Kontoor Brands
First Quarter 2025 Earnings Conference Call
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Presenters
Michael Karapitian - Vice President of Corporate Development, Enterprise Strategy and Investor Relations
Scott Baxter – President, Chief Executive Officer and Chairman
Joe Alkire – CFO

Q&A Participants
Ike Boruchow - Wells Fargo
Brooke Roach - Goldman Sachs
Paul Turney - Barclays
Peter - Stifel
Laurent Vasilescu - BNP Paribas

Operator
Good morning, ladies and gentlemen, and welcome to the Kontoor Brands first quarter 2025 earnings conference call. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press "*" "0" for the operator. I would now like to turn the conference call over to Michael Karapitian, Vice President of Corporate Development, Enterprise Strategy and Investor Relations. Please go ahead.

Michael Karapitian
Thank you, operator, and welcome to Kontoor Brands first quarter 2025 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 and is available on our website at kontoorbrands.com. Reconciliations of GAAP measures to adjusted amounts can be found in the supplemental financial tables included in today's news release. These tables identify and quantify excluded items and provide management's view of why this information is useful to investors. Unless otherwise noted, amounts referred to on this call will be in constant currency, which exclude the translation impact of changes in foreign currency exchange rates.

Joining me on today's call are Kontoor Brands' President, Chief Executive Officer and Chairman, Scott Baxter and Chief Financial Officer, Joe Alkire. Following our prepared remarks, we will open the call for questions. Scott?

Scott Baxter

Thanks, Mike, and thank you all for joining us today. I'd like to begin our call with the exciting news we shared this morning. We have cleared regulatory approval for the acquisition of Helly Hansen. In the coming weeks, we expect to close the transaction and begin the next chapter of our story fueled by accelerating top line growth, stronger earnings and cash generation and significantly improved capital allocation optionality. The goal is clear, drive greater value for our shareholders and structurally increase our TSR potential.

We expect to see an immediate benefit to 2025 revenue growth, earnings and cash flow and long-term benefit is even greater. To ensure we deliver on our commitment, we have established a value creation framework built on four pillars: first, to accelerate Helly Hansen's growth. The global opportunity for the brand is significant. As we discussed in February, the US is the largest outdoor apparel and footwear market in the world. While it is Helly's fastest growing, it remains significantly underpenetrated relative to its peers. Through a combination of wholesale and retail expansion, strong digital growth and investments in demand creation, we see a clear path to double digit growth in our home market.

In addition to the US we see significant opportunities in direct to consumer, China, global workwear and category expansion that will further support long term sustainable growth. As a result, we expect a meaningful increase in our fundamental growth profile, greater diversification and increased penetration in the attractive outdoor and workwear markets where we have deep expertise.

Second, double Helly's operating margin. We expect to increase operating margin from high single digits today to mid-teens through a combination of gross margin and SG&A benefits. We will leverage our global operating model as well as our supply chain and technology platforms. This will provide significant scale advantages for both organizations while driving greater back-end efficiency, improved decision making and increased investment capacities to support growth initiatives.

Third, increase capital allocation optionality. Over the near term, we will focus on improving Helly's profitability and net working capital. Within twelve months, we expect to be under two times leverage and within twenty four months back to pre-deal leverage, while consolidating a significant increase in earnings. Long term, we will deploy the increase in cash flow potential to support our capital allocation framework including our dividend and share repurchase programs.

And finally, establish Kontoor as the employer of choice in the industry. Attracting and retaining top talent will ensure long term success. At the same time, any potential transaction needs to be a strong cultural fit. Helly accomplishes both. We continue to be impressed by their organization. There is depth of talent at all levels, but it is also humble, gritty and committed to doing things the right way. These are the same qualities that you'll find at Kontoor.

Canadian Tire has been a great steward of the business, but there has been one consistent message I've heard from the team above all others. Kontoor will be the first owner of the business in twenty years that operates in the apparel industry. We know the business and speak the same language. They have been executing at a high level on their own, but I am more confident than ever in the significant benefits as a more synergistic global brand owner.

Before turning to our results, let me spend a few moments on the current environment. As you are well aware, there has been an increase in macro volatility over the past few months. In the past, you have heard me talk about our focus on execution and controlling what we can. This time will be no different.

We have operated through multiple cycles and have the team and operating playbook to not only navigate the current environment, but come through the other side even stronger. Our first quarter highlights the resiliency of our organization with multiple paths to deliver our outlook. Despite a slowdown in POS mid-quarter, operational agility and the strength of our supply chain drove a significant increase in gross margin and better than expected earnings and cash flow. While the consumer remains under pressure around the globe, it has been resilient. In times of disruption, consumers and retailers lean into brands they know and trust.

