outlook today. But certainly, as evidenced by our outlook, we're confident in taking the year up. Remember I would remind you that the September, October timeframe is always the hardest to call from a shipment timing perspective. I mean there's a significant amount of activity during that period of time as we begin to really load up things on the wholesale side for fall and holiday. And just given the supply chain pressures, it's really hard to call the puts and takes between quarters.

And to some degree, I think we can expect that quarter-to-quarter volatility will continue in the near-term. However though, with what we know today, while some of the flow may not be perfectly optimized, as we begin the season in particular, we don't expect a meaningful impact on our ability to ultimately deliver the fall holiday season. And I'll remind you that as we have continually done, we expect that we'll perform relatively better than the competitive set.

As it relates to gross margin, what I would say is, certainly, we're holding the year at greater than 56%. We talked about the fact that we're absorbing some higher freight, particularly air freight and other forms of expedited freight. I think we said 20 basis points to 30 basis points in the prepared remarks, so – versus our original outlook. So, in a meaningful amount, I will tell you that the vast majority of that actually sits in our second quarter is the way we would expect that to play out.

The other thing I would remind you is we have currency headwinds that we're up against that will begin to abate a little bit as we move later in the year. And probably, the last point I would make around gross margin, we talked about the fact that our pricing actions, which have been relatively limited through spring 2021, and fall 2021, you'll see the impact of more significant pricing activity as we move into spring 2022. So, the Q4 window will benefit a little bit more from that perspective as well.

Laurent Vasilescu
Analyst, Exane BNP Paribas

Q

Very helpful. Thank you very much and best of luck.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Thanks, Laurent.

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Thanks, Laurent.

Operator: Thank you. The next question today is from Camilo Lyon from BTIG. Your line is now live.

Camilo Lyon
Analyst, BTIG LLC

Q

Thank you. Good morning, everybody. Just looking at the detail you provided and trajectory of the business versus 2020, it seems like you're now going to be trending over the long-term EBIT margins that you provided at Beaver Creek. How do we think about those implications as to what the business can deliver in this environment of full price sell-through, limited inventories and really accelerating demand on a global basis?

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah, Camilo, good morning. Yeah, I guess what I would say to that is, certainly, we're really encouraged by, first of all, the sharp recovery in gross margin that we saw in Q1, which we've signaled, and we certainly anticipated, but certainly happy to see that that play out as anticipated, and the underlying margins in terms of the organic business actually above prior peak levels in our first quarter. And so, think about relative to the outlook raise up to at least 13% operating margin, given the air freight headwind that's at play and that we're calling out, I think it really speaks to our confidence in seeing that SG&A leverage beginning to play out.

We said in our last call that if we saw some earnings opportunity, which obviously we're seeing that come to pass a bit and calling the year up, you'd expect a strong earnings flow through as a result of that. So, I think again seeing that play out, despite the fact that we've got some headwinds on the supply chain side relative to freight that we didn't anticipate in May.

Camilo Lyon
Analyst, BTIG LLC

Q

Got it. And my second question is on, going back to the global regions – or the regions, rather, you raised – in your slides, you raised the Americas, but you kept Europe and APAC the same as the prior guide. Given what you're seeing in Europe in particular, and what you talked about from a growth perspective in meeting demand in China, why would you not have raised EMEA and the APAC regions?

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yes. Good question. So let me start with, first of all, APAC. China continues to be really strong, but you got to remember, rest of Asia is pretty volatile at the moment, given flare-ups in virus. So, it's not an enormous part of our business, but when you look at that total region, there is some impact across what I'll call rest of Asia. Think about Korea, even Taiwan, Japan, Malaysia, Singapore, et cetera. So on the Asia side, there's some puts and takes there, I think, in terms of how we think about that business.

The Europe business continues to be quite strong. And probably what's at play here a little bit, too, is when we laid out our initial guidance in May and talked about the opportunity, it could be a little bit conservative. I think that was predominantly an Americas-related comment. So, I think we're seeing the Americas business in the US consumer come back strong. And that's playing out across our businesses, by the way. That's a broad-based comment across all of our big businesses and really across our portfolio as we see the US consumer coming back strong.

And certainly, that's important from a go-forward standpoint. And obviously, it's critical to the Vans business, I think, in particular, given the size of that business in the US as well as the size of the brick-and-mortar business here as well. So that's obviously really encouraging for us. And remember, the last thing I would say, we still are maintaining a fairly cautious approach from a year-to-go perspective.

