



Kontoor Brands
Q4 Year-End Earnings
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Presenters

Eric Tracy, Senior Director of Investor Relations
Scott Baxter, President and Chief Executive Officer
Tom Waldron, Global Brand President-Wrangler
Chris Waldeck, Global Brand President-Lee
Rustin Welton, Chief Financial Officer

Q&A Participants

Erinn Murphy – Piper Sandler
Adrienne Yih – Barclays
Bob Drbul – Guggenheim
Sam Poser – Susquehanna

Operator

Greetings and welcome to the Kontoor Brands Q4 Year End Earnings Results Conference Call. At this time, all participants are in a listen only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star zero on your telephone keypad. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Eric Tracy. Please go ahead, sir.

Eric Tracy

Good morning, everyone, and welcome to Kontoor Brands Fourth Quarter and Full Year 2019 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 defined 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, the noncash impairment charges related to our Rock & Republic trademark, and other adjustments.

The 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. 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 of foreign currency exchange rates. Constant currency amounts are intended



to help investors better understand the underlying operational performance of our business, excluding the impacts of shifts in currency exchange rates over the period.

Joining me on today's call are Kontoor Brands' President and Chief Executive Officer, Scott Baxter, and Chief Financial Officer, Rustin Welton. In addition, on today's call, we will also be joined by Tom Waldron, Global President Brand President of Wrangler, and Chris Waldeck, Global Brand President of Lee. Following our prepared remarks, we will open the call for questions. We anticipate the call will last about an hour. With that, I turn it over to CEO, Scott Baxter.

Scott Baxter

Thank you, Eric, and good morning, everyone. Thank you for joining us. As Eric mentioned, our Global Brand Presidents, Tom Waldron and Chris Waldeck, will be joining us for this year-end review. We believe this call is a great opportunity to have them share insights from post-spin to today, as well as go-forward strategies for each of their respective brands. We intend to have them join us for these year-end reviews on subsequent fourth quarter calls. You'll hear from each of them in a bit.

Let me start by acknowledging what a dynamic environment we are all currently in. The last few weeks have seen the emergence of the COVID-19 Coronavirus, which has driven quite a bit of headline risk and uncertainty in global markets. While conditions are fluid, we remain extremely confident in the underlying fundamentals of our business. The strategic initiatives we are implementing, coupled with our best-in-class supply chain and robust cash flow generation, provide us with distinct competitive advantage, particularly in times such as these. The path may not be linear, but the levers in our control are significant, and we believe will unlock meaningful value creation for our shareholders over time. I will touch on this more in a bit, but let me first share some thoughts on the past year.

2019 was a highly transformational year for Kontoor Brands. It was a year of successful transition for our organization, our leadership teams, and our employees around the globe. While we have accomplished much over the last year, including delivering on our financial commitments laid out earlier this year, we remain in the early stages of investing behind and leveraging our two iconic brands, Wrangler and Lee, to drive more profitable growth longer term.

Let me remind everyone of our stated strategic plan that was purposely structured over two horizons, in a way that we believe will best represent the evolution of our operating model, investments in globalizing our organization and sequencing of our capital allocation strategies. I want to reiterate that word "sequencing", because it is a really important piece of understanding our story. To develop a global, best-in-class model, we have to first set the healthiest foundation for sustainable longer-term growth, and that is exactly what we have done in 2019. And we will continue to do--during what we call Horizon 1, the first 18 months to 24 months post spin.



First, as you think about our top line growth algorithm, proper sequencing is a critical component. Before fully capturing the multitude of white space revenue and distribution opportunities in front of us, and there are many, we've needed to make some difficult but necessary decisions to level set and stabilize our business. So, during 2019 and Horizon 1, we have been keenly focused on the implementation of strategic quality of sales initiatives that elevate our brands and will better yield more profitable revenue growth. These actions, while necessary to support our sustainable brand building efforts at pressured near-term revenue results, contributing nearly three points of headwind to our 2019 top line. In addition to our proactive strategic actions, disruptions within our rapidly evolving retail landscape, primarily within the U.S., have also negatively impacted our shorter-term results.

Along the way, we've worked to be very transparent with how we select retailer, bankruptcies, and door closures would impact our 2019 sales performance. These factors weighed in our full year revenue by about two points, which is in line with our initial outlook. While we believe it is prudent to expect some continued disruption in certain points of retail distribution and our quality of sales actions are not fully complete, we believe four points are important to consider.

First, our exposure to challenging distribution within the U.S. is limited as we exit 2019. Second, we continue to focus on winning with the winning retailers, including our largest customers, many of which are well-positioned in their respective channels of distribution. Third, while our quality of sales actions may continue, we intentionally front-loaded these efforts post-spin, completing the largest projects first, and we would therefore expect associated top-line pressures to moderate in the back half of this year as we anniversary these items. And fourth, and most importantly, we are just in the beginning stages of new business development, diversifying our existing revenue base as we improve growth across category, channel, and geographic factors. Again, we have always planned that new business development would accelerate in the second half of our Horizon 1 and sequence into Horizon 2.

Make no mistake, our brands are under distributed, both within the U.S. and internationally, a distinct competitive difference to many in our peer set. We have meaningful and exciting expanded points of distribution that will begin in earnest in the second half of 2020, and you will be hearing more about these programs over the next few months. From a margin perspective, which Rustin will detail a bit later, appropriate sequencing is again important to note as we executed several restructuring, cost savings and quality of sales actions prior to and subsequent to the spin that have driven margin recapture opportunities. And really critical to our margin expansion story, we remain highly under-indexed and under distributed within D2C, digital, and international. As we invest behind and distort growth in these areas, we will benefit from the structurally accreted mix shifts to drive incremental profitability expansion. Further, growth of these higher margin businesses will generate the capital that allows us to more meaningfully invest back into revenue enhancing areas like new product development, design and innovation, and demand creation, building a productive virtuous cycle over time.