We are managing the business prudently, but as Joe will discuss, we have seen trends improve in March and April. On tariffs, we do not expect an impact to second quarter results due to recently announced policy changes and mitigating actions have been put in motion that will begin in the third quarter. As an organization, we challenge ourselves to look around corners. Coming through the supply chain disruptions over the last several years, we put plans in motion to create a more agile organization.

As part of Project Genius, we kicked off an SKU level analysis to create increased flexibility within our manufacturing and sourcing operations. This body of work has given us a tremendous head start and I am confident we will be able to meaningfully offset the impact from tariffs in a twelve-month to eighteen-month period. We have dealt with supply chain shocks in the past and have proven the resiliency to maintain profit and returns over time.

With that, let's review highlights from Q1. Wrangler had another solid quarter with global revenues increasing 3%, growth has been broad based across all regions and channels including a 15% increase in digital. Female continues to be a remarkable success story.

During the quarter, Female grew 40%. Our investments in the team, product development and marketing are delivering excellent results. Following a very strong year, our collaboration with Lainey Wilson is off to a great start in 2025. We launched her second collection in the spring including a broader expansion in EMEA that coincided with Lainey's European tour kickoff and we are building on the momentum generated by our female fit innovation Bespoke. We are scaling the platform following a strong '24 and I am pleased to share the collection continues to perform very well, driving greater growth and penetration within the specialty channel.

At just 10% of global revenue, Wrangler's female business is just getting started. What used to simply draft off the male business is now a dedicated focus. We are targeting the female consumer and seeing results, giving me tremendous confidence in the long-term growth opportunity in the years ahead. The heart of the Wrangler brand, Western, also drove strong growth in the quarter coming off mid-single digit growth in 2024 trends accelerated to mid-teens in the first quarter.

Our key wholesale customers are healthy and growing. Western culture is expanding including record rodeo attendance and our product portfolio has never been better. As a result, Wrangler delivered another quarter of share gains. According to Surcana in our men's and women's bottom business, Wrangler gained 70 basis points of market share in the first quarter. Wrangler is on an incredible trajectory and 2025 is off to a great start.

Turning to Lee, the quarter performed as expected with revenue declining 8%. Our brand repositioning is tracking to plan and we are seeing green shoots that give us confidence in sequential improvement going forward. Our new creative vision is starting to show up in the marketplace. We are driving better segmentation across consumer types, sharpening our storytelling to be more aligned with Lee's consumer and addressing challenges in mid-tier distribution.

We are confident we have the right team in place and a new strategic playbook to build our way back to growth over time. To support these efforts, we are leveraging our improved multi brand platform. Over the last eighteen months, we have doubled the tools available to the team to drive greater consumer driven insights. As a result, digital traffic, brand equity and purchase intent all increased in the first quarter.

The barometer of the business is digital where we have a direct path between building better product and telling better stories and engaging our consumers. This is where we expected to see the first proof points that our realignment is working and that's exactly what we're seeing. In the first quarter, digital increased 8% and we have seen that momentum continue in April. Looking ahead, our new equity campaign is planned for the back half of the year, which will bring our new vision to life.

We are sharpening the brand's focus, establishing a stronger foundation and refining consumer choices. I am confident these steps will put the brand on its best footing in decades and fuel the brand's return to growth.

Before I turn it over to Joe, a few closing remarks. Regardless of the environment, we have tremendous optionality in the business. Wrangler has momentum and is winning with the consumer. Lease performance improvement is underway. Project Genius is ramping and Helly Hansen will significantly enhance our fundamental algorithm.

Our first quarter was better than expected and we remain on track to deliver the outlook we provided in February. While our outlook for Helly Hansen has strengthened, our teams are executing at a high level and I am confident we are on a path to drive long term value creation for our shareholders. Joe?

Joe Alkire
Thanks, Scott, and thank you all for joining us today. For the balance of the call, I'd like to focus on three topics. First, I'll provide an update on the acquisition of Helly Hansen. Second, I'll review the highlights of our first quarter results. And finally, I'll provide an update on our full year outlook, including tariffs and add some perspective on the current operating environment and why we believe we are well-positioned to continue to drive strong returns for our shareholders.

Starting with Helly Hansen. As we announced this morning, I am pleased to share we have cleared all required regulatory approvals. The acquisition of Helly significantly increases our long term TSR profile by both accelerating growth and increasing our cash flow optionality. We have progressed well through integration planning and anticipate closing the transaction at the May. We are looking forward to welcoming the entire Helly Hansen organization to the Kontoor family.

We expect Helly Hansen to contribute approximately $425 million to full year revenue as the business is on track to deliver double digit growth on a year over year basis in the second half of the year. We expect Helly to now contribute $0.20 to full year earnings per share, including $0.48 in the second half of the year, excluding synergies. This compares to our previous expectation of $0.15 of accretion.

