

22-Oct-2021

VF Corp. (VFC)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to the VF Corporation Second Quarter Fiscal 2022 Conference Call. At this time, all participants are in listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note this conference is being recorded.

I will now turn the conference over to John Kelley, Senior Director of Corporate Development and Investor Relations. Mr. Kelly, you may now begin.

John Kelley

Senior Director - Corporate Development and Investor Relations, VF Corp.

Good morning and welcome to VF Corporation's second 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've 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. 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 in 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 call for your questions. Steve?

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

Thank you, John and good morning everyone. Welcome to our second quarter call. As we move through the halfway point of our fiscal year, I remain encouraged by the underlying momentum across the portfolio and the broad-based nature of this strength gives me confidence that we are driving the right strategy to accelerate growth in the quarters ahead.

Looking through pandemic-related disruption and near-term headwinds in China, we continue to see a healthy retail landscape, a strong consumer outlook, and accelerating demand signals across our business. While the recovery has not been as linear as we had anticipated for some parts of our business, I'm proud of how our teams continue to deliver through the volatility. This is certainly where we excel. We are focused on what we can control. And despite a more challenging environment than we had envisioned, we were able to reaffirm our fiscal 2022 revenue and earnings outlook, a clear testament to the resiliency and optionality of our model.

We see our business emerging in an even stronger place than before the pandemic. We've accelerated our strategy to be a more digitally enabled enterprise, while driving significant investment behind key capabilities to connect with our consumers. We are driving organic growth as we elevate direct channels, distort Asia led by China, and accelerate our consumer-minded, retail-centric, hyper-digital business model transformation.

On top of that, our number one strategic priority to drive and optimize our portfolio has netted us significant benefits. Over the past five years, we have strategically evolved and simplified our portfolio from 32 brands to 12 brands, each with significant D2C and international opportunity, squarely focused on large, growing addressable markets. The macro trends around outdoor and active lifestyles, health and wellness, casualization and sustainability have only strengthened over the past 20 months. And our current portfolio is well-positioned to benefit from these accelerating tailwinds.

Active portfolio management remains an evergreen process, and M&A remains our top capital allocation priority. This is a differentiator and a competitive advantage for VF as we continue to refine our portfolio mix to maximize exposure to the most attractive parts of the marketplace. We are confident that we have the right strategy and our continued execution on each of these key strategic pillars positions VF for a stronger emergence.

Now moving into our Q2 results. While noisy, our second quarter results highlight ongoing progress against our strategy and reflect the healthy accelerating underlying business with broad-based strength across our portfolio.

I'll start with Vans, which delivered 7% growth in Q2 despite meaningful wholesale shipments pushed into Q3, representing sequential improvement in underlying demand despite a more challenging than anticipated operating environment.

The EMEA business has accelerated meaningfully during the quarter. However, in the US, encouraging brick-and-mortar recovery trends, which had been building into July, were impacted by the Delta surge and its implications across our most important markets. This led to sharp shifts in store traffic trajectory during the peak back-to-school window. Additionally, the brand faced headwinds in Asia-Pacific with virus disruption across the region and a more challenging near-term consumer environment in China.

While Vans Americas Q2 recovery did not meet our expectations, I'm pleased with our team's response. We're focused on what we can control. Our retail associates are driving best-in-class conversion, up 20% relative to pre-pandemic peaks, this quarter in the Americas. And despite the impact of expedited freight, the Vans Americas team has brought full-priced D2C gross margins above fiscal 2020 levels, supported by discounting below pre-COVID levels. At the same, leveraging our strong inventory position, we've secured additional shelf space at several key wholesale accounts for the second half.

So despite a more challenging operating backdrop than anticipated, we are able to hold on to the low end of our prior outlook for Vans and now expect 7% to 9% growth relative to fiscal 2020. We're confident in Vans' strategic choices as evidenced by improving demand signals and strong consumer engagement. The September Vans x Horror collection launch supported the fifth highest sales day on record for our Americas D2C digital business achieving 100% sell-through within days.

We're encouraged by the ongoing strength from Progression Footwear lines, up 15% relative to fiscal 2020, led by UltraRange and MTE, and are pleased with the continued growth in Vans Family membership reaching 18.5 million consumers globally.

Our confidence in the long-term runway for Vans remains unchanged. The brand came into this disruptive period exceptionally strong, and consumer engagement has remained healthy. The active space remains a large and growing TAM, and the casualization trend continues to present a long-term tailwind for Vans.

And although Vans remains a very important part of our story, we must remember that VF is not just one brand. We have a diversified portfolio of global brands, each with exposure to attractive TAMs with enduring tailwinds. We have significant shared platforms of expertise, highlighted by our international platforms and global supply chain, which are enabling broad-based profitable growth. And as a result, our model drives ongoing capital allocation optionality to further enhance VF's growth and shareholder return profile. Matt will build on many of these themes shortly, but I'd like to start with an overview of the broad-based momentum we're seeing across the portfolio.

Starting with The North Face, which delivered 29% growth in Q2 despite significant wholesale shipments pushed into Q3, representing a sharp acceleration of underlying demand alongside meaningful margin improvement. Our international businesses are gaining share, while the underlying US business has accelerated meaningfully this quarter on tight inventories, driving high-quality sales.

We remain encouraged by the strength across categories as TNF has been successful at balancing on and off-mountain messaging to its consumers. On-mountain platforms like FUTURELIGHT, VECTIV and the recently launched Advanced Mountain Kit continue to drive strong sell-through and reinforce TNF's performance credibility. Off-mountain lifestyle apparel and equipment are delivering outsized growth, a strong 365-day demand persisted, led by logo wear, daypacks and duffels.

We also saw strong performance from more versatile athletic inspired products highlighted by the Wander franchise. We are raising the outlook for TNF to 27% to 29% growth in fiscal 2022. We continue to believe this moment for TNF is underappreciated. This will be a \$3 billion business delivering high-teen growth relative to fiscal 2020 levels, with strong margin expansion underway.

