



## **Kontoor Brands' First Quarter 2020 Earnings Conference Call Transcript**

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### **Corporate Participants:**

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### **Eric Tracy**

Good morning, everyone, and welcome to Kontoor Brands' First Quarter 2020 Earnings Conference Call.

Participants on today's call will make forward-looking statements. These statements are based on current expectations and are subject to uncertainties that could cause actual results to materially differ. These uncertainties are detailed in documents filed with the SEC. We urge you to read our risk factors, cautionary language and other disclosures contained in those reports. Amounts referred to on today's call will often be on an adjusted dollar basis, which we clearly define in the news release that was issued earlier this morning. Adjusted amounts exclude the impact of restructuring and separation costs, changes in our business model, and other adjustments. Other adjustments during 2020 primarily represent costs associated with the company's global URP implementation and information technology infrastructure build up. Reconciliations of GAAP measures to adjusted amounts can be found in the supplemental financial tables included in today's news release, which is available on our website at [kontoorbrands.com](http://kontoorbrands.com).

These tables identify and quantify excluded items and provide management's view of why this information is useful to investors. Unless otherwise noted, amounts referred to on this call will be in constant currency, which excludes the translation impact of changes in foreign currency exchange rates. Constant Currency amounts are intended to help investors better understand the underlying operating performance of our business, excluding the impacts of shifts in currency exchange rates over the period.

Joining me on today's call are Kontoor Brands' President and Chief Executive Officer, Scott Baxter, and Chief Financial Officer, Rustin Welton. Following our prepared remarks, we will open the call for questions. We anticipate this call will last about one hour.

With that, I turn it over to CEO, Scott Baxter.

### **Scott Baxter**

Thank you, Eric. Good morning, everyone. Thanks for joining us. We, at Kontoor Brands sincerely hope you and your families are safe and healthy and will continue to be well as we all

seek to navigate these unprecedented times. We will go through our first quarter results in a bit, but before that, I'd like to share perspective on a few key areas. First, I'd like to provide context around the current environment, how and where our business has been impacted by the COVID-19 crisis next. Next, I'll talk to the decisive actions we've taken during the first quarter to support the health and safety of our colleagues around the globe, as well as strengthen our financial flexibility and bolster liquidity.

Many of these actions are consistent with our strategies since the spin (PH) and have now been either amplified or accelerated to more effectively minimize the impacts associated with the coronavirus pandemic. And finally, I'll highlight why we believe our model is more advantaged to not only weather the near-term storms, but positions us for success in the rapidly changing economic and consumer landscape, as we move into the new environment we anticipate following the crisis.

So, let me start by providing some thoughts on how the COVID-19 crisis has impacted our business. In Asia, the most pronounced impact has been in China, where significant demand softening began at the end of January and continued throughout the first quarter of 2020. At the peak of the crisis approximately 90% of our owned and partner stores were closed. Currently, the China recovery continues to gradually build momentum led by the digital channel and all brick-and-mortar stores have reopened. Although the recovery process remains in the early stages, the sequential weekly improvement in recent brick-and-mortar comps we have seen is encouraging.

The China recovery serves as a blueprint with some distinct nuances for our US and European businesses. In Europe, significant demand declines began to accelerate in the middle of March as many key markets went under stay-at-home orders and largely remain so today. Our distribution network remains operational for digital and hotel orders, but offices and stores in the region are essentially closed. In North America, significant softening in demand began during March; although demand remains soft today, many of our largest hotel customers remain operational.

We continue to receive and ship orders from our distribution centers in the US, and while early days wholesale orders had accelerated meaningfully over the last few weeks. To date, we have not experienced significant service disruptions with our customers given our global, diversified supply chain network. During the first quarter, we took several additional strategic actions regarding the well-being of our colleagues, which remains our top priority. As COVID-19 emerged in February and spread globally in March we proactively implemented measures including closing our own retail stores, first in China, and then around the rest of the world.

Our internal COVID task force has been implemented contingency protocols for working remotely as governmental stay-at-home orders emerged. Remote work policies will remain in effect until restrictions are lifted, at which time a phased-in conditional approach will be implemented. Furthermore, across our corporate and regional offices, retail stores manufacturing facilities, and distribution centers, deep cleaning and sanitary protocols have

been implemented to support the safety of company associates. Given COVID-19 impacts accelerated we also took personal decisions, including announcement temporary salary reductions for senior management and other key leaders.

Unfortunately, as the COVID-19 crisis intensified, these impacts extended to our global team as we made the very difficult decision to reduce headcount in certain areas, implement temporary furloughs and additional salary reductions, impacting many of our colleagues around the world and our own retail stores, distribution centers and corporate and regional offices. We are grateful for the commitment of our extraordinary people and we look forward to welcoming our furloughed colleagues back. Also, during the first quarter, we took action to help our communities by producing level one patient and disposable isolation gowns to assist hospitals that are dealing with the influx of patients as a result of COVID-19. The gowns are being produced at our plants with fabric donated by several suppliers and being donated to North Carolina based hospitals.