Our confidence in the significant value creation opportunity as a combined company has further increased. Let me share one example. As we discussed in February, Helly operates as a standalone business today. Within the supply chain, it utilizes its own inbound and outbound freight contracts independent from Canadian Tire. As you'd expect, Kontoor's supply chain and global scale will provide Helly with capability enhancements and significant cost advantages.

More specifically, as part of Kontoor, Helly's freight expenses will decrease between 10% and 20%, the benefits of which are not yet included in our accretion expectations. By leveraging our global operating platform, we have clear line of sight to double Helly's operating margin over time by both gross margin expansion and SG&A leverage. This will create additional investment capacity to further accelerate top line growth, improve profitability and cash flow and generate even greater long-term value for our shareholders.

In April, we successfully completed our financing of the transaction. We have entered into an amended and restated credit agreement, a portion of which will be used to fund the acquisition. Our improved capital structure also provides us with greater flexibility and debt capacity. We intend to fund the acquisition with $660 million of new debt and approximately $240 million of excess cash, driven by stronger cash generation in the first quarter relative to our previous expectations.

In addition, we have entered into a series of interest rate swaps to mitigate our exposure and risk. Our expected effective interest rate is approximately 5% compared to our prior expectation in the 6% to 7% range. Before moving on, I'd like to echo Scott's comments and thank the Helly

Hansen and Kontoor teams for their dedication and commitment throughout the transaction and integration process.

Together, we are creating a powerful, more diversified business with enhanced growth characteristics and even stronger value creation potential in the years to come. Now let's review our first quarter results.

Global revenue was flat with the prior year and consistent with our outlook. As we discussed last quarter, after an encouraging start to the year, POS trends softened in late January and into February. January POS increased 4% and February declined at a low single digit rate through the first three weeks of the month.

Following our fourth quarter earnings call, POS trends further deteriorated with the final week February declining at a mid-teen rate below our expectations. Trends improved from February to March, with March POS declining approximately 1%. Softer than anticipated POS in our key accounts in the first quarter was offset by strength in Western, DTC and our international businesses relative to our plants.

POS trends were steady in April, declining 1% and have turned positive in early May. While we are encouraged by the recent improvement in POS, we have seen month to month variability over the last year and continue to plan the business prudently, as I'll discuss in more detail in our outlook.

By brand, Wrangler global revenue increased 3%. Growth was broad based across all channels and geographies. We saw particular strength in our Female business, which increased 40% in the quarter. US revenue increased 3% driven by 2% growth in wholesale and 14% growth in DTC.

The relative strength at wholesale drove another quarter of market share gains. As measured by Surcana, Wrangler male and female bottoms gained 70 basis points of market share during the quarter. Wrangler International revenue increased 4%, driven by 6% growth in wholesale, partially offset by a decline in DTC.

Now turning to Lee. Global revenue decreased 8% and was in line with our expectations. US revenue decreased 8%, driven by a decline in wholesale, partially offset by 12% growth in digital. We have seen this momentum continue into the second quarter. Lee International revenue decreased 8% with declines in wholesale offsetting growth in DTC. Performance was modestly better than expected despite the uneven macro environment in both Europe and APAC.

Now moving to the remainder of the P & L. Adjusted gross margin expanded 200 basis points to 47.7%, driven by the benefits of lower input costs and mix. This was partially offset by the carryover of targeted pricing actions from a year ago. Relative to our outlook, we exceeded our gross margin plan by 170 basis points, reflecting the strength of our supply chain, favorable mix and the early benefits from Project Genius.

As a great example, SKU rationalization is contributing to improved inventory health and lower promotional support. Over the past twelve months, we have reduced SKUs by approximately 20%

in the US. We will expand these efforts to our international operations in the second half of the year. While the environment remains dynamic, our operational agility is a competitive advantage in support of our earnings algorithm and cash generation.

Adjusted SG&A expense was $201 million, up 3% compared to prior year driven by investments in demand creation. In addition, the quarter included $8 million of incremental acquisition related stock-based compensation expense that was not included in our previous outlook. Excluding the incremental stock-based compensation expense, SG&A was down 1% compared to the prior year. Adjusted earnings per share was $1.20 including an $0.11 impact from the previously mentioned acquisition-related stock-based compensation expense. Excluding this expense, adjusted EPS was $1.31 compared to our prior outlook of $1.16 and increased 13% compared to prior year.

Turning to the balance sheet. Inventory decreased 12% to $443 million. We are pleased with the quality and composition of our inventory and will continue to manage working capital prudently in light of the environment, while opportunistically leveraging our supply chain model. That said, we are also making targeted inventory investments to capitalize on growth opportunities as they arise.