Looking into next year, The North Face will continue to benefit from broad-based brand momentum fueled by innovation, extremely clean distribution channels, increasing year-round relevancy and ongoing tailwinds from the outdoor marketplace, supported by growing consumer interest in active outdoor lifestyles. We, therefore, expect The North Face to be at least within its long-term plan range of high-single-digit growth in fiscal 2023.

Moving on to Dickies, which continues to build upon its incredible run, delivering 19% growth in the quarter. The brand is driving their integrated marketplace strategy, supporting growth horizontally across work and work inspired categories, as well as vertically as they focus on higher tiers of distribution and bring new consumers into the brand. Sell-through remains elevated and demand signals continue to be strong. Across the globe, the Dickies team remains focused on the key drivers of their business, expanding core Workwear beyond traditional channels and leveraging the brand's authenticity to accelerate the lifestyle segment.

Icons have been a focus for the marketing and sales teams, and the results are compelling, highlighted by the accelerated growth of the 874 work pant. There are several versions of this 50-year-old icon, supported by ongoing innovation, which collectively have delivered over 100% growth year-to-date.

In addition to the strong growth trajectory at Dickies, we remain encouraged by the significant margin expansion runway, which accelerated in Q2 on the back of strong full-price selling and SG&A leverage. We're proud of the continued success at Dickies, which we feel is another underappreciated part of the story. We are raising the outlook for Dickies to at least 20% growth in fiscal 2022, representing at least 30% growth relative to fiscal 2020. We expect the brand will approach \$1 billion next year as Dickies celebrates its 100-year anniversary.

Next, Timberland delivered 25% growth in Q2 despite significant wholesale shipments pushed in the Q3, representing an acceleration of underlying demand over the quarter. The PRO business remains a consistent growth driver for the brand, supported by a new campaign celebrating the skilled trades to inspire the next generation of worthy workers. Despite historically low inventory levels, core boots and outdoor footwear continue to show strength as we head into the holiday, each growing over 40% in Q2.

Timberland continues to create an own boot culture, with the September introduction of GreenStride eco-innovation in boots for the first time. The Solar Ridge Hiker launched with much fanfare in New York City and posted 50% sell-through in North America. Two more GreenStride drops will hit in October, driving further momentum behind its important franchise.

At the same time, the TrueCloud collection, another eco leadership story drove strong traffic and social engagement across all regions. We believe the Timberland brand is in a much healthier position today, relative to where it was before COVID.

This leadership team has a sharpened focus on the brand's product architecture, getting back to Timberland's core, work and outdoor, sustainability and craftsmanship, while increasing energy and newness.

They have refocused strategic clarity around the target consumer and on executing the right go-to-market set of choices. The brand is demonstrating strong marketplace discipline, reducing discounts and thoughtfully rebuilding depleted inventory while driving significant improvements in profitability.

The integration of Supreme continues to move according to plan, and our teams are learning from this highly productive business, including how they manage product creation, building energy ahead of drops and optimizing assortments and product flow across regions with great agility.

Looking forward, we remain confident in the significant whitespace opportunity for this brand across geographies, with a clear opportunity to leverage VF platforms. Supreme remains on track to become VF's fifth \$1 billion brand in the coming years.

And lastly, when speaking to the broad-based strength across our portfolio, I'd like to briefly shine a light on our three outdoor emerging brands, Smartwool, Icebreaker and Altra. This group collectively represents nearly \$550 million in revenue with a mid-to-high-teen growth profile longer term.

While smaller today, these brands are all profitable and are exposed to the attractive tailwinds around health and wellness, active outdoor lifestyles and sustainability. And we're seeing it in their results. Smartwool brand is up nearly 60% year-to-date, representing high-teens growth relative to fiscal 2020. We've accelerated investment in brand awareness campaigns, highlighting the high performance and versatility of this product while targeting an active, younger consumer.

We're seeing this pay off with broad-based strength across categories, led by apparel and outsized growth from new consumers. Our other natural fiber brand, Icebreaker, has successfully relocated the core leadership team from New Zealand to our Stabio headquarters, further integrating into our EMEA platform, which will accelerate the brand's global reach.

The brand has grown nearly 30% year-to-date, with balanced growth across its largest markets in Europe and the US. Base layers, tees and underwear represent about 70% of Icebreaker global revenue, confirming the consumer appeal of 100% natural product in next-to skin categories.

And lastly, Altra, the fastest growing brand in our portfolio, is celebrating its 10th anniversary this year by establishing its legendary Lone Peak franchise as the number one trail running business in the US. The brand has continued to build accolades from the running community with awards from Runner's World, Self Magazine, Women's Health, and Outside Magazine across multiple franchises.

Through the first half of the year, the brand has grown over 60% relative to fiscal 2020. And we expect this to accelerate into the back half of the year as the brand continues to expand its presence in road running with innovative new styles and designs. We see tremendous opportunity for Altra to expand distribution domestically and internationally, leveraging its differentiated product and continued strong tailwinds for this category.

I see significant potential for each of these brands to deliver outsized growth in the years to come. We have demonstrated the ability to scale brands into big businesses. And I have confidence that over time these outdoor emerging brands will become another strong component of VF's financial algorithm.

As I conclude my prepared remarks, I'd like to remind everyone that before the pandemic our portfolio was on track to deliver high-single-digit revenue growth and high-teens earnings growth in fiscal 2020. While we remain in a disruptive environment, I believe VF's long-term prospects are even more attractive today.

We've accelerated our transformation strategy. We have further optimized our portfolio. And importantly, this portfolio today is capable of delivering greater broad-based strength relative to where we were before the pandemic. This gives us even greater confidence in our ability to drive high-single-digit top line and low-teens earnings growth at a minimum as we emerge as an even stronger company.

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 happy to give an update on our progress as we navigate the recovery. And importantly, I'm encouraged by the resiliency of our business during the first half of fiscal 2022. The environment has clearly evolved differently than we had planned in May.

However, our teams remain focused on what we can control, and they are delivering. The underlying top line recovery across the majority of our business has exceeded our plan, offsetting new challenges in the APAC region and ongoing disruptions across the supply chain network.