In our direct-to-consumer business, we've got sequential improvement coming, is our expectation. We saw a stronger result in Q1. As I said, we've extrapolated that a bit into Q2, but we remain careful there in terms of how that will play out over time. So hopefully, that answers your question.

Camilo Lyon
Analyst, BTIG LLC

Q

It does. Maybe if I can, just a clarification question on that. Is it fair to characterize Europe as maybe being a quarter behind the US in terms of how you're stacking the resurgence in demand? Is that a fair and accurate kind of depiction?

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Well, our business has been really good, all the way through. What – I would say it's a fair characterization in terms of the consumer, and certainly, the fact that we opened the quarter in Europe with significant door closures.

I think over half our doors were closed in the beginning of the quarter, and many of those were closed through one-third to half of the quarter. And we're open, we're open for business here now, obviously as we close the quarter and as we sit here today.

So, I think from a consumer standpoint, consumer confidence, yes, that's a fair characterization. Our business, though, has been really good and resilient, all the way through. Our business, actually, on a two-year stack in Europe, was up in the quarter.

Camilo Lyon
Analyst, BTIG LLC

Q

Got it. Thanks for the color. All the best.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Thanks, Camilo.

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Thanks, Camilo.

Operator: Thank you. Next question today is coming from Matthew Boss from JPMorgan. Your line is now live.

Matthew R. Boss
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. So on The North Face, maybe could you help speak to order trends that you're seeing in the business and just drivers of the 15% to 17% increased outlook this year, which basically doubles your long term target. Just, what you're seeing in the business and confidence in those targets?

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. Maybe I'll start there, Matt. Good morning. The order trends are good. And honestly, the outlook has come up a bit in The North Face. And the vast majority of that, I think, is related to US order book, just to be blunt. So the order books are good, but probably what's more encouraging, and I'll let Steve talk a little bit here, is the sell-through continues to be really strong across our business, across geographies and across channels. So that's giving us a lot of confidence in the things that we're doing, that's really resonating with the consumers. That strong sell-through, obviously, that begets stronger order book. So, Steve, I don't know if there's anything you want to add there.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. I would just say The North Face sits in that – in the outdoor cam, which has had a lot of energy last year, and that's carried into this year. And North Face is that number one global brand. And with the work that the team has been doing, the focus around really the segmentation between the on-mountain and off-mountain offer, we see very strong growth with our FUTURELIGHT products.

Really proud of the team and the ability to have delivered VECTIV and secure two outside magazine awards across two different categories for one collection of footwear just really validates North Face's opportunity within that outdoor footwear space. But also, you've heard us talk a lot about getting 365-day relevancy to evolve our sports wear, specifically our logo wear, and to be able to drive triple-digit growth in the quarter, and just validates the work being done, the demand that's there for this brand globally.

We continue to see very strong results internationally, led by Europe and China, very strong. And it's just great to see the momentum building here built – based on those strong sell-throughs that Matt referenced, the brand is in a really good position for the balance of the year, and hence, giving us confidence to raise the outlook.

Matthew R. Boss
Analyst, JPMorgan Securities LLC

Q

Great. And then maybe just to follow-up on the expense line. Matt, how best to think about expenses that you see as transitory or more one-time to this year? And is there any change to the flattish five-year forecast, which I think you had laid out? Which I think in the next two years, would drive pretty material leverage on the SG&A line. Just making sure we're thinking about this right.

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. So, yes. There's certainly – when you think about SG&A in the short-term, there are some transitory headwinds. I think we talked quite a bit about that in May, and that hasn't really changed. I think we specifically see that in some of the freight costs, some of the freight-out costs where we've seen a pretty significant increase. I think a lot of that's around supply and demand.

As well as in distribution, we've got some one-time costs that we're navigating here in the short-term as we bring on board some new distribution capabilities, the new capacity in a couple of places in the US, as well as our new distribution center in the UK. So, we'll quickly sort of lap that and move past that and sort of grow through that. So, certainly, I think there's some transitory headwinds.

As it relates to the longer-term view, what we said is that we expect – and first of all, really happy to see our Q1 results, right, and the leverage that we saw there versus our original expectations. Now, I will say some of that is timing related, certainly in terms of the spend shift – or the spend timing, some of that's shifting out a little bit. But, happy to see that kind of progress.