Looking forward, we expect inventory to decline in the second quarter and grow approximately in line with revenue in the second half of the year. We finished the quarter with net debt or long-term debt less cash of $379 million and $357 million of cash on hand.

Our net leverage ratio or net debt divided by trailing twelve month adjusted EBITDA was 0.9 times below the low end of our targeted range as expected in advance of the upcoming acquisition of Helly Hansen. Our liquidity position is strong. Post-closing, our pro forma net leverage ratio will be less than three times and we anticipate returning to under two times net leverage within twelve months and back to pre-deal leverage within eighteen to twenty four months. Our $500 million revolver remains undrawn. Share repurchase activity remains on pause near term as we focus on paying down acquisition-related debt and reducing leverage.

We have $215 million remaining under our current share repurchase authorization. And as previously announced, our Board declared a regular quarterly cash dividend of $0.52 per share. Finally, on a trailing twelve-month basis, our adjusted return on invested capital was 32%, representing an increase of 710 basis points compared to the prior year.

Before moving to our outlook, let me briefly discuss our decision to continue to provide a 2025 outlook amidst the uncertainty of the current environment. First, we delivered strong first quarter results that were well ahead of our previous expectations.

While our business has become more volatile week to week, overall trends have generally improved over the past two months. Despite some puts and takes, we have not seen a meaningful change in our ability to deliver our full year commitments. Our outlook for Helly Hansen has strengthened and our tariff mitigation plans are crystallizing.

We've taken steps to protect the business, including a disciplined posture on discretionary expenses, inventory commitments and capital spending, while protecting the investments required to further advance our strategies. We have a deep sense of responsibility to manage the business appropriately as well as an obligation to our shareholders, employees and stakeholders to communicate what we're seeing in the business and how that's informing our decisions.

We hold strongly a belief that this transparency is even more important in times of uncertainty. Operational agility, execution and optionality are cornerstones of our model. If there is one message to take away from today, it is our commitment to delivering our 2025 objectives by accessing multiple levers, including supply chain agility, operational and financial discipline, Project Genius and the acquisition of Helly Hansen.

We have put ourselves in a position to successfully navigate the current environment, emerge stronger and take advantage of the disruption in the marketplace. So with that, let's review our updated outlook.

Full year revenue is now expected to be in the range of $3.06 billion to $3.09 billion, representing growth of 17% to 19%. Helly Hansen is expected to contribute $425 million to full year revenue, assuming an May closing. Our outlook for 2025 includes the impact of a fifty-third week, which is not expected to meaningfully impact revenue on a full year basis. Excluding Helly, we expect organic revenue growth of 1% to 2%. This compares to our prior outlook of 1% to 3% growth.

We continue to plan the business conservatively and assume no meaningful change in retail inventory positions for the year. This is consistent with our prior outlook. While inventory levels at retail remain suboptimal, our retail partners remain in a conservative posture with regard to inventory management.

The low end of our revenue outlook assumes a low single digit decline in POS for the balance of the year, consistent with our prior outlook. The high end of our revenue outlook now assumes a more modest POS environment than what we experienced throughout 2024 and into January of this year, reflecting the impact of increased macro uncertainty on consumer behavior.

For the second quarter, we expect revenue of approximately $630 million representing growth of 4%. Our outlook includes an expected $20 million to $25 million contribution from Helly Hansen. Excluding Helly, our second quarter outlook reflects POS trends that are consistent with March and April, offset by the timing of seasonal programs and distribution expansion. Our updated outlook implies approximately 3% growth in the second half of the year, driven almost entirely by the benefit of new programs, distribution gains and the impact of the fifty-third week. Moving to gross margin.

Adjusted gross margin is now expected in the range of 45.9% to 46.1%. Our outlook represents an increase of approximately 80 to 100 basis points compared to gross margin of 45.1 in 2024. Helly Hansen is expected to benefit full year gross margin by approximately 40 basis points. Excluding Helly, we expect full year gross margin expansion of 40 to 60 basis points compared to our prior outlook of 20 to 40 basis points. We now expect first half gross margin to expand approximately 100 basis points compared to our prior outlook of 10 to 20 basis points reflecting our stronger first quarter results.

We do not expect Helly Hansen to have a meaningful impact on second quarter gross margin. SG&A is expected to increase approximately 20% reflecting the contribution from Helly Hansen. Excluding Helly, we expect SG&A to increase at a low single digit rate on an adjusted basis, consistent with our prior outlook. We will manage the business prudently while prioritizing investments in support of our strategic initiatives. Full year SG&A now includes $9 million of incremental acquisition related stock-based compensation expense, the majority of which occurred in the first quarter.