And finally, as it relates to sequencing, let me touch on free cash flow generation and our capital allocation strategies with a focus on 2019 and Horizon 1. One of the key pillars to our story remains our robust, consistent free cash flow generation, despite facing top line pressures driven by our quality of sales actions in 2019, that strong cash generation continued. We've stated that, during Horizon 1, beyond our investments and standing up the organization, our capital allocation strategy would focus on aggressively de-levering [sp] the balance sheet and paying a superior dividend.

We're pleased to announce that within just seven months, post-separation, we've paid down \$127 million in debt, \$27 million above our initial guidance, even while making significant restructuring investments in the business. And we've now paid two consecutive quarters of dividends at \$0.56 per share, with the third just recently approved by our board to be paid out in a few weeks. Our superior dividend yield allows us to return cash to our shareholders while we continue to evolve our operating model. So, sequencing matters, sequencing of our revenue growth, margin expansion, and capital allocation strategies are essential in the proper evolution of our model. Rustin, will go through more specifics on our full year 2020 guidance, but, as we turn the calendar, I'd like to offer a few highlights of our 2019 performance relative to our financial commitments and share some thoughts into 2020.

We are on track, executing on the strategies established at our spin, and our playbook is evolving as we've intended. We guided 2019 adjusted revenue of more than 2.5 billion and delivered actual adjusted revenue of 2.52 billion, in line with our expectations, even as we amplified brand elevating initiatives that pressured shorter-term top line results. For adjusted EBITDA, we guided 2019 at 340 million to 360 million. We delivered the actual adjusted EBITDA of 341 million. Without the amplified actions in India, we would have been above the mid-point of our original range. We set our restructuring and quality of sales actions should result in improved, healthier, and more durable gross margins, and we are seeing just that with gross margin expansion for the last two quarters.

Finally, we set our capital allocation strategy during what we call Horizon 1. We're focused on aggressively delevering the balance sheet and paying a best-in-class dividends. We paid down significant debt well ahead of guidance. Our dividend payout offers an attractive yield to our shareholders as we continue to evolve our operating model. While we are absolutely moving in the right direction, we acknowledge some unexpected softness during the fourth quarter. As you've heard from many of our branded apparel and retailer peers, traffic in the U.S. was soft during the holiday period, and we were not immune to this. Slower traffic, coupled with the exit or reduction of some non-core programs and lower distress sales, caused us to come in a bit softer than we expected from our top line perspective. However, as we entered 2020, we saw trends improve, and we are confident in continuing to optimize and globalize our model through Horizon 1. These actions that required some patience will set the stage for what accelerated growth with cash flow optionality in Horizon 2 while yielding more profitable and sustainable growth that unlocked substantial value creation for our shareholders.



Our outlook for 2020 maintains solid, underlying, structural, fundamental improvement, but we recognized the heightened uncertainty around factors beyond our control, most notably, the potential impacts of the recent COVID-19 Coronavirus development. So, let me share some thoughts on the subject, as I know it's on your mind. We are carefully monitoring the situation, which, as you all know, is highly fluid. As always, our top priority is to ensure the health and safety of our employees, and our efforts are focused on addressing their needs. Our thoughts are with those impacted during this difficult time.

We have created an internal Coronavirus task force that monitors developments daily with contingency plans in place should conditions worsen. We realized that, from a demand perspective, the potential impacts are no longer just confined to the China region. And we have factored the global impact within our first quarter color, but most is derived from our commercial business in China. I do want to note that, prior to the emergence of Coronavirus, we were seeing really solid trends in our China business. In fact, during January, our China comps were up a solid double digits year-over-year. And while we expect some impacts to near-term results, we are confident that we will regain momentum as conditions normalize. We have not seen any material issues within our supply chain or sourcing. And, while we believe our own Western Hemisphere production provides a distinct competitive advantage in a challenging environment such as this, we will certainly continue to monitor events as they develop.

As you all know, we were scheduled to launch the Wrangler brand in China this spring. Given the current environment, we believe the proven course of action is to delay the launch for a short period until fall of this year when we can more effectively optimize our go-to market strategies, our interactive consumer engagement, and better leverage our demand creation spent. While the team is extremely excited to get going, and we are ready, this is the best decision for the brand and, most importantly, our employees' safety. We remain optimistic about the long-term growth potential of this market for both our brands, and we will execute against our strategies to most effectively capture the opportunities. And, finally, I want to reaffirm our commitment to our longer-term TSR model of 8% to 10% annualized returns. A special thanks to our employees all around the world for their tireless work ethic, inspiring collaboration, openness to change, and dedication to success in 2019 and the year ahead. With that, I turn it over to Tom Waldron, Global President of Wrangler.

Tom Waldron

Thank you, Scott, and good morning, everyone. Let me begin by saying, without a doubt, 2019 has been the most transformative year in Wrangler's history. While maintaining the authenticity of Wrangler's Western heritage under Kontoor, we have now been able to invest in the brand to drive future revenue growth. The team had never been more excited to compete in the marketplace, and I am truly proud of our efforts over the last year to support a successful transition and setting the stage for really great things to come.



First, let me level set everyone on where Wrangler plays today. We are primarily a U.S.-based brand with a focus on Western and mass channels. These are our roots, and we will continue to defend and grow this core business. But investments we are now making will also allow us to push the brand beyond the core and will act as key enablers in an elevated brand and grow into completely new ways. Let me highlight a few. We've invested in talent leadership to help enhance our go-to market strategies. We hired the brand's first ever Global Lead Designer and Global Head of Marketing and brought in new GMs in both Asia and Europe. What's [really important is we execute against our first global brand architecture.