We've said that we expect to exit the year with SG&A leverage. And we said we expect to see next year, we'll be sort of right on track with the long-range algorithm. And sort of the path towards that mid-teens overall operating margin that we laid out in Beaver Creek will be back on that path. And so hopefully, that gives you the sort of the context you're looking for.

Matthew R. Boss
Analyst, JPMorgan Securities LLC
Q

Great. Best of luck.

Operator: Thank you. Your next question today is coming from Michael Binetti from Credit Suisse. Your line is now live.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC
Q

Hey, guys. Thanks. I have a few. Thanks for all that help today. I guess on Vans, guys, Matt, I could tell you see some optimism in the order book in North America. It really helps you talk about that a little bit. What's changing? Just help us understand where the increases are coming from in that business. I think maybe someone touched on it earlier, there was – it looked like a little bit of a wholesale shift that impacted first quarter. But I think it would be really helpful to understand where the increases are coming on the wholesale order book, particularly in North America, relative to where you were 90 days ago?

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.
A

Yeah. Good morning, Michael. I would say it's really sort of broad-based, honestly, across the US market. And it's really driven by – as we saw in our own stores, we just see a continued improvement in the business, right? I think a lot of that is tied to the fact that consumers are coming back into stores.

We're relatively well-positioned from an inventory perspective coming through spring and as we head into back-to-school. And so we're seeing those sales to stock ratios perform quite well. And again, that's broad-based. We're seeing that in the sort of the specialty channel. We're seeing it with some of our key national partners. So I don't think it's any one place. I think it's relatively broad-based.

And as you know, the order windows are a little tighter in Vans. Meaning, we're taking orders about four to five months out based on our shorter lead times there. And so, we said, we'd have the opportunity to get after more volume if the business came on a little stronger, and we've seen that occur. And so that's sort of playing out as we hoped it would, and it is.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC
Q

And then, I guess, you made a comment in the prepared remarks on Vans that you thought we would see some reflection of Vans being at the top of the competitive set over the next few quarters. And we haven't seen many of the footwear brands report yet here lately. And I would argue, off the 2019, you guys were having very strong growth rates in Vans in 2019, so you are comparing against that. But I'm trying to think, maybe you could just tell me a little bit more what was behind the comment that you think you expect to be at the top of the competitive set as we look at Vans over the next few quarters?

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.
A

Good morning, Michael. This is Steve. I'll take that. Where we see the opportunity to perform at the high level here against our competitive set is really within our supply chain's ability to service the forward demand that we see. And we really keep Vans positioned with inventory, which is having certainly an positive impact on their ability to see the wholesale lift, but also the D2C lift that we're seeing.

You all might remember in the last call, I talked about having significant opportunity as D2C came back on board. And that momentum is building and carrying us really nicely into the back-to-school timeframe here. The demand trends are encouraging. And our ability – we're set for back-to-school with the inventory required. And that comment about the supply chain really is about our ability to chase back into and replenish that inventory if we see an outsized sell-through consistent with what we see here today.

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.
A

Michael, maybe I'll add one thing there, that we've talked about the point about – versus the competitive set that part of that really is also around our retail stores, right? And the retail store teams and those associates really that are the brand ambassadors. We've talked about – that's been a bit of a challenge for us, quite honestly, as stores were closed throughout a large part of last year, not having that which is a big part of sort of the overall ecosystem. Not just the opportunity to buy in stores, but the experience that you get and the connection and the engagement that oftentimes is most robust in those stores. And so we know that as stores are open, as consumers are back in stores, that's going to play to our advantage. And so that's been part of that thinking in terms of how we feel versus the competitive set.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.
A

And I'd pile on there a little bit, Michael. I mean we're reaping the benefits of supporting our retail teams through last year by not furloughing them. But we carry those talented associates forward and the historical conversion rates that we see, we're actually seeing a slight outperformance to that. And that's drive – that's another aspect of the strong D2C results that we're currently seeing.

Michael Binetti
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. Thanks a lot for the help guys.

Operator: Thank you. Our next question is coming from Erinn Murphy from Piper Sandler. Your line is now live.

Erinn E. Murphy
Analyst, Piper Sandler & Co.
Q

Great. Thanks. Good morning. Steve, you talked about in your prepared remarks about the wholesale level coming back to almost pre-pandemic levels. Can you share a bit more about the complexion of wholesale today versus pre-pandemic from a mix perspective? How does it look in terms of the composition between key partners, third-party digital? And then I have a follow-up on Dickies. Thanks,

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.
A

Okay. I'll just follow the line of your question there. Erinn, I think the key account component of our wholesale business is critically important. And some of those key accounts are digital key accounts. And we've talked a lot about our European partners, our Asia partners. But here in the US, we're seeing strength in the outdoor space.

