

Kontoor Brands
Q3 2024 Earnings
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Presenters

Michael Karapetian - VP, Corporate Development, Strategy, and Investor Relations
Scott Baxter - President, Chief Executive Officer and Chair
Joe Alkire - Chief Financial Officer

Q&A Participants

Ike Boruchow - Wells Fargo
Jim Duffy - Stifel
Bob Drbul - Guggenheim Partners
Mauricio Serna - UBS
Paul Kearney - Barclays
Lia Yang - BNP Paribas

Operator

Ladies and gentlemen, greetings, and welcome to the Kontoor Brands Q3 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star and zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Michael Karapetian. Please go ahead.

Michael Karapetian

Thank you, operator, and welcome to Kontoor Brands third-quarter 2024 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 be in constant currency unless otherwise noted, and often on an adjusted dollar basis, which we clearly define in the news release that was issued earlier this morning. Our outlook is presented on an adjusted dollar basis.

Additionally, participants should note that comparability with prior periods is impacted by the previously disclosed \$13 million out-of-period duty charge recorded in the third quarter of

2023. Accordingly, in our following comments, comparisons to 2023 gross margin, operating income, and EPS do not include the impact of the 2023 duty charge.

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.

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

Scott Baxter

Thanks, Mike, and thank you to everybody joining us on today's call. Our third quarter results exceeded expectations, driven by accelerating revenue growth, improving profitability, and strong cash generation. We anticipated a top-line inflection starting in the third quarter, and I am pleased to share we delivered.

Our investments in product innovation and demand creation are driving continued market share gains and a strong foundation for future growth. In what remains an uncertain environment, our strategies are working, and we are executing at a high level.

With that, let's discuss highlights from the quarter. Wrangler revenue grew 4% including 5% growth in the US and 10% growth in global D2C. There are several exciting wins from the quarter, but I want to start with an important milestone. In our core bottoms and shorts business, Wrangler gained 90 basis points of market share in the US according to Circana. This marks our 10th consecutive quarter of market share gains in our largest market. It takes more than one thing to drive this level of consistent performance, but it starts with our people and our incredible product stories that are resonating with our consumers. Let's get to a few of those now.

Starting with outdoor, during the quarter, we launched our Cliffside utility pant and outdoor chino, and both are off to a strong start. We continue to advance our product development capabilities that are driving increased penetration in this large and growing category as well as expanded distribution opportunities within sporting goods retailers. Year-to-date, outdoor has grown 12%, and we continue to expect double-digit increases for the year.

Turning to Bespoke, our new female fit innovation, as I shared in prior quarters, early market response was very encouraging. Today, I am pleased to share demand exceeded our high expectations. We launched across D2C and specialty retail with many styles quickly selling out. We will build on this momentum and look to scale this platform in '25.

Staying within female, we also launched our collection with Lainey Wilson, and as expected, was our single largest collaboration to date. This was also a great opportunity to leverage our new e-commerce capabilities including early access for loyalty members. In fact, we saw a 100% increase in daily sign-ups, and loyalty members accounted for a third of purchases. Lainey has been a fantastic partner, and we are excited to continue this momentum in '25. Taken together, Wrangler's female business grew double-digits.

We also debuted the Wrangler global equity campaign late in the quarter. If you have not seen it, I encourage you to do so. This was our first campaign of this scale as a public company. With Wrangler's building momentum and strong pipeline of new innovation, the timing was right to play offense, and market response has been fantastic. We have received strong feedback from our retail partners as well as numerous accolades. And beyond the energy this is created for the brand, this campaign is a unique success story. Leveraging the investments we are making as part of our new multi-brand structure, it was developed almost entirely in-house, allowing for greater potential ROI.

Finally, the re-launch of denim at Target is off to a great start. While it is still early, performance has exceeded our expectations. Wrangler is closing out the year from a position of strength and will be entering '25 with great momentum. Joe will provide more detail, but we have good visibility to the front half of the year. As a result, we have provided preliminary guidance for total revenue growth of 4% in the first half of '25.

Turning to Lee, revenue decreased 3% sequentially improving from the second quarter. Uneven macro conditions in Europe and Asia have continued to pressure the international business. In the US, revenue inflected positive, driven by 2% growth in wholesale. And we were encouraged to see POS accelerate as the quarter progressed. We are seeing particular strength in our female business, which grew 10%.