We are proud to support the effort of many across the country in fighting COVID-19. We continue to look for ways we can help our communities and the people most affected by this crisis. We've also proactively taken significant financial measures to both ensure near-term financial flexibility and strengthen liquidity, but also position us for future success. And this future doesn't assume a return to pre-coronavirus normalcy, but one in which we assume a prolonged COVID-19 operating environment for the balance of 2020, including our expectation of higher promotional levels and accelerated retailer door closures.

While this crisis has undoubtedly impacted countless lives and disrupted businesses all over the world including ours, we also believe we have an opportunity to help lead our industry in shaping the new future and we are well prepared to do just that. So, let me provide an overview of the financial actions we've taken to support our liquidity in greater financial flexibility. We renegotiated our credit facility including amending covenants for the future periods and drawing down \$475 million on our revolver, in the first quarter prior to the amendment in conjunction with our amended credit facility, we have temporarily suspended payment of a dividend. A topic I will spend more time on in a moment. We've taken reductions across variable and discretionary expenses, as well as select capital expenditures. Let me be clear here though, we continue to invest behind long-term, high-ROI areas including defending and enhancing our core business and driving new business development opportunities. Further evolution of our accretive digital and international businesses, as well as the implementation of our new global ERP. Rustin will provide greater detail in most of these actions a bit later.

But I wanted to address one of these topics upfront and that is the dividend. In conjunction with our recently amended credit facility, we have temporarily suspended the dividend. Key here is the word "Temporarily." The decision to amend the credit facility and suspend the dividend was not taken lightly as we understand how foundational the dividend is to our long-term story. The payment of a dividend has been and will be an essential element of the contour investment thesis in total shareholder return model. And our management team and

the company's board of directors are committed to reestablishing a dividend as soon as appropriate.

In fact, based on the terms of our new credit agreement, the current board (PH) will have an opportunity to reevaluate the dividend as early as the fourth quarter of 2020. We--and we think most in the investment community share this view; believe that cash is king in the current unprecedented environment. So, while we recognize the temporary dividend suspension steps away from our long-term investment thesis, the decision to amend our credit facility and drive enhanced financial flexibility is the right one. Particularly, as we've made the difficult decision to furlough many of our colleagues.

You've seen us take meaningful transformational actions since our spin almost one year ago, from restructuring to cost savings to quality of sales additions. All designed to create the foundation for long-term success. We believe these strategic actions and decisive amplified measures we've taken in response to COVID-19, not only helped navigate the near-term challenges but set us up for success over the long term. Which leads me to offer a reminder of why we believe the Kontoor model is advantaged both during and coming out of this crisis. First, our portfolio consists of two of the largest, most iconic global denim brands that offer consumers an outstanding value proposition. Second, we maintain a long track record of delivering strong financial performance and cash flow during challenged economic cycles.

Third, we are partnered with the best in class winning retailers. Fourth, the restructuring and quality of sales initiatives we've implemented have driven operational improvement and distribution enhancement. Fifth, distorted growth DVC with a focus on own to .com in digital wholesale and international afford accretive diversification. And finally, our supply chain; own (PH) manufacturing currently supports the position of strength and flexibility. Let me dimensionalize each of these competitive advantages a bit further, as always it starts with the brands. We are fortunate to own two of the most iconic global brands within apparel, Wrangler and Lee. These brands have 200 plus years of collective authenticity between them, from the Great Depression to the World War, to cotton inflation, these brands have lived through challenging global crises before. And while this is--current novel Coronavirus pandemic is unprecedented, we believe these brands histories, authenticity and connection to consumers bolstered more recently by investments and demand creation and innovation, position our brands to endure. We believe now is the time to connect with our consumer like never before. And with several initiatives during the first quarter we were doing just that. I'll share just two examples. First, we recently launched a new digital Wrangler campaign called "Long Lived Cowboys" that we're really proud of and believe speaks to the perseverance of our organization through this difficult time, and equally as important, reaches our consumers in a highly authentic way. We encourage you to check up the campaign on many of the large social media platforms including Instagram, Facebook and Twitter.

And given most of the country's stay-at-home orders, we created the "Can't Stop Country Music" series hosted every night at 5 PM on our Wrangler Network and Wrangler brand

Facebook pages, and on the artists Facebook pages as well with participation from country stars Cody Johnson and Jon Pardi. We were able to reach our consumers in a highly unique way, one that provides a bit of an entertaining break on the challenges associated with the crisis. Over 4 million viewers have already tuned into this really personal differentiated entertainment experience.

We will not go quiet with our consumer even during these times, where it is important to stay apart, and we will continue to invest in the highest return areas that elevate our brand's authenticity in connection to our customers and consumers. And just as our brands have maintained a long history through a wider variety of economic cycles so too has our operating model. Just looking back over the last decade or so alone, we've seen a great recession, the cotton bubble, key retailer bankruptcies, door closures and destocking events. We are certainly not immune to these macro-economic shocks, but our fundamentals are resilient, most notably our ability to generate consistent and strong cash flow. Rustin will take you through more details later but let me say this: we have stress tested our model, and we believe we are taking the appropriate actions in support of strengthening our liquidity, driving enhanced financial flexibility and bolstering cash generation through this uncertain environment.