We've accelerated investments in innovation. From a product perspective, we launched our new outdoor performance All Terrain Gear, or ATG, which launched with key retail partners this past fall. And we've made significant investments in sustainability, which drives innovation across both product and manufacturing. These include sustainability platforms such as Indigoood and Rooted, each launched this past year. These are really solid proof points that serving the consumer needs, driving enhanced profitability, and doing the right things for the planet can be harmonized. And, finally, we are enhancing our demand creation spend focused on the highest ROI.

Last fall, we launched our global brand campaign, Wear with Abandon, which kicked-off in the U.S. and will expand its global reach very soon. We've continued to accelerate our collaborations with key retail partners such as Fred Segal and Nordstrom NYC, as well as partnering with organic celebrity brand ambassadors and micro influencers. When you invest in people, product design, innovation, and demand-creation, you win with your core retail partners and consumers. And we are beginning to see some good traction. Excluding the impact of key retailer bankruptcy, the Wrangler U.S. business was flat in 2019, outpacing the market. According to NPD's retail tracking service for the total measure of market, Wrangler grew its dollar share in men's casual pants and jeans in the fourth quarter and 2019. These investments also give us permission to begin to stress the brand, expanding through category, channel, and geographic factors.

First, category extension, under new design leadership, we began to build on the women's category with enhanced design and innovation at both bottoms and tops. As we said on our last call, the t-shirt category is a significant opportunity, and we are in the early days of developing the platform. Just as a reminder for perspective, we currently sell roughly 500 pairs of jeans for every one t-shirts sold compared to most of our competitors that sell as many as five t-shirts for every one pair of jeans sold. We've just put the final pieces of our leadership team in place, and we are ready to aggressively go after this opportunity.

Our ATG line is another example of how we are making natural extensions for the Wrangler brand. We have outdoor in our DNA, and we are developing more performance-based outerwear that augments our core and does so at higher-AURs, something our key retail partners love as they seek to migrate up the pricing spectrum in the overall category. The early results for ATG are really encouraging, and we can't wait for you to see how the line evolves in 2020 and beyond.



Next is channel expansion, because of the investments in design and innovation, we have permission to begin to play in elevated price points of distribution as Wrangler has begun selling upper tier retailers such as Nordstrom's, Free People, Urban Outfitters, and Fred Segal, all at elevated price points. Importantly, we've seen some broad-based success across men's, women's, as well as non-denim-based tops. Further, ATG is not only providing category expansion with our core customers, but also beginning to lead opportunities within the outdoor specialty and sporting good channels. We plan to have more exciting distribution gains to share with you over the next couple of quarters.

Our investments are driving growth and our evolution of our D2C business, primarily with digital. Our digital wholesale business grew 29% in 2019, and our own.com continues to evolve from a transactional to an experiential, allowing us to connect with our consumer more effectively than we ever have. And from a geographic perspective, white space growth opportunities are meaningful for the Wrangler brand. In Europe, these investments support our reset in the region where we have been accelerating trends over the last few quarters. Wrangler inflected positive in Q4, excluding business model changes, a key proof point that our investments are paying off. And, finally, these investments provide the foundation to launch the Wrangler brand into China.

While we have paused our entrance with the Wrangler brand for few months, the delay will not have a material impact on our full-year results, as we've always plan for 2020 to be a test and learn year. We could not be more excited about the vision, the go-to market strategy, with our digital partner T-Mall, and the leadership we have in place to execute against this amazing growth opportunity for the brand in the region. We are in the early days of our brand transformation, and a lot of work ahead remains to navigate that dynamic retail environment. But the strategies we have put in place and the investments we are now making are positioning the Wrangler brand for sustainable and profitable growth going-forward. Let me now hand it over to Chris, who will take you through the Lee brand.

Chris Waldeck

Thanks, Tom. And thank you all for joining us today. Perhaps even more than Wrangler, Lee has experienced meaningful transformation during 2019. We're in the midst of significant change as we look to reposition, elevate, and drive more quality of growth for Lee. In 2020, particularly in the second half, we expect to see the benefits of our team's incredible efforts and can't wait to share some of these exciting wins in the months to come.

I want to acknowledge something out of the gate. Under prior ownership, the Lee brand wasn't prioritized in terms of brand investments. Under Kontoor and this leadership team, this is clearly changing. We've had a lot of cleaning up to do and are pleased with the progress we've made. Let me provide a few examples of the significant actions and investments we've taken to create the building blocks for Lee's future success.



First, the relocation of the Lee business to our global headquarters here in North Carolina has begun to manifest enhanced talent acquisition processes, better leverage of scaled resources, and robust cost savings opportunities. From a quality of sales perspective, under Kontoor, we've exited unprofitable points of distribution in the U.S., India, and Europe. These actions are the right strategic decisions to support the long-term health of the brand. And we've begun to realize the benefits with lower markdown and distress sales that have contributed to margin recaptured experience through the last few quarters.

Leveraging the learning's from our international business, particularly in Asia, we have 20 plus years of operating as a premium lifestyle brand. We are now finally able to make the necessary investments that help bring those successes from product to innovation to distribution strategies back to the U.S. market. Success will continue as we win share with existing customers, and we are confident you will see increasing signs of this during the coming year and success in growing the addressable market through category, channel, and geographic extensions.

So, let me walk you through the specifics of these growth opportunities. With respect to category extension, a perfect example is our body optics technology platform. This was historically confined to Asia region. Last fall, we were able to bring this innovation suite, starting with shape allusions [sp], to the mass channel here in the U.S. We are really encouraged with the first season and have programs in place to build on body optics platform in more premium channels.

Our next generation stretch technology, called MVP, has been one of the most successful new innovation platforms this year, enabling the brand to play at elevated price points. And earlier this year, we launched Lee's global sustainability platform "For A World That Works" at the international fashion fair in Copenhagen, Denmark. We've been thrilled with the reaction from the sustainability community, our retail partners, and, most importantly, our consumers. When we think about channel expansion, while very early days, the impact of the first ever global head of design is having on product is showing through. An example of this, the female vintage modern collection has begun to spur green shoots of enhanced brand expression with increasing permission for Lee to play in premium tiers of distribution. And this has begun to create a halo effect on the brand, cascading across existing distribution. And, with respect to geographic growth, let me be clear. We have significant opportunities internationally with the Lee brand. We remain highly underpenetrated in European region, relative to our peer set. We will use both traditional wholesale distribution expansion, as well as distorting investment within our digital ecosystem to catalyze growth.