As we discussed last quarter, our consumer insights work and refreshed brand segmentation is yielding green shoots with younger and female consumers. As an example, our work led to the development of Lee Layers, which was the top-performing new program of the season, and our premium Ever-fit platform also drove nice growth in the quarter.

We also had several successful collaborations during the quarter with Forever 21, Oliver Cabell, and STUTTERHEIM, aimed at reaching younger consumers while driving category extensions. As a result, we are seeing increases in perceived brand equity and purchase consideration. This is translating to improved sell-through. As measured by Circana, POS for female increased mid-single digits and gained 60 basis points of market share. Over the near term, we expect Lee's US business to further accelerate in the fourth quarter.

To support this acceleration, we are excited about the upcoming launch of Lee X. In the fourth quarter, we will be launching the Lee X Move collection of denim, non-denim and tops. This will

be followed by Lee X Lite in first half of '25. Lee X is a true platform that will provide innovation at scale and support our return to growth.

Finally, I will provide an update on our global transformation initiative. Project Jeanius is progressing well, and we remain on track to deliver \$100 million of combined gross margin and SG&A savings. We have identified three major areas for improvement. First, our global sourcing transformation where we will optimize our business for category growth and our evolving growth strategies, drive greater efficiency in our sourced vendor network and enhance our planning organization; second, back-end efficiencies where we will leverage an improved share platform across both brands while standing up enhanced data capabilities; and third, commercial optimization where we will drive increased speed to market and improved product development.

As I've stated in the past, Project Jeanius is one of our most significant and important undertakings as a public company. The work we are doing will transform our organization to a best-in-class, global multi-brand platform while unlocking significant sources of value. We will see improved decision-making, faster speed to market and a meaningfully higher profitability ceiling. We anticipate Project Jeanius to have a modest benefit to first half of '25 with more meaningful benefits in second half of '25 and into '26.

Before I turn it over to Joe, let me provide some final perspective. Our business has great momentum. Revenue and profit are accelerating. We have raised our earnings and cash-flow guidance, and we have significant capital allocation optionality. We have returned \$168 million to shareholders year-to-date and recently raised our dividend. While the environment remains dynamic, our brands are winning with the consumer, and we expect continued growth as we look to the new year, including 4% growth in the first half.

We are operating from a position of strength, and I'm confident we have the team in place to continue to drive strong value creation for all stakeholders. Joe?

Joe Alkire

Thanks, Scott, and thank you all for joining us today. Our third quarter results were stronger than expected as our business fundamentals continue to strengthen. As expected, revenue growth inflected positively in the third quarter, driven by new product innovation, distribution gains, and accelerating POS. We also delivered stronger profitability and returns on capital as gross margin expansion was higher than anticipated, as a result of lower product costs and supply chain efficiencies.

When combined with our focus on networking capital management and driving further reductions in inventory, we generated significant cash from operations, supporting our capital allocation framework, including \$40 million of share repurchases and a 4% increase in our quarterly dividend. We are pleased with our strong execution and performance year-to-date, and momentum in the business is building as we close out the year, but more on that in a bit.

Let's review our third quarter results in more detail. Global revenue increased 2% and exceeded our expectations. Relative to our prior outlook, we saw modestly stronger results in the US with Europe and Asia performing largely as anticipated. I-brand Wrangler Global revenue increased 4%. Growth was broad-based, driven by strong POS and market share gains with continued momentum in distribution and category expansion, including 10% growth in DTC, 10% growth in female, 7% growth in outdoor and 16% growth in tops.

In the US, revenue increased 5%, supported by increased investments in demand creation, product development, and our digital platform. Revenue growth was balanced as DTC increased 10%, including 13% growth in digital while wholesale revenue increased 5%.

During the quarter, we were encouraged by the strength we saw in POS with trends accelerating through the quarter, including 6% growth in September, the strongest performance we've seen all year. While retailers are in a conservative posture and inventory levels are suboptimal, our sell-through remains strong, and we continue to drive consistent market share gains.

Wrangler International revenue decreased 2%. High single-digit growth in DTC was more than offset by declines in wholesale. We are seeing success with the expansion of our iconic 13-MWZ cowboy cut jean, which was our strongest selling style on our digital platform. And while challenging macro conditions are pressuring our business outside the US, we are encouraged by improving order books in Europe with spring summer '25 up at a mid-single-digit rate.