And perhaps equally as important as the strength of our model is the strength of the retail customers with whom we partner. We had and we'll continue to win with winning retailers including our largest retail partners, Walmart, Amazon, Target and Kohl's. These incredible partners are positioned as stable long-term winners, in their respective channels of distribution. As demonstrated since the spin, we have aggressively invested in defending this core and well positioned to continue our highly productive collaboration with these incredible wholesalers into the future. And there's a proof point that these investments are paying off, we are excited to announce today that we have significant program wins and distribution gains beginning in the second half of 2020.

As you know, over the last year we've been implementing enhanced new business development strategies that are generating material new successes. Let me share two examples. First, as I've mentioned in the past, the Lee brand is under distributed in the US. This fall we have won distribution programs with key North American partners including a sizeable program that launches over 2,000 doors during the third quarter. Second, our Wrangler ATG platform continues to build on its early success in the US, leveraging its value oriented high-performance innovation to scale across regions. In the second half of 2020, we will be launching the program in more than 400 doors with a key European retailer. We are extremely excited to share these second half wins, but rest assured we are just in the beginning stages and we expect to share more in upcoming earnings calls.

In addition to program wins, I also want to touch on the evolution of our digital business. With our digital wholesale business increasing 15% globally during the first quarter, and 41% within the US, we have solid proof points that our investments in this channel are highly productive. We have been and we'll continue to aggressively invest behind our digital business.

And whilst still it's early days, the transformation of our owned digital eco-system is well underway. We're excited to announce the recent addition of our new VP of global digital who brings over 20 years of progressively increasing experience with building branded digital platforms. With new leadership, we will take a step change in developing our best in class omnichannel experience for our consumers.

We also recently went live with our new digital platform in Europe, and we'll soon go live in the US as well. As you all know, the implementation of our new Global ERP system and infrastructure will be a key enabler of our digital evolution. And finally, with respect to our model, let me speak to our supply chain. Currently a distinct competitive advantage, particularly when faced with demand and supply shocks like apparel industry is experiencing now. Owned manufacturing allows us to tightly manage the inventory and positions us to most effectively react, as conditions normalize.

Critical in supporting wholesale partners, need to service consumers when market conditions improve both vertically innovative manufacturing located in the western hemisphere allows us to scale production with shorter lead times as demand stabilizes. So how does this all come together? Our advantage model, coupled with decisive actions we've taken during the first quarter to support the welfare of our global team and strengthen our financial flexibility, highlight our adaptability as an organization, and position us for future success. No doubt uncertain times remain, but we are confident in the strategies and actions we've taken since the spin. And now amplified during the first quarter, that should enable Kontoor to emerge from this crisis well positioned to best serve the future needs of our stakeholders.

With that I'll turn it over to Rustin.

### **Rustin Welton**

Thank you, Scott, and good morning, everyone. We have a lot to cover this morning, so let me outline the balance of the call. First, I will walk through how our actions to address our financial resilience unfolded, as the impacts of COVID-19 accelerated across our business. Specifically, we will cover our employee, liquidity and financing actions and implications as we know these are top of mind issues.

Next, we will review our first quarter results. Where possible we will highlight direct impacts from COVID-19. Finally, although we will not be providing guidance at this time given the uncertain operating environment, we will provide thoughts on shaping the balance of the year. As outlined before, our priority was to support the health and safety of our associates around the world. And we began our response as COVID-19 began to emerge with the actions Scott reviewed earlier. After addressing employees, we quickly turned to liquidity and financing. In March, we announced that we had drawn down \$475 million from our revolving credit facility. We took this action as a precautionary measure, to increase financial flexibility, strengthen our near-term cash position and provide additional funding for working capital. With near-term liquidity secured, we began immediate no regret actions to execute temporary

operating and capital expense reductions and adjust near-term production to better align supply and demand.

Next, given the uncertain nature of the environment, under various demand scenarios for 2020 we modeled and incredibly important to note, we projected adequate liquidity to provide operating flexibility. The strong cash generation aspects of our operating model, which we have discussed many times since the spin, are of paramount importance in challenging times. Our two iconic brands, with over 200 years of history, have weathered many storms, and we believe the compelling value of our trusted brands continue to offer are critical in an uncertain environment.

Based upon the scenarios, we also evaluated the covenants under our credit facility. Under a prolonged COVID-19 scenario in 2020, including accelerated door closures in a heightened promotional environment, we did forecast the potential for future period leverage ratio covenant challenges within our original credit facility. Accordingly, well in advance of any potential issues, we began efforts to proactively amend our facility and announce the successful completion of these actions this morning. Key elements of the amendment include: one, covenant relief in future periods with a focus on our net leverage ratio. Two, minimum liquidity requirements through the end of the second quarter of 2021, or earlier if certain criteria are met. And three, suspension of dividend payments for the second and third quarters of 2020 with restricted payments, including dividends, permitted after the third quarter if certain criteria are met.