Through thoughtful allocation of investment, we've been able to drive continued strategic investment spending while leveraging other parts of our SG&A base to protect earnings. As a result, I'm proud of our ability to hold on to our fiscal 2022 earnings outlook of about \$3.20, despite a more challenging than anticipated operating environment, including an incremental headwind of about \$0.09 from expedited freight. This should be a strong signal that this management team is committed to leveraging the significant optionality in our model to deliver on our earnings commitment.

Before unpacking our Q2 results, I want to quickly run through the operating environment across the region and share the latest outlook for our global supply chain. Starting with the Americas region. Product delays and reduced traffic during virus surges impacted the business during our highest-volume period this quarter. However, the region was able to deliver 22% organic growth in Q2, representing continued sequential underlying improvement.

Retailers remain bullish on the upcoming holiday season, and we are focused on delivering products in time to support strong demand signals. Cancellation rates remain historically low due to tight inventories. Conversion remains exceptionally strong, and we see continued reductions in promotions compared to last year, driving strong average selling prices.

Next, the EMEA region delivered mid-teen organic growth in Q2 despite meaningful supply chain disruption, particularly for The North Face. The underlying business continues to perform above the overall market, supported by strong performance with key digital titans. This region was strong before the pandemic and has shown incredible resiliency throughout this disruptive period.

Stores are showing continuous recapture volumes despite softer street traffic in large metro areas. We are encouraged to see the brick-and-mortar D2C business for both The North Face and Vans inflect meaningfully this quarter, each returning to positive growth relative to fiscal year 2020. Recovery momentum and sustained growth are expected to accelerate throughout the year as vaccine rollouts progress.

Finally, the APAC region delivered low-single-digit organic growth despite a more challenging backdrop than anticipated for parts of our portfolio. Due to a resurgence of COVID-19 across the region, economic growth and consumer confidence has softened since July. Parts of our business in China have been further impacted by weaker digital traffic for non-domestic brands. This has been more impactful for Active brands relative to outdoor.

Across the portfolio, we believe we are performing better in our respective categories versus other international brands. And while we remain bullish on the long-term opportunity in the region, these pressures have impacted our near-term outlook. We now expect low-teen growth in China in fiscal 2022.

Moving on to our global supply chain. The environment remains challenging and has continued to deteriorate following our Q1 call in late July. The resurgence of COVID-19 lockdowns in key sourcing countries like Vietnam, have resulted in more impactful production delays and the logistics network continues to face unprecedented challenges.

We are experiencing increasing product delays from the supply chain disruption, which is creating meaningful quarter-to-quarter volatility in our results. Let me unpack all of this in a little more detail. Due to VF's large and strategically diversified sourcing footprint, our overall production capacity has remained better positioned than most, with about 85% of production operational throughout the quarter. Pressures have generally concentrated in the southern region of Vietnam, which represents about 10% of VF's overall sourcing mix.

We remain confident in our ability to navigate the production environment. However, the logistics network remains under increasing pressure. Ports are generally open, but operations remain severely impacted by labor and equipment availability, servicing significantly higher ship volumes. As a result, our dwell times at point of destination have increased significantly.

In aggregate, supply delays are pervasive and, in some cases, have extended 8 to 10 weeks. As a result, in the most recent quarter, we had a material shift of revenue from Q2 into Q3, with more than half of this tied to Vietnam. Despite these delays, cancellation rates have remained below historical levels, signaling strong demand and tight channel inventories. However, delays ultimately impact product availability across the marketplace.

Virtually all of our brands are experiencing delayed collections, styles and, in some cases, insufficient size assortment, limiting their ability to fully meet strong demand. For example, the Supreme brand has experienced around 30% less inventory around drops. So despite strong sell-through trends, we are losing volume from limited supply. This environment is where our world-class supply chain differentiates itself, highlighting the significant competitive advantage VF has created with this platform.

We have always maintained a diversified sourcing footprint to provide resiliency against unforeseen changes in the operating or geopolitical environment. For example, our largest market, Vietnam, only represents about a quarter of our sourcing mix. And within Vietnam, we work with multiple partners, have a presence in multiple provinces, both between the northern and southern regions of the country, and maintain access to multiple ports.

Our teams are leveraging VF's scale and relationships to navigate the challenging logistics environment in the most cost-effective way. We continue to utilize expedited freight across the large number of air providers. We have doubled our network of ocean carriers and significantly expanded the number of ports utilized across the globe. Our commercial and supply chain teams are working closely with our key wholesale partners, increasingly using direct shipping. And our work indicates we're doing better than most of the competitive set at keeping product on the shelves.

Our relationship with these key wholesale partners continues to strengthen with our open, transparent and timely communication throughout this dynamic situation. So despite the unprecedented level of disruption across the global supply chain, our teams have been able to keep product flowing, supporting our strong holiday growth plan and allowing VF to effectively hold our revenue guide for fiscal 2022.

Moving into some additional highlights on our second quarter. Total VF revenue increased 21% to \$3.2 billion despite a significant amount of orders shifted from Q2 into Q3, implying continued sequential underlying improvement for the portfolio. For context, we estimate this shift represented a mid- to high-single-digit impact to VF's Q2 growth rate relative to fiscal 2020.

Our adjusted gross margin expanded 300 basis points to 53.9% due to higher full-price realization, lower markdowns, favorable mix and around 20 basis points contribution from Supreme. When compared to prior peak gross margins in fiscal 2020, our current year gross margin was impacted by about 180 basis points headwind from incremental expedited freight and FX.

Excluding these two items, our organic gross margin in Q2 is over 100 basis points above prior peak levels, driven by favorable mix and strong underlying margin rate improvement. And as a reminder, our Q2 2020 gross margin was very strong. So, our ability to deliver this level of underlying expansion against fiscal year 2020 margins is a strong testament to the health of our brands in the marketplace.

Our SG&A ratio improved in Q2, down 100 basis points organically to 37.2% despite elevated distribution spend and continued growth in strategic investment. This strong underlying leverage was driven by discretionary choices and is a clear reflection of the optionality within our model, supporting organic EPS growth of 60%.

I am proud of our team's ability to deliver earnings of \$1.11 in Q2 despite incremental expedited freight expense and significant wholesale shipment timing headwinds in the quarter, reflecting the strong underlying earnings momentum of the portfolio.