Now, turning to Lee. Global revenue decreased 3%, reflecting sequential improvement in the business as we work to return the brand to growth. In the US, trends unfolded as anticipated with revenue inflecting to 1% growth, driven by 2% growth in wholesale. Similar to Wrangler, POS accelerated through the quarter with September increasing at a low-single-digit rate.

Our female business, which has been an early beneficiary of our new consumer segmentation and insights work, was particularly strong, increasing 10%. We also saw strength in category extensions, including strong growth in T-shirts. We expect continued improvement for the US Business in the fourth quarter, supported by accelerated growth in DTC, the launch of the Lee X innovation platform and a more than 30% increase in demand creation.

Lee International revenue decreased 7%. In Europe, revenue declined 10%. Growth in DTC, including more than 30% growth in digital, was offset by declines in wholesale.

Performance was consistent with our expectations as the uneven macro environment continues to pressure retailer behavior, leading to more conservative inventory management.

In APAC, revenue increased 1%. Revenue growth was more modest than we expected compared to 90 days ago as the operating environment in the region became more difficult as

the quarter progressed. That said, we are seeing continued momentum in digital, which increased 6% in the quarter.

While brick-and-mortar retail remained soft due to weaker traffic, we are seeing strong results in our new concept stores. Compared to our fleet average, we are seeing a double-digit comp lift in our new store environments. We are encouraged by this performance and the early returns on our investment and plan to continue with the rollout of our new concept stores in 2025. However, we will be prudent and more measured with the pace of investment next year as a result of the environment.

Wholesale revenue increased 5%. As we discussed last quarter, we continue to take proactive measures to improve the quality and health of our retail network in China. That said, we are taking a more conservative view of the near-term outlook for the business while remaining confident in the long-term opportunity for our brands in the region.

Moving to the remainder of the P&L, adjusted gross margin expanded 150 basis points to 45%, driven by the benefits of lower input costs and supply chain efficiencies. This was partially offset by the targeted pricing actions included in our plan. Adjusted SG&A expense was 195 million, up 5% compared to the prior year, driven by investments in demand creation, product development, and volume-related distribution and freight expenses. And adjusted earnings per share was \$1.37, representing an increase of 12% compared to the prior year.

Turning to the balance sheet, inventory decreased 24% to \$462 million. Net working capital management remains a top priority and has contributed to our strong cash generation year to date. We expect further reductions in inventory in the fourth quarter as we approach optimal levels in our annual turnover target of approximately 3.5 times.

We finished the quarter with net debt or long-term debt less cash of \$476 million and \$269 million of cash on hand. Our net leverage ratio, our net debt divided by trailing 12 month adjusted EBITDA, was 1.2 times, trending toward the low end of our targeted range.

During the quarter, we repurchased \$40 million of stock under our current authorization, and as previously announced, our board declared a regular quarterly cash dividend of \$0.52 per share, representing a 4% increase. Year-to-date, we have returned \$168 million to shareholders through share repurchases and dividends.

Finally, on a trailing 12-month basis, our adjusted return on invested capital was 30%, representing an increase of 660 basis points compared to the prior year.

Now turning to our outlook, full year revenue is now expected to be \$2.6 billion, consistent with the midpoint of our prior outlook range. In the fourth quarter, we expect revenue of approximately \$695 million, representing growth of 4%.

Our revenue outlook continues to embed the following assumptions. First, we continue to have good visibility to category expansion, distribution gains, and new innovation platforms in the fourth quarter, and we continue to support these programs with increased demand creation and other investments to fuel our performance and momentum into 2025.

Second, we continue to plan the business conservatively and assume no meaningful improvement in overall POS or retail inventory positions for the balance of the year. While the consumer has been resilient and inventory levels at retail are suboptimal, the environment is uncertain and our retail partners are in a conservative posture with regard to inventory management.

Moving to gross margin, we are raising our outlook to 45.1% from approximately 44.8%. Our updated outlook represents an increase of 260 basis points compared to adjusted gross margin of 42.5% in 2023 and now includes an incremental 20 basis point impact from supply chain and inventory management actions. These actions were taken proactively from a position of strength and are expected to provide a stronger foundation for the business as we close out this year.

More specifically, the supply chain actions were primarily expedited freight to secure inventory positions in support of our growth expectations for the remainder of this year early next year. We took these actions as a precautionary measure in light of recent supply chain volatility to ensure service and support growth plans with our largest customers. Proactive inventory management actions included efforts to more aggressively clear excess inventory, further improve the composition and quality of our inventory, and increase cash flow. These actions further strengthen our balance sheet, free up additional investment capacity, and allow us to reinvest in more productive areas of the business. We remain pleased with the overall quality of our inventory and the progress we've made reducing inventory levels.