As Scott stated, our China business began the year strong, and we will experience a near-term disruption due to the unfortunate Coronavirus situation. We expect to regain momentum in the region as conditions normalize. Long-term, white space opportunities for Lee brand remains significant in the Asia region, driven by deeper penetration into Tier I and II cities, further evolution of digital, and expansion into Tier III through five cities. So, taken altogether, we are confident in the trajectory of the Lee business. We have some really solid proof points of success



in areas where we've made sound investments and perhaps most importantly has visibility as we move through this year and beyond that future successes are even brighter for the Lee brand. With that, I turn it over to Rustin.

Rustin Welton

Thank you, Chris, and good morning, everyone. I am excited to share our results with you and will focus my remarks this morning on three key areas. First, our progress to-date on transforming our model, including our cost savings projects, our global ERP implementation, and our quality of sales efforts. Second, our fourth quarter results for 2019 and, finally, our initial outlook for fiscal 2020 and the potential coronavirus impact on our first quarter. We have a lot to cover, so let's get started with an update on our key transformational initiatives.

Previously, we announced the restructuring and cost savings program that is expected to yield more than \$50 million in annual savings upon completion. We are executing in two phases, and all actions in the first phase have been completed. These actions included exiting unprofitable markets, streamlining our supply chain operations, including closing three manufacturing facilities, and consolidating and relocating operations. We projected \$20 million to \$25 million of annualized savings in 2019 and 2020 from this first phase, and we are ahead of schedule, with significant benefits accruing for second half results. Phase II cost savings of \$25 million to \$30 million are anticipated to begin in 2021 as global processes and systems began to be implemented to drive global efficiency improvements. Our global ERP and information technology infrastructure projects will continue to be our largest investment to enable the globalization of the business.

In 2020, as planned, we will incur a significant one-time cost associated with the implementation, and we remain on track with our first scheduled regional go-live in mid-2020. The remaining two regions are scheduled to go-live in 2021. The Phase II cost savings that will begin in 2021 will aid in mitigating the effects of the technology investment. Finally, we have undertaken a variety of quality of sales actions since the spin. Although this creates near-term top line headwinds and will continue to affect our first half 2020 results until we anniversary these actions, we remain committed to our TSR approach in evolving our business and our pursuit to establish the strongest foundation for our long-term success.

Now, let's get to our review of the fourth quarter results. All comments will refer to our fourth quarter results unless otherwise noted. Throughout 2019, we have undergone transformational changes in the organization from restructuring and cost savings to business model changes to quality of sales efforts. All of the changes will improve performance, address a variety of internal and external factors, and set the stage for a long-term growth. We will highlight how these changes are impacting our performance as we go through our results.

Our global revenue decreased 8% compared with adjusted 2018 revenues. The revenue decline was significantly impacted by three factors. First, proactive, strategic, quality of sales initiatives,



including business model changes, actions taken to exit in underperforming country, and other global points of distribution, including select channels in India. These actions contributed three points to the decline. Second, reduced sales of certain lower margin lines of business and lower distress sales. These actions represented one point of the decline. And, finally, the impacts of a major U.S. retailer bankruptcy in the fourth quarter of 2018. This drove another one point of headwind. As you'd expect, we will continue to see revenue headwinds from these first two actions until their anniversary dates, which are largely in the first half of 2020. But both are contributing to our strengthening margin story.

On a regional basis, adjusted U.S. revenues, which represented 79% of our revenue in the quarter, declined 6%, with approximately four points driven by the previously mentioned factors. The balance was primarily driven by the softer than anticipated U.S. retail environment that Scott acknowledged earlier, as well as the exit or rationalization of select non-core programs. International revenues, which represented 21% of our revenue in the quarter, declined 13%, with the previously mentioned quality of sales efforts accounting for nine points of the decline. To further delineate, market exits and business model changes in Europe and South America represented approximately six points of the decline, while proactive actions to exit select points of distribution in India drove three points. Lastly, a timing shift on a shipment in China drove an additional two points of headwind. For the full year, our China business increased 2% while the fourth quarter was down 7% due to the previously mentioned shipment. Excluding this shipment, China was up 3% in the quarter as we continued to see strong comp store sales and digital growth.

Turning to our channels, our U.S. wholesale channel, which represented 66% of our revenue in the quarter, declined 7% driven by the previously mentioned factors. In the U.S. wholesale channel, we continued our strong performance, with our digital wholesale business increasing 52%. Our partnerships and investments in this area continue to provide distorted returns, and we remain bullish on this accretive growth opportunity. Our non-U.S. wholesale channel, which represented 16% of revenue in the quarter, declined 16%. Proactive strategic initiatives such as shifting the business model in Russia, Israel, and Chile, as well as rationalizing select channels in India contributed roughly 10 points to the decline.

The previously mentioned timing shift in China also contributed approximately three points. Our branded direct-to-consumer channel, which represented 14% of our revenues, increased 3% behind the global strength of our owned digital business that increased 15%. We were very pleased that the digital strength was seen in all regions with the U S increasing 17%, Europe up 36%, and Asia up 8%. Given the accretive under index nature of this channel, we will continue to invest heavily in this important growth area.