Now, a few comments on our revised fiscal 2022 outlook. We are holding our revenue guidance to be about \$12 billion despite a weaker China outlook in the near-term and a lower than expected back-to-school performance at Vans in the US and ongoing supply chain challenges, all of this highlighting the broad-based strength across our brands and geographies.

Our gross margin outlook is now about 56%, including 40 basis points of incremental freight cost relative to what we had expected in July, implying an improving underlying gross margin outlook. And adjusting for incremental freight and FX, our fiscal 2022 outlook implies over 100 basis points of underlying gross margin expansion relative to peak gross margins in fiscal 2020, driven by favorable mix and clean full-price sell-through.

We are holding our operating margin outlook to around 13% for fiscal 2022 despite the incremental freight costs covered. As Steve said, we're focused on what we can control. And for me, SG&A control is clearly top of mind. We are offsetting supply chain and distribution costs headwind with spend reduction actions, while protecting strategic investment and demand creation. The business is driving impressive underlying leverage and our confidence is strong that we can continue to accelerate this over time.

Finally, as discussed, we are reaffirming our full year earnings outlook of around \$3.20, despite about \$0.09 of incremental costs directly attributed to the supply chain disruption, a strong testament of portfolio resiliency and the optionality of our model.

Steve introduced an important concept that VF is not just one brand, and I want to reiterate this as I conclude our prepared remarks. Before the pandemic, VF was more reliant on the Vans brand. Today, however, we have a much larger portion of our business performing at or above our expectations. There is broad-based momentum across the portfolio. VF also has powerful enterprise platforms, highlighted by our world-class supply chain, which provides a significant competitive advantage to our business.

And lastly, VF has the capacity to drive meaningful incremental shareholder value through capital allocation optionality. We've demonstrated this over the course of the pandemic by maintaining our dividend and trading our Occupational Work business for the Supreme brand.

And as you may have noticed in this morning's release, our share repurchase program has been reinstated, with remaining authorization to repurchase up to \$2.8 billion of common stock. As we have line of sight for our leverage threshold, we have this additional optionality, and we'll be opportunistic on share repurchases moving into the balance of this fiscal year.

VF is not just one brand. We are a diversified portfolio of strong brands, supported by world-class enterprise platforms, which we believe, at minimum, can drive high-single-digit revenue growth, low-teens earnings growth and provide meaningful capital allocation optionality moving forward.

Let's open the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Thank you. And our first question comes from the line of Matthew Boss with JPMorgan. Please proceed with your questions.

Matthew R. Boss

Analyst, JPMorgan Securities LLC

Q

Great. Thanks. So, maybe to start with Vans. So, global brand revenues more or less flat to pre-pandemic in the first half of the year. I guess, could you just help walk through drivers behind the confidence in 7% to 9% for the year? What exactly accounted for the forecast cut this year? And any change to 12% to 13% as a multi-year target?

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Hey. Good morning, Matt. Let me start off. We see nothing in the Vans strategy that would tell us that we cannot grow double-digits long-term. This brand sits in an active TAM with a very [ph] – attractive on a day – today, (00:29:37) and we think only growing as this casualization megatrend accelerates.

We've grown high-teens since the acquisition. That's over a decade of high-teens growth. And we continue to see significant international white space in China, in Europe, but continue to see growth here in the US. I think what gives us confidence as we look forward, is we have a renewed focus on our icon management strategy. A proof point this quarter was the 25% growth that we saw in our skate high as they leaned into marketing that particular icon.

And as we come through Q3 towards the back half, you'll see us begin to elevate the icons in general and really getting back into the systematic cycle of pushing the five key icons, while we also continue to support our progression, which is where the Altra sits, MTE, where we've seen very strong sell-through as well as leveraging the growth in apparel, which is really opening up those multiple wear occasions that the brand can enjoy.

We'll continue to leverage the in-store experience. That is a core element of how this brand connects with its consumers. And we'll continue to lean into growth here in the US and Europe, and look to really support our Asia teams as we focus on that China growth trajectory and getting the brand back in sync with what we know is very possible as the brand pushes the notion of creative self-expression in a very brand right, but local consumer relevancy to elevate the brand there in China.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Hey, Matt. I'd just add a couple of things in terms of thinking about the acceleration in the back half of the year that's implied. And this is a true statement across all of our brands. But certainly, there's a significant inflection in the wholesale business based on the order books. And we've talked about the differences in the spring order books versus the fall order books and the time that those order books were placed has impacted that pretty significantly.

And just to give you an example, for Vans on a global basis, our wholesale business was down, call it, high-single-digits in the first half. We expect it's going to be up, sort of, low-double-digits in the second half. And again, that's supported by the order books that we have. And we've really got visibility at this point pretty much all the way through the end of our fiscal year. So that's one thing I think it's worth understanding. And certainly, again, it's relevant for all of our brands.

The other thing is our demand creation efforts will accelerate from a spend standpoint in the back half of the year. That's always been our plan. And you'll see that we've got that built into our modeling from the beginning. We did have a bit of an acceleration through back-to-school versus what we saw in the first half of the calendar year, but even more so as we move into the holidays. So strong demand creation investments and strong programs coming to support the business.

And then probably the last thing, as we've said all along, we expect some continued improvement in our traffic into our large and highly productive brick-and-mortar base of business. And we've generally seen that. We did see a little bit of a – a little bit lower than our expectations in the month of August, in particular, here in the US in terms of the traffic builds. And we think that was certainly tied in some ways to the Delta variant and some of the new restrictions that were placed back on consumers there in that period of time.

But generally, from the beginning of this calendar year all the way through September, setting aside August, we've seen the business sequentially improve. From a traffic standpoint, September was our best month of the quarter. October has actually started off good. We're actually on track. And honestly, we're slightly ahead of our expectations in the Americas region from a D2C perspective during the month of October. So just a few more data points there for you relative to really what's supporting the acceleration implied in the outlook.