An 8-K was filed this morning, with additional details on the amendment. As Scott mentioned, in conjunction with our amended credit facility, our board of directors has temporarily suspended the payment of a dividend. In addition to the flexibility the amendment affords, we believe it was the appropriate action. Scott walked through some of the operating and capital expenditure reductions, but I want to assure you that we continue to challenge all operating expenses, from travel to non-business critical meetings, to samples and prototypes to outside services.

As part of this process we have engaged and encouraged our associates around the world to rethink our traditional norms of doing business and share their thoughts on how we can streamline and improve operations. Let me share a couple of examples where we have leveraged technology and reimagined key business activities. First, in China we held our first virtual meeting through WeChat with our dealers that included online product assets, marketing highlights and 24x7 support.

Next, globally we shifted all sales meeting to a virtual format, where new products, marketing campaigns and best practices are shared. And finally, in the US, we've conducted virtual design workshops, and prototype sessions, enabled by collaboration software. In addition to rethinking how we work in this new reality, we are also continuing as we have done since the spin-off, to explore additional cost saving and streamlining opportunities. This week, we are announcing the consolidation of our VF Outlet Headquarters, from Reading, Pennsylvania, to our corporate



headquarters in Greensborough, North Carolina. This difficult decision was not taken lightly, and we want to thank our Reading associates for their dedication and commitment.

We anticipate the actions will be completed by the end of 2020, and over the next few months, we will further define our future structure, operations and transition plans. Although, we remain focused on streamlining our operations, we are committed to continued investment behind key strategic initiatives including, but not limited to, our global ERP implementation and the digital enhancements Scott mentioned earlier. Finally, I'd like to address our supply chain, as I know inventory is a topic of interest. Our supply chain remains a competitive advantage, particularly with respect to inventory management. As we minimize demand and supply and balances in this dynamic landscape, our vertically integrated manufacturing, which represents just over one third of our production, allows us to reduce production in light of decreased volume requirements, avoid the creation of excess inventory, minimize cash flow impacts, while providing the agility to meet demand and support new program wins as governmental restrictions permit.

We are also actively working with our supply partners around the globe to minimize inventory and service delays. While select countries continue to have operating restrictions in place, our diversified supply chain network of internally manufactured and source product reduces risk. To date, we have not experienced material interruptions with our customers in our supply chain. Now let's get to our first quarter review. Unless otherwise stated, results will be on an adjusted basis. Given the unprecedented times, our revenue review will be modified to provide additional detail that we believe is important to give context as to how performance evolved during the quarter. Although it is not possible to clearly delineate the COVID-19 impact and we are not attempting to do so by sharing further breakdown within the quarter, we believe it is meaningful perspective in light of the environment and will therefore take this unusual step for this review.

Global revenue decreased 20% on a reported basis in the first quarter, compared with adjusted revenues for the same quarter in 2019. Headwinds from foreign currency represented one point of the decline. As expected, driven by restructuring and quality of sales initiatives, February year-to-date global revenue declined mid-single digits compared to prior year with approximately one third of the decline from China, where the impact of COVID-19 was most pronounced. In March, as pandemic efforts accelerated on a global basis, revenue declined in the high 30% range compared to the prior year. On our last call, we also talked about our ongoing quality of sales actions that began in 2019 as well as planned decline in select dilutive lines of business. The quality of sales actions to improve our long-term operating performance that began in 2019 were the right thing to do then, and they are clearly proving the right moves in this environment.

These initiatives included business model changes and actions taken to exit in underperforming country and other global points of distribution including select channels in India. Coupled with planned declines in diluted business such as reduced sales of certain lower margin lines and



lower distress sales, these actions pressured first quarter revenue in the mid-single digit range outside of the COVID impact consistent with our expectations. On a regional basis for the quarter, US revenues were down 14%. Through February, revenue declined in the low single digit range as anticipated given quality of sales actions. March revenue declined in the high 20% range.

These declines were partially offset by growth in digital with US digital wholesale increasing 41%, and our own .com digital increasing 7%. Today, most of our largest online and brick-and-mortar retail partners are open, are placing orders and are receiving shipments albeit at lower volumes. Despite lower sales volumes, we estimate that approximately 70% of our North American customers based upon 2019 sales volume remain open with at least reduced hours. The US represented 75% of our revenue in the quarter. Outside of the US, international revenues declined 32% in constant currency. Breaking down performance versus prior year by month January international revenue increased in the mid-single digit range. As effects from COVID-19 were more fully realized in China, February international revenue declined in the 30% range.

Finally, as the effects from the pandemic continued in China and were more fully realized in Europe and other international markets, March revenue declined in the high 50% range. As Scott mentioned, our China recovery has continued to make progress in April. Digital continues to lead the way with positive growth in both March and April, and all wholesale partner and owned stores have reopened and have been experiencing week-on-week improving comp performance. Beyond COVID-19 impact, the first quarter international decline was affected by planned exits and the business model changes, quality of sales actions and foreign currency, which combined pressured international revenue by high single digits.