For the fourth quarter, our outlook now implies 150 basis points of gross margin expansion, which compares to our prior outlook of an increase of approximately 120 basis points. SG&A is expected to increase approximately 4%, consistent with our prior outlook. Operating income is now expected to be \$385 million, reflecting growth of 11% compared to the prior year.

Relative to our prior outlook, adjusted operating income now includes \$6 million of incremental supply chain and inventory management actions previously discussed.

Fourth quarter adjusted operating income is expected to be \$105 million, reflecting growth of more than 20%. EPS is now expected to be \$4.83, including an impact of \$0.08 from the incremental supply chain and inventory management actions discussed. Our updated outlook represents growth of approximately 9% compared to our prior outlook of approximately \$4.80, reflecting growth of 8%. As a reminder, full-year EPS growth will be negatively impacted by about 5 percentage points from a higher tax rate, including a 25 percentage point headwind in the fourth quarter. We expect fourth quarter EPS of \$1.31, reflecting a decrease of 3%.

Normalizing for the tax rate differential, fourth quarter EPS is expected to increase approximately 20%.

We now expect cash from operations to exceed \$360 million as a result of stronger earnings growth and further reductions in inventory. This compares to our previous outlook for cash from operations to exceed \$350 million. Our increased outlook highlights the cash generative nature of the business and provides additional capacity to pursue our capital allocation framework.

And finally, I'd like to provide perspective on the preliminary 2025 outlook we included in the earnings release this morning. While we are not providing the full details of our 2025 outlook at this time, we want to take the opportunity to provide an early look at how we see the business evolving next year. Our preliminary 2025 outlook reflects our current visibility of the business and the confidence we have in the momentum building into next year.

First, we expect revenue growth to be driven by ongoing market share gains, category expansion, new distribution, and strong momentum in outdoor and female. Based on current visibility, we expect revenue growth to approximate 4% in the first half of the year. For the full year, we expect 2025 revenue growth to be more weighted to the front half as we begin to anniversary category expansion and distribution gains in the second half.

Second, we have a high degree of confidence in our ability to continue to expand gross margin next year, supported by Project Jeanius. Based on current visibility, we expect the benefits of Project Jeanius and our ongoing structural mix to be partially offset by modest product cost inflation and ongoing supply chain volatility.

Third, we expect operating income growth to outpace revenue growth, driven by both gross margin expansion and SG&A leverage. We expect to increase our rate of investment in areas such as demand creation, product development in DTC, and international expansion while remaining prudent with regard to discretionary spending. Project Jeanius is expected to fuel investment capacity, and we expect to both expand operating margin and reinvest a portion of the savings to further support growth.

And finally, we expect the benefits from Project Jeanius to vary by halves next year. We expect the first half of 2025 to benefit from SG&A savings, primarily related to back-end efficiencies in our shared platform. We expect the second half of the year to include the added savings from supply chain initiatives that will begin to scale and support gross margin expansion.

As we move into 2026, we expect Project Jeanius savings to mature to a full run rate, providing us with a higher level of investment capacity to further support growth and expand profitability and returns on capital. We intend to share more specific details about Project Jeanius and its evolution along with our investment plans in the context of our 2025 outlook in February.

Before opening it up for questions, a few closing remarks: we are executing well and operating from a position of strength. Revenue growth is accelerating, and the momentum of the business is building. Wrangler is driving broad-based growth, and the fundamentals of Lee continue to improve. We expect Project Jeanius to create meaningful savings and investment capacity to support growth while improving profitability and returns on capital. And the strength of our balance sheet and cash generation provide us with significant capital allocation optionality to drive additional layers of value creation.

This concludes our prepared remarks, and I will now turn the call to the operator.

Operator

Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. If you would like to ask a question, please press star and one on a telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star and 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 the star keys. Ladies and gentlemen, we will wait for a moment while we poll for questions.

The first question is from the line of Ike Boruchow with Wells Fargo. Please go ahead.