Our investment priorities and expected benefit from Project Genius are unchanged. Project Genius savings are expected to mature to a full run rate in excess of $100 million in 2026, consistent with our prior outlook. EPS is now expected to be in the range of $5.40 to $5.50 representing an increase of 10% to 12%. Helly Hansen is expected to benefit full year 2025 EPS by approximately $0.20 excluding synergies. This compares to our prior outlook of $0.15 Excluding Helly, we expect full year adjusted EPS of $5.20 to $5.30. This is consistent with our prior outlook and now includes an incremental $0.13 of acquisition-related stock-based compensation expense.

The Helly Hansen business exhibits revenue and earnings seasonality, similar to other brands in the outdoor industry. Historically, the second quarter has been Helly Hansen's smallest quarter, which has resulted in operating losses. Including Helly, we expect second quarter EPS of approximately $0.80. Excluding Helly, we expect second quarter EPS of $1.80 representing an increase of approximately 10%. Finally, we expect another year of strong cash generation. Cash from operations is now expected to exceed $350 million including Helly Hansen.

Moving to tariffs. The situation clearly remains highly dynamic. That said, we have evaluated a range of outcomes and have developed a robust set of mitigating actions that will begin to take effect in the third quarter should tariffs prove to be more permanent. The majority of our expected 2025 US production volume originates from Bangladesh, Mexico, Egypt, Pakistan and Kenya. Our China exposure is immaterial as the sourcing we do from China is directly for China.

Based on currently available information, Mexico is exempt under USMCA. Excluding Helly, the unmitigated impact to operating profit in 2025 is now approximately $35 million based on the current tariffs in effect. This compares to our prior estimate of $50 million. Helly Hansen is 100% sourced with the majority of its US production volume originating from Southeast Asia, including China, Vietnam, Bangladesh and Cambodia. Recall that approximately 75% of Helly's global revenue is outside the US. Should tariffs remain at the currently proposed levels on all imports, the unmitigated impact to operating profit in 2025 is approximately $50 million including Helly Hansen.

This assumes no mitigating actions, including transferring production within our global supply chain, pricing increases, inventory management, supplier partnership initiatives and other proactive mitigating cost actions. While we are not immune over the near term, our supply chain is a competitive advantage. We expect to begin to offset the impact of tariffs beginning in the third quarter of this year. And we expect the mitigated impact of tariffs in 2025 to be below $50 million and are confident we can substantially offset the impact of tariffs within a twelve-month to eighteen-month period. As Scott discussed, we have successfully navigated supply chain shocks in the past, including cotton spikes, supply chain and ocean freight disruption and inflation and have proven the ability to recover and maintain profitability and returns on capital over a relatively short time horizon.

Before opening it up for questions, I'd like to reiterate the confidence we have in our 2025 objectives and our ability to successfully navigate the environment and emerge stronger. In the coming weeks, we expect to complete the acquisition of Helly Hansen, significantly increasing our value creation potential. Combined with Project Genius, our strong fundamentals and operational agility, we have multiple paths to drive increasing revenue and earnings growth.

Operational execution and financial discipline are hallmarks of Kontoor's organization and culture. Our operating model has proven resilient regardless of market conditions, and I am highly confident in our ability to drive superior returns in the years ahead.

We are in a position of strength and well-positioned to capitalize opportunities that arise from the disruption and volatility in the marketplace. This concludes our prepared remarks, and I'll now turn the call back to the operator.

Operator
Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press "*" "1" on your touchtone phone. Should you wish to cancel your request please press "*" "2". If you are using a speaker phone please lift your handset before pressing any keys. Once again, that is "*" "1" should you wish to ask a question.

Your first question is from Ike Boruchow from Wells Fargo. Your line is now open.

Ike Boruchow
Hey, thanks. Good morning, everyone. A couple of questions from me. Maybe I wanted to start high level. Just state of US consumer, I think you used the word confused three months ago when kind of describing the end market. Is that still the case in your mind? It sounds like things are a little better, but is anything changing?

And then just to kind of take that same conversation over to your retail partners, how has that trended relative to the last time we heard from you?

Scott Baxter
Morning, Ike. This is Scott. I'll go ahead and take that one. Yes, I think incredibly resilient is how I would term it now and coming back in a very, very positive way. The start of the year was really strong in January. And then all I would say about February is that people were absorbing all the information that was coming in at them from the new administration and all that was happening.

I think things have settled now down to a normal path and we've seen March bounce back incredibly strong, April also and now it's inflected positive in May, which has been really nice. And I think really what it boils down to for us is we're controlling what we can. Our product is terrific, our male and female, which is really nice to be able to talk a lot about the great female product that we're making right now. In addition to the fact that we continue to gain share, Joe talked about that, I talked about that. We continue to market.

We're going ahead and taking advantage of the time. And I think the other thing I can we've talked about this in the past is times like this for product like ours, we're catching the up and the down. We are in a great space. We're at a great price. We're at a trusted brand and we have very broad distribution across the globe.