We're seeing strength in the sporting goods space. And as we get our brands in a position to fill that demand, the pent-up energy that we saw coming out of Q4 into Q1 is driving that wholesale performance.

Erinn E. Murphy
Analyst, Piper Sandler & Co.

Q

Got it. Great. And then on Dickies, I mean the growth has been really incredible, both on the top line as well as the margins. Can you share a bit more about where you see the incremental share gains coming from, both in the Americas from here as well as in China? Thanks.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Sure. I'll grab this one. And Matt, if I miss anything fill in the blanks here. But we're excited about the Dickies business. Since that acquisition, this brand has significantly outperformed our acquisition plan and even despite COVID. We're seeing strength in our core work business. Here in the United States, we're seeing really nice acceleration in the work lifestyle component. That's now about 40% of our total revenue.

So this team over the last two years has really simplified their approach to the business, focusing on their core icons, building out the lifestyle piece of the business, while really respecting that core Workwear. We have channel expansion opportunities that we see going on beyond just that those core work points of sale, we're growing into sporting goods. The recent launch of the Skate collection is accessing a whole host of new specialty skate accounts, which is just a great brand-building image component.

It's also giving them permission to elevate some of the offer. We've recently launched the Signature Collection, which is an elevated higher price point, better gross margin. Collection of items really built off those core icons. So, they just – I think, it's – I think, the point here is they've focused the business. It's broad-based across all three regions, building against the traditional channels. But because of this broad-based momentum, they're able to now extend into adjacent channels of distribution, new wholesale partners, while we, at the same time, build our digital acumen and our ability to speak to consumers directly.

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. Maybe just one thing to add there. Maybe a little less sexy, but also really important and to give credit to the team. And thanks for asking about Dickies. That was great. The brand is performing, and the teams are doing a great job. We didn't make it easy on them after acquisition. We had to spin the Kontoor business, and we sold off Occupational Work. All of which had impacts because of the connections in the back end of some of the things that we were doing there.

So, we've had some fits and starts there in the early days. But we're really now starting to see the benefits in the supply chain from some of the integration activities around demand planning, as an example, which ultimately allows us to service the business in a better way, too. So that's certainly helping. While at the same time, obviously, there's a lot of momentum from a brand heat perspective. So those things coming together is, I think, sort of a one-two punch.

Erinn E. Murphy
Analyst, Piper Sandler & Co.

Q

Thanks so much.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Thanks, Erinn.

Operator: Thank you. Our next question is coming from John Kernan from Cowen. Your line is now live.

John Kernan
Analyst, Cowen & Co. LLC

Q

Yes. Excellent. Thanks for taking my question. Wanted to go back to Vans. You gave some helpful commentary on North Face and where that business is. From a margin standpoint, I think, you said mid-teens for this year, which is an impressive recovery. Where does Vans fit in the overall margin profile relative to where it was back in Beaver Creek in pre-fiscal 2020? It was significantly higher from a margin – contribution margin than every other brand in the portfolio. Just curious where that sits now and where you think it's going to go in fiscal 2022 and beyond.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. It's – I think, it's still in the same spot, right? It sits well above most of our brand portfolio from a profitability standpoint. Really strength in the gross margins, strength driven from the direct-to-consumer business, a really, really profitable brick-and-mortar franchise.

As you think about – I mean, the one thing I would say, versus pre-COVID levels is, there's still a little bit of a headwind there, primarily because of two things. One, the freight side of things that they're dealing with, as all of our brands are. But remember too, that's the one business where brick-and-mortar is really significant. And while we're seeing sequential improvement, and while fortunately, we're seeing that even be a little stronger than we thought, we're still modeling brick-and-mortar to be down across the year and not really fully recover until early fiscal 2023. That was my point earlier about we remain fairly conservative in our outlook there as we move through, and particularly the back half of the year. So, there's a little bit of overhang there in the short-term. But yeah, Vans profitability that you would have seen in Beaver Creek and what we've talked about historically, that remains and the outlook on a longer-term basis, it's really compelling in terms of value creation.