Turning briefly to our channels, our reported revenue in our US wholesale channel which represented a 66% of our revenue was down 13%. The decline was primarily driven by COVID-19 impacts. As mentioned, US digital wholesale remains a bright spot increasing 41%. This performance is a reflection of long-standing partnerships with leading digital wholesale platforms and the investment we've made into this important area. Our branded direct to consumer channel which represented 10% of our revenues, declined 17%, due in large part to owned brick-and-mortar door closures. Our owned digital business increased 1% driven by 7% growth in the US. While the impacts of COVID-19 have been far reaching, we continue to see positive results from our investments in our digital platform. The implementation of our global ERP system will be a significant enabler in developing our digital ecosystem. Given the accretive under-indexed nature of this channel, we will continue to restore investments to grow in this area.

Finally, let's turn to our brands. Global revenue of our Wrangler brand declined 17%, including one point of headwind from foreign currency. Wrangler US revenue declined 14% in the period. The impacts from COVID-19 planned lower distress sales, and the planned exit or reductions of select non-core programs were the primary drivers of the US decline. These declines were

partially offset by growth in digital both owned and wholesale. Wrangler international revenue was down 27% reported during the quarter, driven by COVID-19 impacts, the actions taken in India and business model changes in Europe. Lee brand global revenue declined 24% including a point of headwind from foreign currency. Lee US revenue decreased 9% driven by the previously mentioned COVID-19 impacts, and the transformational factors.

We remain encouraged by the underlying progress of the Lee US business, including the previously mentioned new program wins. Through February, our Lee US business was up high-single digits. Lee international revenue was down 38% with a point from FX. Nearly half the decline was driven by China, as much of the country was placed on lockdown for the majority of February and March. Now on to gross margin, total adjusted gross margin decreased 320 basis points to 38%. The decline was primarily driven by the following factors. First, inventory provisions based upon higher levels of excess and distressed goods and lower anticipated recovery rates, represented a 340-basis point headwind in the quarter.

Next, lower international revenue lead by China also adversely impacted geographic mix by 210 basis points. Finally, the cost of downtime in our plants as we reduced production to align supply and demand and tightly manage inventory, represented a 40-basis point headwind in the quarter. These declines more than offset the underlying structurally accretive mix shifts and proactive measures we have discussed as an important part of our business model and TSR drivers. During the first quarter, the favorable impacts of restructuring and quality of sales initiatives, pricing and product cost improvements as well as improving channel mix, positively impacted gross margin by 270 basis points.

Adjusted SG&A as a percent of sales increased 310 basis points to 33.6%. The year-over-year increase was driven primarily by increased allowances for credit losses due to COVID-19 and fixed cost deleverage due to revenue declines. These increases were partially offset by tight expense control and restructuring benefits. We delivered adjusted earnings per share of \$0.27 in the first quarter.

Now turning to our balance sheet and cash flow. We ended the quarter with \$479 million in cash and cash equivalents, which was a \$373 million dollar increase from year-end. As mentioned, we drew \$475 million on a revolver during the period which drove the increase. Excluding the revolver, cash decreased \$102 million in the period driven by working capital, global ERP and IT infrastructure investments and our dividend payment on March 20th. Approximately half of the decrease was due to working capital. So, I want to provide a little additional context here. Our business has historically experienced seasonality in our working capital needs. Specifically, we tend to have higher AR balances in our first and third quarter of the year due in part to elevated international shipments as product for new seasons are introduced. Further, inventory in the US tends to peak during the third quarter as we prepare for holiday shipments and moderate in the fourth quarter as shipments occur. Thus, the first and third quarter tend to be the largest uses of working capital, while the fourth quarter tends to be the largest source of working capital.

In the first quarter of 2020, our working capital use was \$49 million compared to a use of \$71 million in the first quarter of 2019. Finally, I will close with some shaping for the balance of the year. As we previously announced and as a result of the uncertainty and significant business impacts caused by COVID-19, we have withdrawn our 2020 guidance provided on our fourth quarter call in March and will not be providing an updated outlook at this time. While we're not providing formal guidance, additional perspective and assumptions are as follows. We believe we are continuing to take the necessary proactive steps to accommodate a prolonged COVID-19 environment. We anticipate negative impacts on revenue, operating income and EPS will be most pronounced in the second quarter of 2020. As we think about the second half of 2020, we are not guiding the impact COVID-19 will have on our results.

However, we do anticipate and would highlight that outside of COVID-19 underlying revenue and gross margins in the second half are expected to benefit from new programs and distribution gains, moderating top-line headwinds as actions taken in 2019, our anniversary and increasing realization of a accretive restructuring, cost savings and quality of sales actions taken in 2019. Finally, due to predictions of a prolonged economic downturn, we have performed stress testing for a variety of financial demand scenarios during 2020, and believe the actions taken are expected to support liquidity requirements and provide operating flexibility. Although it has only been a little over 60 days since our last earnings, we had much to cover on today's call and appreciate the opportunity to walk through the many actions we have taken.

In closing, I just want to reinforce how confident we are that these are the right steps at this time to position Kontoor for continued success in the new environment. This concludes our prepared remarks and I will now turn call back to our operator. Operator?