Matthew R. Boss

Analyst, JPMorgan Securities LLC

Q

That's great color. Matt, maybe just as a follow-up. On the gross margin, so the 56% for the year. I guess, could you just break down the underlying drivers that improved in the outlook, which helped to offset the worst freight headwind? And just any color in the third quarter versus the fourth quarter as we think about gross margin?

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah, sure. So it's pretty simple, I think, in terms of the underlying drivers, Matt, that are offsetting – yeah, we continue to see some headwinds from expedited freight, and we mentioned that in our prepared remarks. It's underlying rate. It's better sell-through. And ultimately, the merchandise margins are stronger. And that's – generally, we're seeing that across the board. So I think that's pretty straightforward.

As it relates to some shaping in the second half, what I would say about gross margin is, we expect Q3 to be about 57% with organic expansion a little bit stronger than what we saw in Q2. And we'll continue to have some expedited freight hitting that quarter as well. A lot of what we went into the forecast that's different from the prior forecast is sitting in the third quarter.

Matthew R. Boss

Analyst, JPMorgan Securities LLC

Q

Great. Best of luck.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. Thank you, Matt.

Operator: Our next question is from the line of Erinn Murphy with Piper Sandler. Please proceed with your questions.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Great. Thanks. Good morning. I guess I have a question first on China. It did decelerate versus the last quarter, and you called out some of the COVID challenges there. But as we take a step back, can you just share a little bit more about your confidence in the region longer term? And then I do think you cut your APAC region outlook by about 600 basis points. Was that all China? Or are there some other regional headwinds we need to be mindful of?

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Hey, good morning, Erinn. Yeah, the region issue sits squarely in China. There have been some Delta impacts in some of the smaller markets. What we've seen is certainly an issue building here in China. I mean, there's a number of factors that are impacting our China business. First is the resurgence of COVID across the Greater China region. It really has had an impact on economic growth and, more importantly, consumer confidence.

And we've seen that in our store traffic coming into brick-and-mortar. And we've also seen that challenging some of the digital titan platform traffic, where we have a big presence from a digital standpoint. And some of our legacy marketing tools, specifically key opinion leader marketing, are no longer available and having a short-term impact.

It doesn't mean long term that we won't adjust and in fact, we are, but that did have a short-term impact. But I think, importantly, what we do expect to see is a re-acceleration. And I think there's three really key reasons here.

From our decision to establish an even stronger structure and presence in Shanghai, something we've been working on now for many months, allows us to better understand the marketplace variables and to speak to the local consumer in a more relevant and authentic way for each one of our brands.

Our decision to hire our leader in China and expand Winnie's scope beyond just Greater China is having a very outsized impact. Her confidence and experience in understanding the local market, local consumers, how to engage with our key strategic partners, is certainly elevating our brands and our business' ability to understand the consumer and navigate some of these new variables that we see.

As we stand up our brand teams in Shanghai, that local market knowledge is going to help us really bring our brands purpose, our VF purpose for our associates to bear. And we're seeing that as a really important element today, as we focus on the health and well-being of our associates.

There's a notion here in our brand marketing. We see it coming to life in The North Face. We're really putting our purpose in place and really elevating our messaging and our connections and delivery of value around health and well-being to the Chinese consumer and really looking to improve their life through engaging with our brands, the experiences that our brands enable and connecting in a much more one-to-one way.

We think these strategic shifts that we've been really driving over the last 12 to 18 months position us in a very strong way to navigate these new variables and get that re-acceleration back into the business.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Great. Thank you. And then if I could – yeah.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Erinn, a couple of data points there to build on from Steve again. When you think about the China reduction that's implied in the guide, about a third of that is coming from, let's call it, COVID-related impact, primarily demand, I mean, a little bit of supply challenges there, but primarily demand.

And then the rest is sort of the comment that Steve made about the consumer and what we've seen here in the short term. And then as you said, there's certainly some COVID-related impacts across the rest of the region, as we saw some lockdown measures and closed stores and just generally consumer confidence in some of those other countries that waned a bit during the quarter.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Got it. No, that makes sense.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Maybe last thing I would say, because I think it's important. From a VF perspective, we certainly – we didn't really change our guidance. We did soften the language slightly. I can tell you that's all really driven by China. Without

that, you wouldn't have seen any change. And I would also tell you, without what we saw occur in China, we would have not changed our Vans outlook.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Okay. That's very helpful. And then just if I can add one more. As we move into holiday, obviously, inventory is very clean. What is your promotional outlook for this holiday? And then as we move into the early part of 2022, we'll all be particularly in this marketplace, lapping a pretty hefty stimulus. Just curious on, do you see the promotional outlook evolving as we move into the first calendar quarter? Thank you.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yes, I would say we expect the promotional environment to be quite clean for the holiday time period. That's how we're set up and what we expect. And certainly inventories continue to be really lean across the marketplace. That's the case for our brands and, I would say, for most. So we expect a really clean and lack of promotional kind of environment certainly versus historical.

And as we think about moving into spring next year and even beyond, certainly, our view will be that the promotional environment is going to continue to be quite good. I'll remind you that our business historically is clean. We don't promote a lot in our brands. And that's been one of the things we've been trying to help everyone understand when you look at the two-year compares versus some of the peer set. Our business was really clean and healthy two years ago. It's that way now. We expect it will be next year.

As you think about gross margins next year, we expect margins will expand bottom line. I think we expect margins will expand probably at least 0.5 point in line with our LRP. Certainly, there's some headwinds, input costs, inflationary pressures, the elevated freight costs that are certainly going to continue for a period of time, but there's tailwinds as well.

As I said, promotional environment remained clean. We certainly would expect we're not going to see the same level of expedited freight that we've seen this year. Our mix benefit will be intact. We've got continued momentum in some of the brands, we've had opportunities to strengthen gross margins on the back of stronger brand equity. Timberland and Dickies are examples of that.

And then last but certainly not least, the biggest, I think, tool in the toolbox here is pricing. And we certainly expect and we've talked about we're going to start to see meaningful impacts from pricing as early as our fiscal Q4 and as we think about spring 2022 and even more so fall 2022 of next year.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Thank you so much.

Operator: Our next question is from the line of Bob Drbul with Guggenheim. Please proceed with your question.