John Kernan
Analyst, Cowen & Co. LLC

Q

Understood. And then just going back to, I guess, North Face and Outdoor. The growth you're giving off of fiscal 2020 pre-COVID levels, indicates a nice recovery. Can you talk to the sequencing of that as we go through the year? I think, the guidance for the remainder of the year was above where you were in Q1. So just curious how we're thinking about North Face as it relates to both wholesale and DTC as we go through the remainder of the year?

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. Certainly. I'm not going to be specific quarter-to-quarter. But you can expect sequential improvement as we step through the year, notwithstanding what could be some volatility from a shipment timing standpoint, around that peak shipping window as we begin to move into fall holiday. I think the thing to remember there is the strength – it's still a heavily weighted business toward fall holiday winter time, and the strength of our performance last year from a sellout perspective, and the order book profile as a result of that, both in the US and in Europe.

So that's a big part of the growth as we see that wholesale business bouncing back sharply, and as we see our direct-to-consumer business continue to recover sequentially as we talked about in Vans, similar kind of comments there.

John Kernan
Analyst, Cowen & Co. LLC

Q

Understood. Thank you.

Operator: Thank you. Our next question is coming from Bob Drbul from Guggenheim. Your line is now live.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Hi. Good morning. Thanks for taking the question, I guess I would love to hear some more about what you've learned so far on Supreme, the update, the integration, the game plan, any early learnings. I think the accretion was probably a little bit better than we anticipated. Any commentary you could share with us would be great. Thanks.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. Good morning, Bob. So, I would tell you, first, we're really happy with the progress of our integration. Thoughtful, really targeted approach that we're taking, allowing Supreme the opportunity to learn about VF, our VF teams the ability to learn about the Supreme business and where are those opportunities to provide capabilities. The brand is performing in line with our expectations. And those expectations, we're seeing stronger results versus the long-range growth targets that we have for the business.

I think where we're connecting most – probably most effectively is with our supply chain teams. And it couldn't – certainly couldn't come at a better time as we look to leverage our logistics capabilities, leverage our scale and the relationships, specifically to assist in shipping and work in partnership with the Supreme team to assure that their weekly cycle of the drops stay as close as possible to the going in seasonal plan. So it's early certainly in the – in our understanding of the business, but we're very confident about the long-term value creation thesis that we've put forward for the Supreme business and continue to see regional expansion and partnering with the team to leverage our skills and capabilities.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Great. Thanks. And just on the supply chain. I guess if we go back to the decision to add the incremental air freight. Is that a function of just trying to make sure you have the product to meet the demand? Is it incremental bottlenecks that you're seeing in Vietnam or in China? And I guess, is the expectation just in the coming quarter? Or maybe you could just give us an idea in terms of how long do you expect the incremental – pressures on the margin from the incremental air freight? Thanks.

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. And certainly, what we're dealing with there – what we've said, I think the posture we've taken here is that the business is strong from a demand standpoint. And we're going to ensure that we can satisfy that demand in the most optimal way. So, we're certainly looking – where it makes sense, we're going to spend against air freight and other expedited freight avenues to ensure we do that. We're seeing certainly some delays in the supply chain. I will tell you, for us, it's generally weeks, and certainly not months, but we are seeing some delays in the supply chain, given the environment in Southeast Asia, in particular.

Fortunately, by and large, most of our factory base is operational. That's not 100%, but most of it is operational. And where it's not, obviously, we're working really hard to understand what those impacts will be. And I think, again, as I said earlier, we anticipate maybe some sub-optimization from a flow standpoint at the beginning of the season. But we certainly expect as we move through the season, we're going to be able to support the business and ultimately deliver things for fall holiday.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

And maybe to pile on here, Bob. I think as we look at strategically using airfreight and other expedited forms of moving our goods, we see an opportunity to capture share, because we do think in some cases, because of our factory partners, their current operational capabilities, certainly not operating at full capacity, but at sufficient capacity, we think we have the opportunity to be in a position to grab share with some of our large brands, certainly with our own distribution, our own D2C and e-commerce, but there's opportunities to work with our key wholesale partners and advantage their position as well.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

And Steve, if I could just follow up on that. And are you saying that you've taken additional orders because you feel like you can meet the demand? Or are you still working with your original order books across the various brands? Just trying to understand the dynamic.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. So, job one is to really fill the initial order demand. We did see additional demand come into our fall order books. That's reflected in our outlook. And within that, there is some additional goods to service upside demand. You know us well. It's not going to be an exceptional amount, but we are really playing to win because we see an opportunity here to recapture share and advantage at least our largest brands, but really looking across our whole portfolio because of the strength and capability of our supply chain teams. It's not going to be easy. I mean, this is a very difficult environment. You know, we are not the only ones to talk about that. But this is where our teams really come to life. This is where you know, VF is built to compete in this kind of environment and we feel very confident about our ability and those things that we can control to supply the demand and air freight, expedited freight is a critical part of our being able to do that.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Thank you.