Now, let's turn to our brands. Global revenue of our Wrangler brand declined 5%. Wrangler U.S. revenue, which represented 88% of the brands global revenues, declined 3% due in large part to the previously mentioned domestic factors. International sales, which represented 12% of the brands global revenues, declined 18% due in large part to the actions taken in India and



business model changes in Europe and South America. In Q2, we indicated that we anticipated global Wrangler sales would accelerate in the second half of the year, driven primarily by improvement in our U.S. business. Although our global sales were higher in the second half of the year compared to the first half, our year-on-year comparisons were softer than we anticipated as the second half finished down 5% compared to the first half finishing down 2%. The previously announced softness in the U.S. retail landscape around holiday, coupled with the actions taken in India, impacted our results.

Global revenue of our Lee brand declined 11%. Lee U.S. revenue, which represented 57% of the brand's global revenues, declined 12% due to the three factors mentioned earlier, as well as the softer U.S. retail environment and the exit or reduction of select non-core programs. Lee international revenue declined 11% driven by the actions taken in India and market access and business model changes in Europe and South America. Now, onto gross margin, total adjusted gross margin increased approximately 40 basis points for the quarter. Year-over-year, gross margin comparisons have improved in each of the last four quarters, including a positive inflection during the last two. The improvement was due primarily to the impacts of quality of sales initiatives and favorable channel mix, which more than offset the negative impacts of actions in India. Cost savings initiatives also continue to mute inflationary product cost pressures.

Moving forward, structurally accretive mix shifts to higher margin channels such as digital and international will fuel further gross margin expansion. In addition, we anticipate cost savings from our initiatives to drive improvements in product cost. Adjusted SG&A as a percent of sales decreased \$23 million, or 80 basis points, to 28% of revenue. Despite fixed cost deleverage due to revenue declines, we were able to reduce SG&A costs with tight expense control, as well as the benefits of restructuring and cost savings initiatives.

Adjusted operating profit was \$85 million, or 13.1% of sales, an increase of 2% from prior year, driven by the margin expansion and SG&A reduction from the transformational changes made to improve the business. Adjusted EBITDA was \$93 million, or 14.2% of sales, compared with \$92 million last year. The actions we took in India drove an approximate \$4 million adverse impact in the quarter. Net interest expense was approximately \$15 million, and our adjusted effective tax rate was approximately 21%. We delivered adjusted earnings per share of \$0.97 in the quarter.

Finally, from a balance sheet perspective, we'd like to highlight our inventory performance. Inventories, as mentioned, declined 3% in the year. During the quarter we reduced inventory by more than \$85 million, or over 15%. Despite the softer than anticipated shipments given the U.S. retail environment on holiday, we delivered on our commitment to drive inventory below prior year levels. We are pleased with the results. However, we have more work to do, and inventory debt reduction will remain a focus in 2020.

Overall, as Scott outlined earlier, we are pleased with our full-year financial performance and meeting our financial commitments that were outlined in April. Given the complexity of



executing a spin transaction, transitioning from a regional to global operating model, implementing a multitude of restructuring, cost savings, and brand-enhancing initiatives, and developing a new global infrastructure, including the building of a global ERP platform, we accomplished a great deal in 2019. But the journey is just beginning. As Scott highlighted, sequencing matters greatly. We've been very intentional in the way we structure our actions during the first year, allowing us to deliver on near-term results, while also giving us the opportunity to do what's best for a long-term business and our shareholders.

And now, before covering our 2020 outlook in detail, let me begin by providing some additional context. In the news release this morning, we shared our outlook for 2020. As we considered how to provide guidance in the midst of the very fluid and dynamic macro backdrop with the emergence of the coronavirus situation, we wanted to make sure we presented a clear view of the underlying and ongoing fundamentals of our business. 2019 was a year of transformative change as discussed, and we understand there is complexity as our model evolves. We want to make sure we provide the best line of sight to the underlying operations of the business, including context for quarterly cadence, while also providing some color with respect to potential coronavirus impacts. With this as background, let's turn to our outlook. Again, all figures exclude the impact of Coronavirus.

Our outlook for fiscal 2020, which includes a 53rd week, compared to adjusted 2019 is as follows. Revenue is expected to be largely consistent with full year 2019 adjusted revenue, with branded Wrangler and Lee revenue anticipated to increase low-single digits, while the other non-strategic revenues for non-branded products sold through our VF Outlet domestically, as well as our Rock & Republic brand is expected to decline double-digits for the full year 2020. The 53rd week is expected to contribute approximately one half of a point to full year revenue. The negative impact of 2019 strategic business exits, quality-of-sales initiatives, and lower revenue associated with non-strategic lines of business are expected to represent up to three points of headwind to full year 2020 revenue, with the majority occurring during the first half of the year.

In addition, timing shifts between our second quarter and third quarter shipments are anticipated. Due to these reasons, first half revenue is expected to decline. Second half revenue is expected to grow year-over-year based on the moderating headwinds from restructuring and quality-of-sales actions, benefits of expanding programs and points of distribution, as well as the timing of shipments. The strongest revenue growth is anticipated in the fourth quarter.

Gross margin is expected to be in the range of 41% to 41.5% compared with full year 2019 adjusted gross margin of 40.8%, driven by ongoing restructuring and quality-of-sales initiatives, as well as structural mix shifts to more accretive D2C [sp] and international businesses. Adjusted EPS is expected to be in the range of \$3.55 to \$3.65 compared with full year adjusted 2019 earnings per share of \$3.84. Our outlook for 2020 includes an additional five months of interest expense that impacts full year adjusted EPS by approximately \$0.23 compared with 2019 adjusted EPS, which will negatively impact first half 2020 comparisons. Cash flow from operations



is expected to be greater than 325 million, generating significant financial flexibility. We anticipate our strong and durable operating model will be augmented with significant working capital improvements. Free cash flow, after funding capital expenditures including the investment in our global ERP and infrastructure, is anticipated to be in excess of 255 million, which provides ample opportunity to support our best-in-class dividend and continued aggressive debt repayment priorities.