Robert Drbul

Analyst, Guggenheim Securities LLC

Q

Hey, guys. I guess the first quick question is, are you thinking of changing the name of the company to Vans, given all the questions that we have on Vans?

But I do have a couple of questions on Supreme, if you could. I think you talked about Supreme missing or just missing some supply opportunities in terms of the business. Can you quantify that a little bit? And just as you think about the back half of the year, do you expect to sort of get that product in? And will you continue to sell it there? And could you just give us an update on the international expansion plans for the Supreme business over the next 12 months? Thanks.

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. Hey, Bob, good morning. To Supreme, Supreme has had a disproportionate impact to the supply chain disruptions that we're talking about. They've got an exposure into Vietnam. And if you think about the model, due to the nature of how they flow products, they don't carry forward inventory. So when a particular drop is not able to be delivered on time, yes, they have an agile model and they're able to move around. But the impacts that they've seen this quarter were such that it had a pretty material impact on what we were able to do in Q2.

The good news is sell-through trends continue to be very strong. And – but we saw a decrease in inventory. We did see a continued strong interest and a clear opportunity for the brand to continue to grow. But I think the supply chain interruptions are helping us all see the further benefit of the supply chain integration that is in place that will help us, help our Supreme team really diversify their footprint and focus in areas where we can help them maintain better flow.

As we think about longer term and coming into the second half, we have line of sight to delivery, the inventory required for the weekly drops. And that wasn't true six weeks ago. So I think there's a lot of confidence here that we can recapture that momentum. And we really start to recapture that lost volume. In some of the most recent drops we've have seen are really strong evidence of that demand. So I think, in light of this disruption, the plan that this group operates with the agility to be able to flex continues to be a competitive advantage. And as they integrate into our supply chain, will help be able to mitigate some of these impacts.

To your European question or international expansion, COVID's had an impact on our team's ability to travel, [ph] begin (00:45:10) to meet and work with our European and international team. So that work is continuing virtually. Our Supreme team needs to get into market. The model by which they look for new stores that really anchors the brand in new cities has been slowed based on COVID. That work with our team certainly will help them speed up that knowledge base as they hit market. But we're certainly a few months off of what would have been a plan that we were ready to execute on into fiscal 2023. But the geographic expansion potential remains very strong, a key part of our growth, and you'll see us continue to open stores both in Europe and Asia as the teams are able to get into market.

Robert Drbul

Analyst, Guggenheim Securities LLC

Q

Great. And I guess just a bigger question on – you talked about wholesale shipments sort of not making the second quarter shifting into the third. I think you specifically called it out for Vans. Can you quantify how much of the wholesale business will shift into the third from the second, or what you missed in the second that you'll catch up in a third one?

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. Sure, Bob. Let me see if I can get to what you need here. So from a – first of all, this is why we didn't provide guidance for the quarter or try to call the split there between Q2 and Q3 as we knew it was going to be a pretty volatile environment, and it certainly played out that way.

From a shipment timing perspective, we said mid to high-single-digit impact to VF's organic growth in the quarter relative to fiscal 2020. And that's really impactful across all of our businesses, certainly several points of growth for the Big 3 brands. And also, as Steve just described, pretty impactful for Supreme in the quarter as well. And this was especially true, I would say, in the US and Europe and, to a lesser degree – to some degree, in Asia, all those small impacts there.

At a brand level, Vans would have been sort of at pre-pandemic levels in the quarter. And TNF and Timberland in particular would show meaningful acceleration versus where we were in Q1, adjusting for the impact of the wholesale shipment timing.

And I think in terms of what we expect. We expect virtually all of that's going to get out the door and ship here in Q3. And as a result, it's one of the reasons that we've been comfortable, essentially holding our full year revenue outlook, and then coupled with what we see in terms of the strong underlying momentum from a sell-through perspective.

Robert Drbul

Analyst, Guggenheim Securities LLC

Great. Thank you.

Q

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

Bob.

A

Operator: The next question is from the line of Michael Binetti with Credit Suisse. Please proceed with your questions.

Michael Binetti

Analyst, Credit Suisse Securities (USA) LLC

Hey, guys thanks for all the detail here. Steve, I think – thanks for all the color here today. I think the most helpful thing – and I can't believe we're still here in late 2021 talking about these big coronavirus disruptions, but I guess here we are. So, I really appreciate some of the commentary on the revenue and EPS outlook, I can tell you're starting to look ahead to fiscal 2023 already. And I know you spoke to North Face and Dickies, outlooks for 2023, you gave us an overall revenue and EPS thought. I'm wondering if you could help us complete the picture a little bit on what you – how you're initially thinking about Vans and Timberland for 2023.

Q

And then, I guess, Matt, I know you just gave us a little bit of color on Bob's question on revenues in third quarter versus fourth quarter. Is there any way you could just quantify what you see is the revenue dollars into the quarter, growth rates into the quarter? And it sounds like a lot of the wholesale snapback is in third quarter. But we've heard some of the other athletic brands and footwear brands speak to some supply chain constraint landing in the March quarter, so your fourth quarter. I'm just curious what you baked into the fourth quarter there.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Steve?

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Thanks, Michael. I'll start. To your question on fiscal 2023, clearly, it's early for us to be able to talk about how we're looking at that. But I think the confidence that we have in our portfolio, which we spent a lot of time strategically evolving to where we are today. Each one of our brands has the potential of achieving this long range plan. And you see that happening this year with many of our brands.

Specifically to Vans, we see them getting back to low-double-digit growth and being able to deliver that on a consistent basis. Our North Face business is building momentum. You've heard us really begin to talk with a lot of confidence, the work that's been done to really strengthen that team, tighten up our merchandising strategies, get the flow between the on-mountain and off-mountain product collections, raising our outlook for the year on a two-year basis to 16% to 18%, I think is a proof point of that confidence.

Timberland's inflecting. We see them really owning and driving that boot culture. And as we really drive our integrated marketplace strategy and the merchandise flow, the new products coming with GreenStride, TrueCloud, some of the things you see going on in the women's business, give us confidence that this business is inflecting and has great potential.