And you probably saw the results in our international markets was pretty strong too. So I would characterize this as a really good time heading into an even better time and we feel real confident going forward, Ike.

Ike Boruchow
Got it. And then just one more for Joe. Just the guidance that's kind of implied for 2Q in the back half, is it basically kind of POS in that flattish range that you're kind of baking into plan? And then Joe, any chance you could help us with some initial 2026 algo commentary, you'll have Helly, obviously things will be a little bit more stable. Just curious if you could give us any insight to how you would start to plan that out?

Joe Alkire
Yes, sure. Good morning, Ike. Yes, on the second half, we took the top end of our full year revenue growth down about a point. So we now are expecting 1% to 2% growth on an organic basis. That implies second half growth of just about 3%.

The growth in the second half that we have contemplated is effectively all driven by the fifty-third week new programs and some distribution expansion where, frankly, our visibility is quite high, similar to the same dynamic we had in the second half of 2024. We have moderated our POS assumptions somewhat, on the top end of our guide relative to where we were before, just given the overall environment.

And we have assumed that inventory levels remain at their current state, which as we've talked for several quarters in a row now, they continue to be quite lean as our retail partners manage inventory very conservatively, as you would expect.

On '26, while we're not going to hit a '26 outlook today, certainly appreciate the question given all the moving parts to our story. But I will give you a high-level framework and again, this is barring a major slowdown in the macro environment.

The organic business, Wrangler and Lee, the brands are performing well, and we do expect those businesses to grow. Next year, we do have the tariff impact or potential tariff impact, but we expect to substantially offset that impact over a twelve-to-eighteen-month period, as we said.

You'll have Project Genius savings that will be maturing to a full run rate, and we'll reinvest at least a portion of those savings back into the business to continue to drive growth. The Helly business, as you can see, is performing really well. Given the cash we expect to generate as a combined company, we'll delever quickly and that will be a tailwind as well as add some additional capital allocation optionality as we consolidate and grow the earnings and cash flow of the combined business.

So again, we like where we are. We like our model. We clearly have a lot of levers we can pull to drive accelerated growth and returns over the next handful of years.

Ike Boruchow
Thanks, guys.

Scott Baxter
Thanks, Ike.

Operator
Thank you. Your next question is from Brooke Roach from Goldman Sachs. Your line is now open.

Brooke Roach
Good morning and thank you for taking our question. Scott, I was hoping that you could unpack the lead transition in a little bit more detail. How is that progressing versus your expectations? And how should we be thinking about the timeline for an inflection back to growth in the Lee brand specifically in the US business?

Scott Baxter
So I would characterize it like this and I'm going to hit three bullet points that are really meaningful to me. I've been around this business, Brooke, for almost twenty years now. And in those twenty years I have never seen better product. And that's where it all starts, with great product.

We have been testing some product. We've been pushing some product out early. We've done some collabs. We've done some things that we've never done before. And what we're hearing and what we're seeing and the feedback we're getting is exceptional. And we've been rolling product out as you can imagine for fall and spring next year.

So I would start with the fact that in those twenty years we're listening to our consumer, building better product, doing things that we've never done before. So that's what gives me incredible confidence. The next piece is the digital piece. That's the thing that we can get after quickest and that's the thing that we can be closest to storytelling online, things like that and the consumer is just grabbing our product; they love it. So both male and female.

So we're up as you heard us both say about 8% in the digital space and it continues to grow and we see that continuing throughout the year and into next year. So really positive from the standpoint of where we can touch the consumer very quickly. It's really resonating and working exceptionally well.

And then there's one other thing that's really interesting that's been really good for us and really good for the team is that we are now coming out with a fairly sizable equity campaign and that comes out in the fall. And we're testing that and it tested even better than the Wrangler campaign that we just rolled out this past year that's done exceptionally well that all of you have seen.

So we've got a really good campaign being supported by incredible product and really good storytelling. And we've really worked really hard at this and I want to give a shout out to the teams that have been leading this effort. And I think that in 2026, we'll start to see this inflect positive again, but feel very confident about what that team has done and real proud of that group and what they've done to put us in a position to win in the Lee brand here going forward.

Brooke Roach
That's really helpful. Thank you. Joe, can you help us understand the drivers of the significant gross margin outperformance this quarter and the levers that are driving the higher margin outlook that was offered today for your base business? How should we be thinking about the sustainability of each of those drivers of outperformance?

Joe Alkire
Sure. Good morning, Brooke. So, yes, in the quarter, on a year over year basis, we were up about 200 basis points. Mix was about 80 of that. We're still seeing the benefits of lower product cost. That was about 40 basis points and then the balance is Genius and handful of other things, which adds the additional 80.