We'll refer you to our news release for greater detail, but some high level thoughts on other full year assumptions include, at the midpoint of our guide, we expect adjusted EBITDA to increase mid-single digits compared with full year 2019 adjusted EBITDA of 341 million. CapEx is expected to range between 55 million and 70 million, including 30 to \$0 million to support the design and implementation of our ERP and information technology infrastructure. We anticipate the total reduction in long-term debt for 2020 to be an excess of 125 million. We expect an effective tax rate of roughly 22%, and interest expense, including funding fees related to our accounts receivable sale program, are expected to be approximately \$50 million in 2020.

Finally, I will conclude my remarks today with providing a little more color on the potential Coronavirus impact for the first quarter for your models. As a reminder, the following impacts are excluded from our outlook. In terms of commercial impacts, our China market has been most impacted during the first quarter. So, let me provide more context on our operations in this important market.

China represents approximately 7% of our annual global revenue, consisting of wholesale channels, including digital and partnership stores, as well as owned and operated full-price and outlet stores. As Scott mentioned earlier, we had a strong start to the year in January. During the month of February, the majority of our owned and partner retail doors were closed for the month, while most of the remaining doors saw very severe reductions in traffic and comps. But over the past few weeks, the number of open doors is increasing, and today, we are at approximately 75% of doors open.

Although we anticipate more door openings will occur as we move through March, we also anticipate significant reductions in traffic and comps will continue. Globally, including China and other select markets in Europe, we anticipate the impact of a Coronavirus situation could potentially pressure first quarter revenue by approximately four points. Again, this is not reflected in the previous 2020 outlook we just discussed.

In terms of supply chain impacts, while you may have other citing problems to-date, we have not experienced any material issues. In fact, we believe our supply chain creates a distinct competitive advantage with our scale vertically integrated manufacturing in the Western hemisphere. As of today, nearly all of our China mills have resumed operations with minimal product flow issues. At this time, we do not anticipate any material interruptions in our ability to

supply the market. With that update, it's now time to turn the call back to the operator for the question-and-answer discussion. Operator?

Operator

Thank you. We'll now be conducting a question-and-answer session. If you'd like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing star one. One moment, please, while we poll for questions. Our first question today is coming from Erinn Murphy from Piper Sandler. Your line is now live.

Erinn Murphy

Great, thanks. Good morning, gentlemen. I guess my first question, Rustin, for you, just on the guidance. Your guidance excludes Coronavirus, but then you've obviously given some context for Q1, just given the China hit in particular. So, are you telling us that--the first half revenue was obviously down, but, on top of that, Q1 has another four percentage point kind of hit? Just trying to marry the two comments, as you exclude it from your guidance, but there is clearly a real-time hit.

Scott Baxter

Hey, Erinn. How are you? This is Scott. I'm going to go ahead and start, and then I'll turn it over to Rustin, because I think it's important that I talk a little bit about the entire situation. It's currently a very fluid situation, but I think it's important for everyone to know that we are closely monitoring it. One of the things that's been helpful is that we've learned some things from this already happening in Asia. So, that has been beneficial for us.

We've got a really complete task force on this, of which many on our executive leadership team sit on, and we're meeting daily on this, sometimes more than that. It's important to note that we have contingency plans in place. So, we're pleased with where we are. The one thing that we've done is that we really decided that we're going to base all our decisions on fact. So, we're not going to get ahead of ourselves, and we're not going to speculate. But we've really tried to base all the decisions and our strategic actions on the facts and what's happening in the marketplace.

And I mentioned earlier--and I think this is really important for us in our China business. In the month of January, we were up double digits in that business, and we still feel really confident in that business and the people, because nothing about the product, the marketing, or the people has changed and starting to slowly recover. I would say very slowly. But recovery is taking place, and normalization is starting to happen at the beginning stages. So, we're encouraged by that back here. So, with that I'll have Rustin take the rest.

Rustin Welton

Yeah. Thanks, Scott. Good morning, Erinn. In regards to the outlook, we purposely chose to provide the outlook, excluding the impact of Coronavirus. And let me emphasize again kind of why we took that path. Obviously, as we talked about, we've had transformational change in 2019 with our actions. And many of these actions will continue to affect the first half, primarily in 2020 as we anniversary those actions. So, to answer your question, yes, the 4% would be in addition to the shaping that we provided on the quarters and the outlook, because, again, the Coronavirus impact is excluded.

But we thought that was really important and prudent to make sure that everyone understood the true fundamentals of our actions and how that was affecting our business. Obviously, it's a fluid and dynamic situation. We sized up the Q1 revenue impact, as Scott mentioned, because we want to focus on that [sp], and where we are confident. We didn't want to reflect a partial year into the outlook, as it's unclear, the timeline and trajectory this will take, but we did want to provide some color for you as you start to build your models.

Erinn Murphy

Got it. No, that's helpful. Thank you. And then, just maybe sticking with this theme, you talked about really strong trends in China pre-effectively [sp] COVID-19 breaking out. Can you share a little bit more what you're seeing now though even if—even as it's in its recovery phase between the digital and the physical within China? Are you seeing any outperformance in digital within China right now? And then, I guess secondly, you guys are one of the first companies to report since we've seen this outbreak really accelerate in Europe. Can you talk about what you're seeing now in markets like Italy, in particular?

Scott Baxter

So--Erinn, this is Scott. So, from Asia-China standpoint, we're really pleased with how we position the brands. I think one of the things that's most important for us as we enter the New Year was that we've got a really good leadership team there, so fairly new. But we talked a little bit about that before. So, we put ourselves in an advantaged position in that respect. Also, our product is really good, and our marketing is really good. So, obviously, we were very encouraged by how it started. I think the one thing that's really important about our business is we're very balanced. So, we have a D2C business, we have a digital business, we have both. And that really helps us in the marketplace, because we're able to cater to the consumer in any way that they want to go ahead and enjoy our products from that standpoint.