And I'll take one more point. Our Dickies business, raising our outlook, as we did this year, just now to greater than 30% on a two-year stack. This business is very unique. We saw this [ph] with the (00:50:57) point of acquisition. And the way our team is really looking at horizontally playing out that work and work inspired piece, but also [ph] been (00:51:04) thinking on a vertical axis against the different distribution opportunities and moving into higher tiers of distribution with higher – with product with a little bit more style, a little bit more quality of materials and opening up that lens and grabbing new consumers on a global basis. We have a brand that has the potential of achieving \$1 billion here quickly, while at the same time becoming a benefit from an operating margin standpoint to the larger VF.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Well, Michael, your question on shaping of revenue. So yes, I'll answer your question. Barring further supply chain disruption, but certainly contemplating what we know today and, in particular, around the flow of inventory as Vietnam ramps up, I would tell you in Q3, we expect revenue to be about \$3.6 billion, including high-single-digit organic growth versus fiscal year 2020.

And let me just fill in the rest of the blanks while we're at it, because I assume it's going to come up. We talked about gross margin. I'd say operating margin of about 16%, earnings of at least \$1.20, inclusive of about \$0.06 of incremental expedited freight versus fiscal year 2020.

Michael Binetti

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. So the other \$0.03 from the \$0.09 then goes in the fourth quarter? It sounds like a little bit of a placeholder there.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Well, the \$0.09 is the incremental – from our – by our outlook for this outlook. That \$0.06 is just to give you a sense of the difference versus the two year compare from an earnings standpoint, about \$0.06 in that quarter is our current view.

Michael Binetti

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And I guess the elephant in the room is how much is in that \$3.6 billion from Squid Game?

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah.

Michael Binetti

Analyst, Credit Suisse Securities (USA) LLC

Q

[indiscernible] (00:52:59) I can't believe you made it this far in the call without a question guys. I can't believe Drbul let it slide.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. Let me say this Michael, yeah, Squid Game is – we saw a nice spike – well, I'd call it a small spike, but I'll promise this is not a damned annual event. [ph] This certainly (00:53:16) has helped raise some media attention that we'll leverage, to my point, of us leaning into the Classics campaign. We'll use this moment and continue to build on Vans connection to pop culture. But I think we're focused on things that we can control and the flow of new products and the benefits that has on Vans connection to consumer. It's probably more where our emphasis is for sure.

Michael Binetti

Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. Thanks again for the details guys.

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Thanks, Michael.

Operator: Our next question is from the line of Dana Telsey with Telsey Advisory Group. Please proceed with your questions.

Dana Lauren Telsey

Analyst, Telsey Advisory Group LLC

Q

Hi, good morning, everyone. As you talked about the wholesale business and the shift to the back half of the year, are you seeing a difference by brand in terms of that shift? And is it specific accounts where you talked about the strengthening and what you're seeing? And then just lastly, on price. Is price – besides full price, are you seeing – are you taking any price on any of the brands with any of the newer product that you're introducing? Thank you.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

Hi, Dana.

A

Dana Lauren Telsey

Analyst, Telsey Advisory Group LLC

Hi.

Q

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

Nice to talk to you. In terms of the shipment timing, I think it's impacting all of our brands. I would say it's most impactful for the outdoor brand. And honestly, I would say the two brands that are probably feeling it the most are The North Face and Supreme, honestly. But all of our businesses – and as I said, it's impacting at least several points of growth for the Big 3.

A

And as it relates to the comments about strength and sell-through, that's broad-based, really across the businesses. And I'm talking specifically about the US. We see it in our big brands, certainly. We're also seeing it with the emerging brands and the outdoor emerging brands, in particular, that Steve talked about. So it's not any one place. Certainly, The North Face brand is really strong, and the product is moving really quickly as we can get it on to the shelves. We're seeing significant growth in sell-through despite inventories still well below where they would have been two years ago. So it just speaks to the velocity that we're seeing from a sell-through perspective, in particular, in that brand.

Dana Lauren Telsey

Analyst, Telsey Advisory Group LLC

Got it.

Q

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

As it relates – go ahead.

A

Dana Lauren Telsey

Analyst, Telsey Advisory Group LLC

No, you go ahead. Just one follow-up on the digital business, which I think the guidance had been adjusted to 20% growth from previously 29% to 31%. Is that due to the stores reopening? Or is there anything you're seeing in China or the other markets given that adjustment?

Q

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

Yeah, it's primarily a China impact, Dana. That's really the primary driver. I mean there may be a couple of modest very small changes in other parts of the business, but basically it's a China story.

A

Dana Lauren Telsey

Analyst, Telsey Advisory Group LLC

And just lastly, on the freight side, do you expect that to go into 2022 – into calendar 2022?

Q

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah, we do. We expect the freight – some of the pressures there on freight and I assume you're asking about cost, right? We expect that to continue from an inflationary standpoint moving into calendar 2022. Over time, I think it will begin to moderate a bit, but we're planning as if we're going to continue to see pretty meaningful increases in freight moving forward.

Now we do expect the level of expedited freight that we've had to navigate this year because of the shutdowns and the COVID challenges in the supply chain will certainly look a lot different next year. That's our expectation. But in terms of the underlying rates around freight and just the challenges of around capacities and those kinds of things, that we expect to continue for several quarters.

Dana Lauren Telsey

Analyst, Telsey Advisory Group LLC

Q

Thank you.

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

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks. Good morning, guys. Hope you're doing well. You've spoken about this a little bit as it relates to the supply chain disruptions, but I'm hoping you can discuss some of the inventory flow dynamics, what that might result in, in terms of mismatches and assortments. And I'm curious, is that likely to have an enduring impact? Or what are the strategies to manage through that?

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Yeah. Good morning, Jim, I think, long-term, this isn't an issue. It's really short term that our teams are having to navigate a disrupted supply chain as certain factories were shut down. Others have been operating at less than max capacity. But then as we look to bring our goods onshore to the different shipping lanes. It's really a short-term issue, Jim. And I think we can, for the most part, get ourselves back into sync as we come through Q3 and certainly position ourselves well for spring 2022 deliveries.