I'd say relative to our plan and our prior outlook, we were about 170 basis points higher than where we thought we'd be. There was some conservatism built into the outlook in light of the environment, and we executed really well across the quarter. We also have a fairly meaningful mix benefit with Western DTC and our international businesses performing above plan.

As you know, those are accretive areas of the business for us and you start to have Project Genius benefits that beginning to kick in a fairly meaningful way. As you think about the balance of the year, the mix benefit will moderate a bit, but still remain positive. Our Genius benefits are intact. And then our input costs, our product costs will become more muted in the second quarter relative to the prior year and flip to a modest headwind as we enter the back half.

Brooke Roach
Great. Thanks so much. I'll pass it on.

Laurent Vasilescu
Thanks, Brooke.

Operator
Thank you. Your next question is from Paul Turney from Barclays. Your line is now open.

Paul Turney

Hi, good morning. Thanks for taking my question. One quick clarifying question and then a follow-up. What's assumed in the $50 million unmitigated tariff impact? Is it just a continuation of the tariff rates for the pause period?

And what are the mitigating efforts already being put into place?

Joe Alkire
Yes. I'll start. Good morning, Paul. So on the $50 million so recall, Paul, last quarter, we had estimated $50,000,000 for just the Kontoor business. That's now $35 million and the biggest change there is Mexico.

So where we had assumed Mexico would be at a 25% tariff rate, that's now zero and protected under USMCA, at least currently. For the rest of the world for KTB, we've assumed the 10% baseline tariff. China for us is de minimis. On the Helly side, there's about a $15 million estimated impact. That's really 10% for Southeast Asia and then you have China at a more elevated rate.

Paul Turney
Okay, great. And then the follow-up is with the advantage that Mexico now has under the current tariffs, what is the capacity in Mexico to take on further production? What are the opportunities to further lean on vertical integration? And what are the constraints? Thank you.

Scott Baxter
Hey, Paul, it's Scott. I'll go ahead and take that. We run those plants really well and have for a very long time. And then if you recall about a year ago, we moved out of Nicaragua and we moved a lot of the production from there into our Mexico plants. So I got to say that there's not much room left, but I got to say that that's an extreme positive because we run those plants so well and so efficiently.

So we do a really nice job down there. So right now I think we're in a really good place.

Paul Turney
Thank you. I'll pass it on.

Operator
Thank you. Your next question is from Peter [inaudible] from Stifel. Your line is now open.

Peter
Hi. Thanks for taking my question. I was curious how we should think of the annual run rate contribution from Helly Hansen relative to the $650 million revenue and $75 million EBITDA performance in 2024. As you scale to the US penetration opportunity, can you help us think of the pace of development upon ownership?

Joe Alkire
Yes. Hey, Peter. I'll start. Scott can jump in. Yes, I think a little bit premature to go too far given that we don't own the business yet, but I will say a couple of things.

So year to date, through the first four, five months of 2025, the business has performed in line to modestly better than what we expected. For the second half, we talked about $400 million to $405 million of revenue. That reflects double digit growth on a year over year basis. So pretty solid growth, pretty broad growth across channel, geography and categories. We do expect the brand to expand margins and profitability in the second half of the year.

That excludes synergies. So the fundamentals of the business are in pretty good shape.

I think longer term, medium term, we have said that our expectation for the brand is to grow at a high single digit rate. And we think under our ownership, we can not only invest more back into the business, but also improve profitability given our capabilities.

Scott Baxter
And, Joe, I'll add a couple of things. Peter, maybe this will help clarify some of maybe what you're getting at a little bit. Relative to an outdoor brand, and we've all been around outdoor brands quite a bit, seasonality can play a big part in that, that being weather. The one thing we love about Helly Hansen here is that workwear component. That large workwear component is a very steady annuity in the business month to month, year to year.

So that is a benefit relative to how we think about owning this entire business. And I think Joe's points are spot on for the rest. But as you think about how the business is going to play itself out, I think of it as an outdoor company and how that usually works and you know the strong quarters there but now underpinned with that really, really strong workwear business that's just very steady month to month.

Peter
Thanks for that perspective. And then I was curious on working capital, strong working capital progress in the quarter. Can you talk about the requirements for working capital for the Helly Hansen business and how that contributes to the $350 million of cash flows from operations? I think the commentary was for inventory in line with forward sales growth in the back half, and I just wanted to make sure that that was on a consolidated basis with including Helly Hansen.

Joe Alkire
Yes. Thanks for the question, Peter. Yes, on the KTB side, from an inventory perspective, we expect inventory to be down year over year and then grow in line with our revenue expectations in the second half, which are more in that 3% kind of range. As it relates to Helly, you can see the cash contribution that we expect from that business. That does not yet include a fairly significant working capital benefit that we see for the business that will happen over the course of 2026.