Operator: Thank you. Our next question is coming from Jonathan Komp from Robert W. Baird. Your line is now live.

Jonathan Robert Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Great. Thank you. Just maybe one clarification first. When thinking about the D2C outlook, I know you raised the full year target. But are you assuming the trend you're seeing currently for Vans does not continue? Or is that just the message? And I guess, globally for D2C, have you reflected the more positive order book indications into how you're thinking about your own D2C business?

Matt Puckett
Chief Financial Officer & Executive Vice President, VF Corp.

A

Yes. I think from a D2C perspective, what we've done is certainly we've sort of banked what we saw occur in Q1. And we've begun to uplift our D2C projections, in particular, in Q2, in particular, in the Vans business, and in particular, in Vans Americas. So, I mean, I think that's a statement that's true across the majority of the direct-to-consumer business where we're reflecting some of those trends, but it's most significant in that Vans business. So, we are doing that.

I think just to the point we had in the last question. What we have done, we haven't – we've been pretty cautious still in our actual assumptions from a revenue perspective in the back half of the year. We haven't really changed those, just to be frank. But what we have done, in particular in Vans, and this is the point that Steve was making, we are leaning in a little bit from an inventory perspective to create some additional capacity there for upside, whether that be in our own stores or potentially even in terms of wholesale reorders. So, we're beginning to lean in a little more aggressively from an inventory posture standpoint in Vans in particular, and to some degree, in our Dickies business as well.

Jonathan Robert Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. That's really helpful. Thank you. And Steve, if I can follow-up one more question on Vans. I'd be curious, any learnings you have from the newer approach in the recent months? With the product drops and the incremental marketing attention you've been focusing on Vans, any learnings from that? And then how should we think about your plans in those areas going forward?

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. No. Thank you for that question. This is an exciting development for Vans. It's something they pivoted and moved on very quickly. Just remind everybody, this idea of a 52-week drop model was to really think and act like a true retail operator and bring a more predictable, a more visible understanding of the product flow, and use this to create brand heat. And we've seen that play out extremely well. We're only about seven weeks in. They're learning every week about just how to really manage the offer for the week, how to marry the content and the storytelling, how to lever broad-based global drops that could be available across multiple channels of distribution versus various select vault type products. But the point here is they're providing visibility. And they're giving visibility and enough time for consumers to learn about it, build the excitement.

And that frenzy demand that we've seen really reflect itself in some of the key collections that have dropped this year. Bodega, from a specialty Vault collection to the broad-based SpongeBob SquarePants, and most recently, the Metallica drop. What you're going to see us do or our Vans team do is they get just refining the model. They'll start to publish the drop list. And we think that's something that will be possible by Q3. So, they'll give the consumer visibility of what's coming and begin to allow themselves to be positioned to capture the product if it's a limited drop or be in the queue if it's a broader-based drop. So, I think this is just a really thoughtful evolution to what was already a well-designed go-to-market model. But this is about driving brand heat and increasing consumer demand, and ultimately, consumer loyalty.

Jonathan Robert Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. That sounds very innovative for a brand like Vans. Thank you very much.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

A

You bet. Thank you.

Operator: Thank you. We have reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Steven E. Rendle
Chairman, President & Chief Executive Officer, VF Corp.

Great. So just real quick. Thank you, everybody, for taking the time to join us this morning. I would just tell you, we couldn't be prouder of our teams who helped deliver an outstanding quarter. We continue to work hard to meet the demand and to be able to power back to pre-pandemic revenue levels slightly ahead of where we thought we would and to see that earnings recovery. It's just a validation of our model. The growth is broad-based across brands, regions and channels, despite continued COVID-related impacts that we're seeing both from a consumer standpoint, but also back through our supply chain. We're going to remain very focused on the things that we can control. And we're going to drive against those parts of the business where the consumer is coming back strong and continue to drive towards delivering a year that is stronger than what we originally committed to and meets your expectation, but ultimately drive the value for our shareholders that you expect.

Operator: Thank you. That does conclude today's teleconference and webcast. You may disconnect your lines at this time and have a wonderful day. We thank you for your participation today.