Ike Boruchow

Hi, guys, good morning. Scott, Joe, Mike, congrats on the quarter. I guess maybe for Joe, maybe also for Scott, just wanted to kind of dig in a little bit more on the 2025 commentary and specifically just drivers of revenue that gives you the confidence in that 4% in the first half. And then just my follow-up is, based on the commentary, is it fair to say that you're basically expecting the revenue growth weighted to the first half, but due to the timing of Jeanius and some saves, maybe margin expansion weighted to the back half? So just kind of curious if you could comment on the shape.

Scott Baxter

Sure. Hey, Ike. How are you? Thanks for the call with us today. I'll go ahead and start and kick it over to Joe. But I think for us, really, Ike, it boils down to, as we kind of discussed a little bit, but consumers are choosing our products, and the way that we look at it is through -- since POS, our performance in POS has been really strong. It's been broad-based. Our performance with our own D2C has been really good. Our digital platforms across the globe have been really strong.

We've had 10 consecutive quarters of growth and market share gain with Wrangler, and that is really significant. I mean, that's two and a half years, and we continue that -- expect that to continue as we move forward. But we're making really significant investments in our talent. We've never had a more talented team. We've upgraded the talent over the last year and a half significantly. You're seeing the results from that. Investments that we're making in product, in

innovation, they're all starting to pay off. So, we've got really good momentum as we head into the second half here and as we head into next year, too.

And I think the thing that's really important for us, helpful for us as we look into '25 is we know what we have out there from a new business standpoint, and we have things like outdoor, which I touched on a little bit, but a lot of tops business that we've grown, our Lee-X line, which is coming out here in the Q4 and then Lee-X Lite in the Q1 next year is exceptional. I'm really looking forward to that hitting the marketplace and see how it does. But again, we have really strong collaborations from our team and our new distribution.

So all of that kind of rolled together with the positive momentum we have right now with the team that we have behind that puts us in a really good spot. Joe?

Joe Alkire

Yes. Hey, good morning, Ike. So, yeah, we're not providing the specifics of 2025 at this time. But, look, we thought it would be helpful to at least provide our initial perspective on 2025 and how we see the business evolving into next year and really to underscore the confidence we have in the trajectory of the business as well as highlight the strength of our fundamental profile.

The profile we're delivering in the second half, low to mid-single-digit growth, gross margin expansion, strong operating earnings growth, cash generation, we see that continuing into next year and the building blocks to drive another year of strong growth and return. So we've got Project Jeanius that will fuel the investment capacity. We've got a strong balance sheet, a lot of dry powder and flexibility to drive additional layers. So, yeah, as we look into next year, we're fairly confident. We'll give you more specifics as we get to February.

Ike Boruchow

Great. Thank you.

Operator

Thank you. The next question is from Jim Duffy with Stifel. Please go ahead.

Jim Duffy

Thank you. Good morning My compliments on execution across the year. I'm very interested in Project Jeanius opportunities. I'm hoping you can speak in more detail on the mechanics of Project Jeanius and how that translate to both strategic opportunities on the top line and then the P&L impact of how that plays forward in the first half and second half of '25 and then into future years. Thanks.

Scott Baxter

Jim, I'll start and then I'll kick it over to Joe. Jeanius for us has been an all-encompassing project. We've got a terrific team working across Jeanius and putting in a lot of long hard hours, so

we're much appreciative of that. But it's going to break down into three very specific categories. It's our global supply chain transformation. It's the back-end efficiencies that we need to do a better job, which we're going to of capturing and also strategically thinking about moving forward, and then it's our commercial optimization.

Let me take you through a little bit on how we're thinking about those, and then Joe can kind of fill in the blanks. But if you think about our sourcing transformation, when we spun off, we were a complete clone and go from our parent company before. So we were just a denim supply chain and just a clone from where we were and where we are and where we're trying to progress to now.

So, you think about our business and how it's changed and you think about the outdoor, you think about some of the different products that we have, you think about our tops, just all those different things that are making our supply chain a little bit different now and we've got to grow and change and become more efficient when it comes to that. So we're spending a lot of time working on our product portfolio on how we can customize the supply chain for what we're going to look like in the future.

We've got to drive big efficiencies with our current source vendor network, which is really important. And then one of the things that we needed to do another, another example of where we needed to grow and evolve as a company is in our planning department. So we've recently hired a planning expert who joined the company about a month ago; thrilled to have that person on board. It will help us think about, as our business has gotten a little bit more complex, a little bit more global, and a little bit different, we've got that team in place now to go ahead and help us kind of plan for that here going forward.