So, pleased with where we are. It will slowly get itself back to normal and a lot of confidence going forward in the marketplace. Too early to tell a little bit on Europe. We understand what's going on in Italy right now. That's all kind of fairly new. We're monitoring it really closely. We don't have a lot of stores there. So, we're right now, just kind of dealing with the facts as they come in, because it's a pretty fluid situation.

Erinn Murphy

Thanks, Scott.

Operator

Thank you. Our next question is coming from Adrienne Yih from Barclays. Your line is now live.

Adrienne Yih

Good morning, everybody. I'm going to start with focusing on cash flow, one longer-term horizon question. And then, Rustin, I'm going to start with sort of just a clarification. So, the--at least 325 million of cash flow, it includes 30 million to 40 million of the ERP, but can you reconcile that with the adjusted EBITDA, and exclude the 90 million of the ERP and IT expenses? And then, for Scott, can you talk about actually the cash flow over the Horizon 1 and as we transition into Horizon 2? So, just taking a longer-term view of the cash flow prospects of the business. So, I'll start with that. Thank you.

Rustin Welton

Yeah, Adrienne. Good morning. It's Rustin. Let me go ahead and start with your question around the cash flow. Our guidance was 325 million in operating cash flow. So it wasn't free cash flow, so it does not include the 30 million to 40 million of anticipated capital expenditures associated with the ERP. Obviously, in 2019, despite sort of significant one-time restructuring and separation costs, we generated pretty significant operating cash flow. Obviously, we've guided in 2020, north of 325 million, which includes some significant working capital improvements.

You may recall at the time of the spin, we talked about our cash conversion cycle had softened over the past several years, and we saw up to \$100 million of opportunity in working capital as we move forward. We see that opportunity in 2020 and are confident we're going to be able to deliver upon that. And that gain is coming from inventory receivables and payables. So, we have programs underway in each of those areas. Obviously, we made significant improvement in inventory in the fourth quarter, and we have some significant opportunities moving forward.

As we think about beyond 2020, cash flow is clearly a critical part of our investment thesis, and that's why we placed as much focus on it as we have. So, we'll continue to move into Horizon 2 as we start to go forward, and that strong cash flow will generate optionality for us. So, that could take the place of share repurchase, M&A activities, or additional organic investments into the brand, and obviously the focus in 2020 is going to be on paying this best-in-class dividend and delivering the balance sheet.

Scott Baxter

And, Adrienne, I'll just make one comment. I think from my vantage point, the thing that is most encouraging for me and the team is, we laid out a strategy for both Horizon 1 and Horizon 2, and, as we start to merge closer to Horizon 2, we're watching that strategy take hold. We're watching and seeing that strategy work, and we're putting ourselves in an advantaged position to go ahead and take advantage of that going-forward. Rustin mentioned the levers that we have the option

to pull. But, if you think about how we laid this out and how it's playing itself out, I couldn't be more pleased with how the team is executing at this standpoint.

Adrienne Yih

Great, thank you. Rustin, one quick [technical difficulty]. What is the assumed margin flow through on the portion that is—that 4% of sales? And, of the stores that have reopened, what capacity are they running at? And do you see them improving sort of on a daily or weekly basis? Thank you.

Rustin Welton

Yeah, Adrienne. I'll go ahead and talk a little bit. Obviously, we didn't dimensionalize [sp] the bottom line impact on that flow through in the 4% top line. It's a little too early for that, so I'm not going to dimensionalize that further in terms of our operations. In terms of the stores, specifically in China, clearly we are starting to see stores and the doors reopen, but we've been very conservative about how we're anticipating kind of that traffic and the comps during the completion in the month of March.

Operator

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

Bob Drbul

Hey, guys. Good morning. I think--you commented on the inventory position. I guess your own inventory versus partner inventory, can you just walk us through the different areas in terms of where you think inventory levels are in the channels, maybe geographically?

Rustin Welton

So, yeah. I'll go ahead, Bob. It's Rustin. Good morning. I'll start with sort of our owned inventory here. Obviously, we've made marked improvement here in the fourth quarter as we had projected. The inventory is in really good shape, as you might expect given our operations. The bulk of the inventory value sits in finished goods here in the U.S., given that's largely where our business sits. And maybe I'll turn it over to one of the other guys to talk a little bit about retail inventory and what you guys are seeing. Tom, maybe you can start?

Tom Waldron

Yeah. Hey, Bob. This is Tom Waldron. Yeah, our inventory ratios at retail are really healthy right now. It's something that our teams and our category management and our approach to managing the business has really enabled us to make sure that we're in good shape from an inventory standpoint and making sure it's matched well to sales ratios.

Chris Waldeck

Bob, this is Chris. On Lee's side, same thing with Lee. Our inventory levels are in good shape with our partners, both domestically and internationally. And the team, they are on top of it as it

relates to the different moving parts with the [sp] Coronavirus or others. So, we feel good about where we sit right now.

Bob Drbul

Okay, great. And if I could just sort of follow up a little bit more on the I guess China situation generally. I think you gave us a number--the updated number in terms of sourcing in the Western Hemisphere. But, in terms of material sourcing and the composition of the denim et cetera, how much of the material are you getting from China? And are you seeing any disruption from sourcing materials when you think about the manufacturing process throughout the supply chain?

Scott Baxter

Hey, Bob. How are you? It's Scott. From the standpoint of how we sit and where we stand, one of the things that we've been very fortunate about, you've heard us talk about it a lot is our internal sourcing capabilities. So, we're really confident in that. Obviously in these times, that's been a big strategic advantage. And then the other thing is, the sourced part of it, we're actually in very good shape. Rustin mentioned in his pre-planned comments about the fact that our mills are up and running again, and we've heard from our mill owners that the workforce is back at 75% to 80% plus, which is pretty normal after the Chinese New Year, as people kind of trickle back in. So, right now, Bob, things are very fluid. But, right now, we're in really good shape and we're--what I mean, monitoring the situation daily, and our supply and our sourcing team feel real confident going-forward as it stands today.