## **Question and Answer Session**

### **Operator**

Our first question today is coming from Robert Drbul, for Guggenheim Securities. Your line is now live.

### **Bob Drbul**

Hey, guys. Good morning. Hope you guys are well.

### **Scott Baxter**

Hey Bob, how are you?

### **Bob Drbul**

Good, good morning. Got two questions for you guys, I guess the first one just on the dividend, can you maybe just elaborate a bit more in terms of the discussion around resuming the dividend in the Q4, what does have to happen? Can you just talk us through that maybe a little bit more? And I think the second question is, on some of the new programs that you do expect, similar question but the visibility and the confidence in some of those new programs, if you

might just walk through that a little bit more in depth? I think those would be helpful for us. Thanks very much.

**Scott Baxter**

Sure, Bob, I'll take those, and Russ will add in some color as we go along. But I think it's important to know, in the dividend, that this was temporary, it's part of our covenant amendment and it's still absolutely foundational to our investment thesis in our TSR model, so that hasn't changed at all going forward. And I think everybody's in the same situation, that cash is really important right now in the business, but as we've said, we're committed to at the appropriate time reinstating that dividend, and we can do it as early as Q4. And, obviously, I think the thing that most want to see in this industry, and the world, in the sector is continued improvement, and for the world to migrate into a better place, and just to move forward past what we're all going through right now.

But I do think there's one other component that's critically important to the whole dividend discussion, and that is that we take our culture real seriously here, at Kontoor Brands, and unfortunately, and I made mention of it in my comments, had to furlough some folks, and we don't take that lightly at all, and give some pay reductions and do some really tough things to make sure that our business is sound and moves forward in a really constructive way. And we didn't feel as though it was right to go ahead and pay a dividend as we were taking some of those actions. Rustin, anything to add to that?

**Rustin Welton**

No. I think the only thing I would say, Bob, is we did file an 8-K this morning with the amendment around the credit facility, and to Scott's point, the board will have an opportunity to re-evaluate that dividend as early as the fourth quarter of 2020, based upon performance and certain criteria. And you certainly can review that in the 8-K, or we can discuss it at a later detail around that release. Thanks.

**Scott Baxter**

And then your second question. You know, Bob, I think one of the things that, as the CEO, that I'm most proud of, is how the team has managed through this process, but also, if I just step back in time and think about when we transitioned our business and spun off just a year ago, the date is coming up here real quickly, in a couple of weeks, we were a maintenance business for the company that owned us. And at that point in time we had to start a lot of things from fresh, from the start, from scratch, I guess, and one of those things was putting together a comprehensive strategy for our business going forward.

We thought really long and hard about how this world is going to change and what's going to happen, and obviously we never thought that something like this was going to happen. But when we sat back and talked a lot about our strategy here recently, and when we thought about what we did as a team, in developing that strategy, and how it's played into a benefit for us through this period of time, we feel very fortunate. And I'd like to talk about a couple of

those things because I think they're really important. One of the things that we talked a lot about was winning with winners, and if you think about going through this period that we've gone through, we've gone ahead a lot and spent a lot of time with the investment community, talking about the quality of sales initiatives, how we've really cleaned up our sales throughout the globe. That looks like a really smart move right now, because we've aligned ourselves, as I mentioned in my script, with Walmart, Amazon, Target, Kohl's, and I could name several others, but the highest quality retailers in the world, and we feel really good about that position right now.

In addition to that, we talked a lot at time about category expansion, and one of the categories that we expanded in was outdoor with our all-terrain gear. And, like I did mention earlier, that we just landed a significant new account in Europe because this is going to be a global expansion for us. Now, it's taken off really nicely, as we've talked about before, in North America, but now it's going to expand globally. And we've gone ahead and done that and had a nice little program here for the second half of the year.

But one of the things that I talked a lot about earlier was new business development, and new business development is so important for us because, again, we were a maintenance business, spent a lot of time in that, I think everybody knows that, just because you talk about new business development on day one, it takes a long time to develop that with the customer, create product, you know, gain trust and do all the things that you need to do, build relationships. And one of the reasons that we needed to do that was because Lee was under-penetrated here in the United States, under-distributed.

So, fortunately for us we've done a lot of work, and I want to go ahead and send a shoutout to the team that's done all that work, both the Lee team and also the new business development team, that works on behalf of all the Kontoor Brands, they've done an outstanding job. And in the second half of this year we do have a couple of programs coming in, but one really big program coming in that we're pretty proud of. So again, a lot of work done there and I would tell you that one of the reasons why that's worked really well and you heard mention of this from Rustin, and I think this is really important for everybody to think about long term. We pulled Lee into Greensboro this past year and now we have a collective team working together. Lee developing strengths that they learn from Wrangler, Wrangler developing strengths that they learn from Lee collaborating together, working as a team. It's really--and a competition too, a healthy competition for a company which we love and then Rustin mentioned earlier about us now bringing in our direct-to-consumer team. So, all of our forward-facing businesses now will be headquartered together which we think is critically important.