But it's an issue that we don't typically have to deal with. And it's really – it's more broken assortments where you may not have every item that was planned for a floor set either in our environment or our wholesale partners. But that's where our teams swing into action are able to navigate what we do have to reset those assortments and get the proper amount of product as we wait for the supply chain to be able to fill back in the gaps.

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And I also want to ask on the Altra brand. Valuations of some of the comps in the marketplace represent a beacon. Can you maybe give us an update on the size of the Altra business and expected trajectory for that as you look out over the next year or so?

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yes. So Jim, I don't think I would give you the exact size. I would tell you it's more than double what it was when we acquired it. Actually, at this point, moving towards triple here fairly quickly, I would say in that sense. And we've said that business is growing around sort of 30% or north of 30%. And as we look into sort of the near-term view, no reason to think we're not going to continue to see this brand grow certainly north of 20% to 25% over the next several years.

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Yes. Jim, it has such a unique position in the market from it – how it thinks about the foot and how the athlete's foot needs to really move through the different motions of running and trail running. And I think that – we're seeing that really play out. The Lone Peak, it's no secret that it's been called out as the number one trail running shoe here in the US marketplace by multiple publications. And as the team's understanding, building on that 10-year history, but we're playing in a very significant TAM with a very unique brand that is scaling at a very rapid rate.

And I'm glad you picked this up because we talked about our outdoor emerging brands, over \$550 million in revenue. They're profitable. They're growing high-teens. And each one of them are in significant TAMs. If you think about that in context of some – what's going on in the broader marketplace and some of the IPOs that we see, we have had a history of growing brands. What we've done with The North Face and Vans is – we have the potential of doing with brands like an Altra and helping them achieve their full potential by leveraging the skills and capabilities and leveraging those aspects of our model to really help them drive their growth. So, I appreciate you asking the question. We're excited about Altra and what it means not just for the team but for broader VF.

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Q

You bet. Thank you guys.

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Thank you, Jim.

Operator: Thank you. Our final question today will be coming from the line of Laurent Vasilescu with Exane BNP Paribas. Proceed with your question.

Laurent Vasilescu

Analyst, Exane, Inc.

Q

Good morning. Thanks for taking my question. I wanted to ask about Dickies. You materially raised your guidance for the brand from mid-20s growth to over 30%. What's driving that? Is that driven by a particular region, product category or new distribution? And – or is it driven by some of the entrants into the scrub business? And can you see this brand surpass the \$1 billion mark? Or is the TAM limited to this \$1 billion target?

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

A

Hey. Good morning, Laurent, I appreciate you asking the question, and you're going to get tired of this word. But Dickies' growth is broad-based. It's happening across both work. And as they talk about the work inspired or the lifestyle component of the brand, really leveraging that work element more broadly, it's growing across all regions.

And it's growing vertically beyond its core work, but looking for new points of distribution, even into Tier 1 and Tier 0 type distribution channels.

The brand had a really interesting pop-up shop with Fred Segal during the quarter and saw significant sell-through and energy just validating this team's approach to harnessing the elements of the brand anchored to work and extending it into that maker economy, but really building the strong community around all the aspects of creative self-expression, certainly moving into the maker piece. There's a skate element to this brand. It's always been there with the 874 work pant and really acknowledging that, speaking to that consumer, helping stretch into a new concentric circle.

But really just looking at the integrated marketplace opportunity and really leveraging the core work heritage, driving those icons. But you'll continue to see us evolve our product offer, higher price points, higher quality materials and make into those higher tiers of distribution, but continuing to expand internationally in Europe and Asia and really leveraging that core work heritage that comes from the US marketplace.

Laurent Vasilescu

Analyst, Exane, Inc.

Q

Very helpful. Thank you very much. And then the last question. Obviously, there's a lot of chatter around cotton. I think 10 years ago I'm sure you were asked repeatedly about cotton. Obviously, the spun out Contour Brands, but just – if you can just remind us about your cotton exposure, just your hedging and just the contracts. I don't think you buy directly cotton, but any thoughts on just raw material inflation broadly would be appreciated.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

Yeah. Laurent, I assume that one I should probably take. Yeah, cotton – certainly, there are programs in terms of how we're buying cotton. And that's all, I think, fairly straightforward and consistent with what the industry would do by and large. But I think it's worth recognizing as we've evolved our portfolio over time to be more focused on outdoor and active, cotton is probably less in terms of, say, the component parts of our product than it would have been historically. It's about 10% of VF's product costs today. And based on what we know about the pricing as well as, again, our forward contracts, et cetera, we expect this to negatively impact our product cost somewhere between 0.5 point and 1 point in fiscal 2023, very limited impact this year, really sort of immaterial. And we're planning overall product cost inflation next year to be, let's call it, somewhere around a mid-single-digit headwind sort of in total.

Laurent Vasilescu

Analyst, Exane, Inc.

Q

Thank you very much Matt for all that color. Appreciate it. I think you said gross margins will still be up next year. Is that still the right way to think about it despite the inflationary environment?

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

A

That's the right way to think about it.

Laurent Vasilescu

Analyst, Exane, Inc.

Q

Thank you, Matt.

Matt Puckett

Chief Financial Officer & Executive Vice President, VF Corp.

Yeah. Thank you, Laurent.

A

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

Thank you, Laurent.

A

Operator: Thank you. At this time, I'll turn the call over to Steve Rendle for closing remarks.

Steven E. Rendle

Chairman, President & Chief Executive Officer, VF Corp.

Thank you, everybody, for joining us this morning. Just a few things, I'd love to reiterate. We're very pleased with our broad-based strength across our portfolio and, I think more importantly, the execution of our teams, particularly in this changing and challenging environment. We are seeing improving outlook across the majority of our brands and regions. And I take a lot of pride in our organization's ability to continue to adjust through these unprecedented times. While the pieces of our business have come together slightly differently than we anticipated six months ago, we are delivering high single-digit organic growth versus fiscal 2020. It gives me a lot of confidence in the resiliency that we enjoy from the diversity of VF's business model and our ability to accelerate momentum going forward.

So thank you for your time, and we look forward to talking to you next quarter.

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

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