And then from a back-end standpoint, we want to get to the point where we're really comfortable from the standpoint of a very similar back end for the brands, but then the front-end, brands can go and be and have their own identity on what they're going to evolve to and what they're going to be, but a little bit of a differentiation there from back-end to front-end, but take advantage of all the scale that we can in the back-end.

And one of the things that we invested in, which is really important in this process, is data analytics. So we've got a really good team. It's added -- you know, it's been very additive here in the last 18 months and only getting better as we move forward. And obviously, everyone here on the call knows about our new ERP system, and we want to test that, put that to work and really push that because it was such a significant investment.

And then, from a commercial standpoint, we've got to increase our speed to market, and we've got to improve product development. It's a great opportunity for us. And especially since we're getting into these new categories, it'll be significant as we go forward.

Joe, is there anything I missed?

Joe Alkire

Yeah, Jim, just financially, we expect \$100 million of savings at full run rate. We said \$50 to \$100 million roughly a year ago. So we've gravitated to the high end of that range. We've got certain work streams that are in the execution phase, other work streams that are -- continue to move along from a planning perspective. We'll share more specifics in February, but assume we're pretty confident in that \$100 million.

The savings will be more gross profit driven versus SG&A. I think we've said that before. And I would think of it as roughly two-third, one-third. So, the way this will evolve, it'll be a gradual build. We will start to see the SG&A savings in first half of '25, and the gross margin savings will begin to work their way into the P&L into the back half, just given the lag of when they'll start to show up.

So, look, overall, we're really excited about the program and what we think we can deliver in terms of freeing up investment to accelerate growth, improve profitability and returns on capital.

Jim Duffy

Great. Thank you.

Scott Baxter

Thanks, Jim.

Operator

Thank you. The next question is from the line of Bob Drbul with Guggenheim Partners. Please go ahead.

Bob Drbul

Hey, good morning, guys. Two questions, really - I think the first one, can you spend some time just on the performance improvement at Lee? I think definitely seems like there's a step change there and just love for you if you expand on that a little bit. And then, Joe, you talked about sort of end of '25 product cost inflation. Can you expand on what you guys are seeing there and sort of when exactly it sort of flips because I think you're seeing some product cost benefits right now and sort of surprised to hear that into '25? Thanks.

Scott Baxter

Sure. Hey, Bob, I'll go ahead and start with Lee. I think the single most important thing for me from a Lee perspective is the leadership that we've put in the Lee team. So we've got Tom leading it. We've got Jenni and Holly and Tom, that team working together with the Lee team right now, looking at all aspects of the business, looking at design, looking at product, looking at go to market, looking at all those things and bringing that kind of story together, and that started a little while back, as you know, and we've started to see some really interesting green

shoots specifically around our female business. And you heard me talk a little bit about some of the really big wins that we've had in female, whether it would be Bespoke and some of the other things that we've done there, but it's been significant, and we're really happy with that.

But we've got a long way to go. We've got a lot more coming. We've got Lee-X and we've got Lee-X Lite here coming in the men's area, which is really important. But I want everyone to know that, behind the scenes, we've really, really dug into this in a pretty significant way. It's still early on, which is fairly encouraging because of all the good things that are yet to come as we move forward, but yet, we're seeing some really good things that are really helping the business.

And I think the other thing too, Bob, it's really helping the morale of the team around the globe, too, seeing these early wins, seeing that they can really contribute to the rest of the organization in a significant way. And the leadership has really brought everybody in this, and everybody is in this together. So really pleased with what we're seeing here with the team, how they're thinking about it, how they've torn this whole thing apart. I think there's a lot for us to talk about going forward, and we'll spend some time -- we've talked about our Investor Day. We'll get that date nailed down, and we will really dig into this at Investor Day and have some of our big leaders from the lead team there to participate and share with what they're doing. But a lot more to come, but encouraged with where we are right now, ahead of what and where I thought we would be when we made those changes and started to move this forward.

Joe Alkire

Yeah, hey, Bob, good morning. On the product cost front, look, I mean, it's been a more volatile supply chain environment more recently, one I think that our supply chain is well suited to navigate. As we look at next year, we expect to see a neutral product cost environment overall. Certainly, there are some puts and takes to that. We're seeing increases in labor. Certainly, freight rates have elevated more recently, but we've got supply chain efficiencies and some other things that'll help us.