And I'll tell you two other things that really are really important because this is playing out for us a little bit with Lee in China too is the emphasis that we've had in our strategy on digital a long time ago and how that has through this situation obviously, been critically important. We talked a lot about, and we had questions from people about "Why aren't you building more stores?" Well, we've focused on building out our digital and we think that has been a really

accretive part of our strategy. And I'll leave you with this, at this point in time, we have two really great brands, but those brands also offer a great value.

And I mentioned a little bit in my script about how our business is pretty strong right now. We started to see a strengthening in our business at the end of April and here it's really picked up in the beginning of May. And that has to do with our strategy. The strategy, we put in place; strategy we're implementing. Now listen our strategy is going to evolve over time and we're going to continue to do things that we need to do to go ahead and grow this business going forward, but right now we're pleased with where we are, we're going through a really difficult time with the rest of the world, but we like how we are--aligned our strategy and our people and we're really pleased with how the second half is shaping up. So, thanks for the questions Bob. And I hope you and your family are doing well.

### **Operator**

Our next question today is coming from Erinn Murphy, from Piper Sandler. Your line is now live.

### **Erinn Murphy**

Great. Thanks. Good morning, and hope you are all healthy and safe. A couple of questions for me as well maybe just following up Scott on the last thing you were saying. I'm curious if you could speak to what fell through specifically looked like exiting the quarter here in North America and then in April, if you can comment on quarter to date, just given you guys are in a unique position that's you've had channels that are actually open.

And then the second question probably more for Rustin on inventory. Can you just talk about which quarter you expect the inventory to peak in? And then maybe a little bit more from your inventory management actions, how you're thinking about outlets? Can you liquidate US inventory and China? Just curious on some of the actions you're thinking of taking going forward. Thanks.

### **Scott Baxter**

Sure. So, Erinn let me start with China, a very important market for us. We've seen nice progression. I would call it moderate progression every week, which to me is the most important thing. I don't think any of us thought that this thing was going to go back to normal in a 30, 60, 90 day period of time, but what's happened is and what we're monitoring and what we're pleased with is that we've seen week-to-week progression in the business. So at some point in time we'll get back to normal, and then we'll get back to growth, but for us not taking a step back has been really critical seeing the consumer come back, seeing our digital business come back and the consumer reengaging with our brand, having all of our stores open. Our partner stores are really critical and important to our strategy over there.

So, pleased with what's happening from a recovery in China, but again, I'm more pleased with the fact that it's been steady and not something that's been spiking or anything like that. So, pleased with that. I'll take you through a little bit of how I've been thinking about and how

we've been talking about the quarters, as we go here things got really difficult for a lot of folks here at the end of March, the last two weeks and we weren't different than anybody. But we were very fortunate in that some of our retailers we open. We weren't a priority for them at that point in time but what's happened over time is people have started to come back to apparel and people have started to think about what's next, and people have been holding off on some purchases.

And we've seen a nice progression through the month of April and then towards the end of April we saw some increased orders and just started to see it pick up and we're pleasantly surprised about the strength. And I attribute that again to the help of our partners, winning with winners and May has started off like I mentioned in my script very well and we're pleased with how it's coming along, and feel really good about how we're positioned going forward. Now what I would say and this is really important, is one, the country is starting to open up so we've got a lot of states opening up this weekend; a lot of states that have already opened up and many more coming in the very near future. So it's going to be really important to see how others do, because not only a significant part of our business is with current retailers that are already open, but we do have a significant part of our business with people that are starting to reopen.

So it'll be really important to watch and we want to make sure we do all the right things for our associates and for all of our customers, and continue this progression moving forward, but what's really important is we're continuing to invest in the brand, we're investing in our digital space, we're investing in both Wrangler and Lee. We're continuing to invest in the ERP which is going to help position us going forward. It helps us with our platform from a digital standpoint. So, we've got a lot of good things going on in the business right now. Got a lot of good things that we've talked about in the second half. I think one of the things that I'm most proud of with this team is, hey, we went through a tough time. We've got some experience on this team if you come visit us and a lot of you folks know us, a lot of us have been in this industry for a long time, and we've been through some bad times before.

And I think the one thing is we all know we're going to come out of these bad times. That's just how it works. It's pretty tough when you're in it, but for those of us who have been through it before we can see the potential on the other side. We stuck to our strategy and it's paying off right now. So please, Rustin?

**Rustin Welton**

Yes. Thanks, Erinn. Good morning. I'll take the second half of your inventory question here. Let me step back. In my prepared remarks I did mention a little bit about the seasonality we've seen in our working capital trends. So historically Q1 has kind of been a quarter where we build inventory. So certainly, the fourth quarter as holiday ships, we end the year and in pretty good inventory positions and we typically build in the first quarter. So, our inventory in the first quarter of 2020 did increase about \$30 million dollars that was up about 7% from where we ended the year. But just for a little bit of perspective, as we look back to '19, the first quarter



we went up about \$45 million dollars, or about 10%. So, we've been very focused on inventory management and as you'll recall from the last call, we highlighted that that was going to be a big focus of working capital improvement for us in 2020.