Operator

Thank you. Our next question is coming from Sam Poser from Susquehanna. Your line is now live.

Sam Poser

Thank you for taking my questions. I want to follow up the question that Adrienne asked about the EBITDA and the \$90 million. And it appears as if you're talking about the EBITDA and what portion goes into SG&A and so on. That \$90 million, you're talking about that differently than you did at the beginning--in Q2 of last year. Can you give us some color on why that should be regarded as an adjustment this year when it wasn't mentioned last year?

Rustin Welton

Yeah, Sam. So, at the time of the spin--this is Rustin. Good morning. At the time of the spin, we talked about having up to \$115 million of one-time items associated with the separation. And ERP was the largest piece of that. So, when we provided guidance for 2019, we only spoke about the CapEx portion, because we only guided on CapEx. Obviously, as we're starting to move through the implementation cycle, 2020 will be the heaviest year for those one-time expenses, and we remain on TSAs with VF Corporation until really the next 18 months to 24 months after the spin. So, those expenses are showing up here. We're just making sure that we're not double counting for the investments we're making with the ERP system.

Sam Poser

Thank you. And then, I want to follow up on first quarter, and this may be a little bit of beating the horse a bit, but the sales that come down aren't necessarily going to be recovered next year. Like, if people were going to buy a pair of jeans this year and they didn't buy it, doesn't mean they're going to buy two pairs in first quarter of next year. In which case, these are sort of legit lost sales relative to what you know, and you've already talked about it as they hit. So, why wouldn't this be in the guidance despite the fact that you're making good progress with all of your various initiatives from a long-term basis? And then—because—I mean, what is that impact in the first quarter beyond the 4%? Because you can't really take it out as a non-GAAP adjustment when the dust settles here versus the 355 to 365 guidance that you gave for the full year.

Rustin Welton

Yeah, Sam. It's Rustin. I'll go ahead and start. As we think about the actions that we're taking in the first half or the implications, we thought it was important to provide the cadence, as it relates to the quarter from a revenue perspective, because we have taken these actions in 2019, and we'll continue to see headwinds until the anniversary. So, that's what we're reflecting in the guidance. We did not include the Coronavirus piece, because we absolutely wanted to make sure that it was clear for people what those headwinds would be from the actions we took this year. And so, hopefully, that gives you a better sense of the cadence of the first half and the quarterly piece, excluding the Coronavirus piece.

Operator

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

Scott Baxter

Thank you for joining us today. While the conditions are dynamic, our underlying fundamentals are improving, our cash flow generation is robust, and we are uniquely positioned to generate significant value creation for our shareholders over time. Thanks again, and we look forward to speaking with all of you on our first quarter call. Thank you.

Operator

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

About Kontoor Brands

Kontoor Brands, Inc. (NYSE:KTB) is a global lifestyle apparel company, with a portfolio led by two of the world's most iconic consumer brands: Wrangler® and Lee®. Kontoor designs, manufactures and distributes superior high-quality products that look good and fit right, giving people around the world the freedom and confidence to express themselves. Kontoor Brands is a purpose-led organization focused on leveraging its global platform, strategic sourcing model and best-in-class supply chain to drive brand growth and deliver long-term value for its stakeholders.

Forward-Looking Statements

Certain statements included in this release and attachments are "forward-looking statements" within the meaning of the federal securities laws. Forward-looking statements are made based on our expectations and beliefs concerning future events impacting Kontoor Brands and therefore involve several risks and uncertainties. You can identify these statements by the fact that they use words such as "will," "anticipate," "estimate," "expect," "should," and "may" and other words and terms of similar meaning or use of future dates. We caution that forward-looking statements are not guarantees and that actual results could differ materially from those expressed or implied in the forward-looking statements. Potential risks and uncertainties that could cause the actual results of operations or financial condition of Kontoor to differ materially from those expressed or implied by forward-looking statements in this release include, but are not limited to: risks



associated with Kontoor Brands' spin-off from VF Corporation, including the risk of disruption to Kontoor's business in connection with the spin-off and that Kontoor could lose revenue as a result of such disruption; the risk that Kontoor does not realize all of the expected benefits of the spin-off; the risk that the spin-off will not be tax-free for U.S. federal income tax purposes; and the risk that there will be a loss of synergies from separating the businesses that could negatively impact the balance sheet, profit margins or earnings of Kontoor. Other risks for Kontoor include foreign currency fluctuations; the level of consumer demand for apparel; disruption to distribution systems; reliance on a small number of large customers; the financial strength of customers; fluctuations in the price, availability and quality of raw materials and contracted products; disruption and volatility in the global capital and credit markets; response to changing fashion trends, evolving consumer preferences and changing patterns of consumer behavior, intense competition from online retailers, manufacturing and product innovation; increasing pressure on margins; ability to implement its business strategy; ability to grow its international and direct-to-consumer businesses; Kontoor's and its vendors' ability to maintain the strength and security of information technology systems; the risk that Kontoor's facilities and systems and those of third-party service providers may be vulnerable to and unable to anticipate or detect data security breaches and data or financial loss; ability to properly collect, use, manage and secure consumer and employee data; stability of manufacturing facilities and foreign suppliers; continued use by suppliers of ethical business practices; ability to accurately forecast demand for products; continuity of members of management; ability to protect trademarks and other intellectual property rights; possible goodwill and other asset impairment; maintenance by licensees and distributors of the value of Kontoor's brands; ability to execute and integrate acquisitions; changes in tax laws and liabilities; legal, regulatory, political and economic risks; the risk of economic uncertainty associated with the pending exit of the United Kingdom from the European Union ("Brexit") or any other similar referendums that may be held; and adverse or unexpected weather conditions. More information on potential factors that could affect Kontoor's financial results is included from time to time in Kontoor's public reports filed with the SEC and Kontoor Brands' Registration Statement on Form 10 also filed with the SEC.