Peter
Thank you.

Operator
Thank you. Your next question is from Laurent Vasilescu from BNP Paribas. Your line is now open.

Laurent Vasilescu

Good morning. Thanks for all the color this morning. So back in late October, I think it was called out that 1H ‘25 top line should grow 4%. But today’s guidance calls, I think, for 1H [inaudible] slightly down, maybe down as much as 1%. Organic compares do get harder in 2H so curious to know what gives you the confidence that 2H organic revenues should grow slightly low to mid-single digits? Thank you very much.

Scott Baxter
I’ll go ahead and start and then kick it over to Joe. I really think it’s the team and you think about as I think about this, the product that we are developing here is so exceptional. The fact that we’re getting after our female consumer in a really significant way. You’re seeing this Wrangler campaign that we kicked off really gaining traction. You’re seeing us continue 12 quarters in a row to gain market share in bottoms, which is really significant.

You’re starting to see the turnaround of Lee and an equity campaign of Lee. So you’ve got a lot of green shoots there. You’ve got a really strong resilient economy and consumer. We play at a great price point, really good distribution, adding Helly Hansen and a really, really strong workforce. And then we’ve got our target business that kicks in, in a more significant way.

So as I look around and think about all the things that are going very well and the things that we simply that we can control, it’s a really positive environment. And then the one thing that’s been really nice is the international businesses have really found their footing and have done really well. So we’ve been pleased with that too.

And then I’ll tell you, there’s another thing here too. And lastly, and then Joe, I’ll kick it over to you if you have some comments. But the fact the Helly Hansen acquisition has been a real shot in the arm for the organization. I think the organization is really, really energized and really excited about the fact that we’re adding them to our portfolio.

And then on the reverse side of that, I think the Helly Hansen Group is really excited to join our organization because we speak the same language. They haven’t worked for an apparel company for twenty years, haven’t been owned by an apparel company for twenty years and now they’re going to be and I think there is high energy there.

And I’ll tell you what we have been thrilled with the talent that we’ve seen there too. So absorbing that talent, bringing that brand in house, all of us working together, all the things that we have going on, I think it gives us a lot of confidence here at Kontoor Brands.

Joe Alkire
Yes. Laurent, I’d say just a couple of things. So as you think about what we communicated or flashed last fall for the first half versus today, a few pieces. So FX became a larger headwind than what we saw in the fall. We clearly did not anticipate a high single digit decline in POS for February and certainly did not anticipate the volatility the overall environment.

Those are the biggest pieces. I think as you think about the implied growth in the second half, like I said, it’s really the fifty-third week and the visibility we have into new programs and distribution. As Scott just mentioned, the POS assumptions are pretty much what we saw in March, April, which is down about 1%.

Laurent Vasilescu
Super helpful. Thank you very much. And how much of the fifty-third week contribute for top line and bottom line? And then I've got a follow-up question on HH. Thank you.

Joe Alkire
On the fifty-third week, Laurent, I mean, we don't have a big retail business. As you know, it will be bigger with Helly. So just pure KTB organic, it won't have a meaningful impact, but it is bigger for the second half and for the fourth quarter in particular.

Laurent Vasilescu
Okay. Very helpful. And then the remaining question is on HH. It looks like it's losing $0.28 in 2Q per the guide, but that's only with one month of ownership since the deal closes in late May. So I'm just curious, is it the right way to think about it that if you owned it for three months, it would lose something around $0.70? Or asked another way, how should we think about this business, as we think about an NTM basis like EPS contribution 2Q and 1Q? Thank you.

Joe Alkire
Yes, I'll take that, Laurent. So this business does exhibit typical seasonality similar to other outdoor peers, as you know very well. Q2 is Helly's lowest volume quarter, and it has historically generated losses in that quarter. I'd say the $0.28 impact for really just June is not reflective of a full quarter, so I would not run rate that. It's really timing within a single month, which can have an outsized impact.

You also have some interest expense and financing amortization for that month without the benefit of the earnings of the business. So there's a little bit of noise in the stub period, but I would not take the $0.28 and assume that that's what a full quarter will be for the business going forward.

Laurent Vasilescu
Okay. Thank you very much. Best of luck.

Operator
Thank you. There are no further questions at this time. I will now hand the call back over to Scott Baxter, CEO, for the closing remarks.

Scott Baxter
Thanks everyone for joining us for the call. Really appreciate it. We're looking forward to getting together again this summer and we'll continue to stay in touch. Best of luck to all of you as we head into the summer season, late spring and we'll talk to you soon. Thanks again, everyone.

Operator
Thank you. Ladies and gentlemen, the conference has now ended. Thank you all for joining. You may all disconnect your lines.