In terms of trends you asked a little bit about trends and what you should see. We do project inventory increasing in Q2 and really peaking in Q3, and that is very consistent with what we've historically seen in the business. I would also note that we will peak in Q3 as we have some of the new programs that Scott mentioned earlier, as well as holiday sales as we build inventory for that. You also talked a little bit about liquidation and how we're thinking about that. So, let me give you a little bit of color on that. Fortunately, in our business, we have a lot of core product and we have a quite a bit of product that carries over season to season. We don't have a lot of fashion goods that are at risk. We do have seasonals.

I'll tell you that we're in conversations with retailers that at this point are open to sort of pack and hold on seasonals, and we're working on some of those commitments, so in some cases we may hold inventory. While we do expect higher levels of markdowns as reflected in some of the inventory provisions we took in the first quarter, really think right sizing our production and flexing supply chain to reduce the inventory is an advantage as we indicated in our prepared remarks. Last thing I'll kind of mention on the liquidation side. We do have an 80-store fleet approximately in the US, and VF outlets, Lee Wrangler outlets, Lee Wrangler clearance centers to move excess goods at higher recovery rates. So, we are laser focused on managing inventory and we'll continue to be so over the next few quarters. Hopefully that provides a context.

**Operator**

Thank you. Our next question today is coming from Alexandra Walvis, from Goldman Sachs. Your line is now live.

**Alexandra Walvis**

Good morning and thanks so much for taking the question here. And thank you also for all the color on the call so far. I wanted to ask a question about digital sales. So, a very strong growth rate through the quarter. Could you comment on the cadence of digital sales through the quarter? I'm most interested in whether it accelerated as some of your partner stores are closing and I think your own stores. And then any comment within that digital sales growth of which wholesale digital partners are performing particularly well and thinking about the distinction between mass, department store, dotcom and any other wholesale dotcom. And then my second question is on the gross margin and the puts and takes of that going forward. Should we expect that 200-basis point tailwind to continue through the year and on the other hand, how big could be impacted in inventory positions downtown and manufacturing facilities be going forward? Thank you so much.

**Scott Baxter**

So, Alex, I'll start this is Scott and then Rustin will share the answer with me. So, we think of it as our owned, our partner and our wholesale. And we're really pleased with how our business has transpire there. Obviously, it's been a core tenet of our strategy, and it's been a piece of

business during this time, the consumer has migrated to. We do think that, that migration is going to continue and it's going to pick up a little bit as things go forward. And we've done some things to go ahead and make sure that we're going to be there for the consumer. We recently just put a new platform in Europe. And in the next month, we'll be putting a new platform in North America. So, we're really excited about that, because it's going to make the experience all that much better in our owned piece.

Our partner business is really good, and then our wholesale digital and our consumer business are exceptionally strong too, but we've invested a lot of time and energy in that. We saw that a long time ago, and we've been very, very direct about the fact that we spent more time in the digital space and more money in the digital space than we have been in building physical stores. We just think that's where we're--the consumer's going to long-term play out, it's actually turned out to be a really good decision. And then, I think the last thing for me before I turn it over to Rustin is, is we've really thought long and hard, but we need to have great leadership there too. So, we recently hired a new global leader for our digital piece, someone with a tremendous amount of experience that's coming in and making very nice change immediately, in how we think about it and we love to bring in new talent that can help us all think differently and it can be a game changer for us going forward. So, we're very, very pleased with that. And with that I'll turn it over to Rustin.

**Rustin Welton**

Yes, thanks Scott, just--I'll close with one other comment on the digital piece, Alex, you talked a little bit about the cadence of how it unfolded throughout the quarter. Obviously, the first couple of months prior to COVID-19 impacts, certainly we were seeing strength in this channel as we have seen over the prior quarters as well. I would say March was softer as it was really across to all markets. And then certainly it has picked up a little bit in April.

Shifting to your second question, Alex, about gross margin puts and takes going forward. I'm not going to guide specifically on gross margin, but we did indicate in the outlook that we expected revenue and profit to be most pressured in Q2. There's a lot to think about the pieces as it relates to gross margin in the second quarter. The downtime impact on our margins will increase. We did take some downtime at the end of the first quarter in our production and certainly have done so to, again react to some of the demand signals early here in the second quarter. So, I think the demand impact will increase as a pressure on their margin. And the geographic mix pressure is likely to continue as well but that will be offset in part again, with the structural improvements that we talked about.

As Scott indicated on his first remarks, we really feel good about the actions we took late last year, and have continued into this year to really focus on quality of sales, taking some of those restructuring actions that will certainly help us from a gross margin perspective. And then just continued focus on price and product cost as we have been in this business for a long time. So hopefully that gives you a little bit of context around gross margin. Thanks Alex.

**Operator**



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

**Scott Baxter**

Wanted to say thank you to everybody for participating today. Certainly, appreciate your support of Kontoor Brands and all of our folks and wishing all of you safety and health and you and your extended families. And we're all in this together. We're going to get through it together, and we look forward to spending time with you on our next quarterly call and talk to some of you folks in between that. So, thank you everyone, appreciate it. Please stay safe.

**Operator**

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