You'll have a first-half, second-half dynamic. We are starting to anniversary the lower product cost that we started to see last year. So that benefit will become smaller and smaller as we move into the first half, and then we'll have more modest product cost inflation as we get to the back half. And then I think, for us, we've got certainly our structural mix that will continue to benefit us, and then we've got Project Jeanius. So, we'll lay that out in more specifics in February, but big picture, that's how we see things evolving.

Bob Drbul

Great. Thank you.

Scott Baxter

Thanks, Bob.

Operator

Thank you. The next question is from the line of Mauricio Serna with UBS. Please go ahead.

Mauricio Serna

Great. Good morning, and thanks for taking our questions. Would like to focus on your commentary about the incremental supply chain and inventory actions. I'm curious to hear like -- it seems like you raised the gross margin outlook by 30 basis points despite this 20 cent impact that you are highlighting in the release. Maybe could you talk about like the puts and takes there? That would be very helpful. Thank you.

Joe Alkire

Sure. Hey, Mauricio, good morning. So, yeah, the actions that we talked about were worth about \$6 million in terms of operating profit, about \$0.08 of EPS impacting really the third quarter and the fourth quarter. These were proactive actions that we took from a position of strength really to secure inventory to support growth initiatives as we round out this year and move into next year and further improve the strength of the balance sheet as we move into next year.

So on the supply chain side, really expedited freight, somewhat of a precautionary measure just given the recent supply chain volatility to ensure that we can continue to service growth with our largest accounts. Nothing material to the business, but we have seen some delays, given some of the volatility, Bangladesh port strike and the like.

On the inventory side, this is really an evergreen process for us. We saw an opportunity to be more aggressive, clearing excess inventory and improving the composition and quality of our inventory, and freeing up cash to reinvest in other areas of the business. So absolutely the right thing for us to do.

In terms of the outlook, we raised the full-year gross margin guidance by 30 basis points. That does include about a 20 basis point impact from these actions. And from an EPS standpoint, we raised the full year by \$0.03 including the \$0.08 from these actions. So said differently, excluding the \$0.08 impact, we would have likely raised our outlook by about \$0.11.

Mauricio Serna

Got it. Very helpful. And then just on the Project Jeanius initiatives, so is it fair to assume that you're going to get like a big portion of \$100 million savings in fiscal year '25 and then just the rest is in '26, or how should we think about those savings flowing through? Thank you.

Joe Alkire

Yeah, this will be a gradual build. So quantitatively, we'll be back in February. Certainly, appreciate the question, but we'll see modest benefits in the first half. Really from an SG&A perspective, the gross margin benefits will start to unfold in the back half but gradually scale.

And as I said, as we move into '26, we'll be pretty much at full run rate and expect to reinvest a portion of those savings to further support growth.

Mauricio Serna

Understood. Thank you, and congratulations.

Operator

Thank you. The next question is from the line of Paul Kearney with Barclays. Please go ahead.

Paul Kearney

Hey, good morning. Thanks for taking my question. With the operating margin target of over 15% well in sight and an additional \$100 million of savings on Project Jeanius, how are you thinking between reinvesting the savings for growth versus flowing through to earnings? And then related to that, there was an acceleration of repurchases in the quarter. How should we think about your capital allocation strategy going to next year? Thank you.

Joe Alkire

Yeah, I'll take these. So look, Paul, we laid out financial targets in 2021 that reflected a gross margin of 46% and an operating margin of 15%. Now, that was pre significant supply chain disruption, inflation, everything that you know. I'd say the incremental for us is really Project Jeanius. We're on a nice glide path to achieve the prior targets. Where we go from here we haven't declared. We'll do that in the context of our new long-term plan. But safe to assume, with Project Jeanius, we see a path to these targets moving higher.

From a capital allocation standpoint, look, the priorities are unchanged. Certainly, reinvest in the business. We've demonstrated the appetite to do that. We will continue to do that. We've got a strong commitment to growing the dividend, and then you've got share repo and M&A. We've certainly been more active on the repurchase front. Cash flow for us has been really strong. Cash is building. The balance sheet is strong. Our net leverage is starting to move toward the low end of our targeted range. So we've got a lot of optionality, a lot of flexibility, and we'll be nimble here.

Paul Kearney

Thank you. Best of luck.

Operator

Thank you. The next question is from Lauren Vasilescu with BNP Paribas. Please go ahead.

Lia Yang

Hey, good morning. This is Lia Yang on for Lauren. Thanks for taking my question. So on gross margin, I think you guys adjusted the gross margin by nearly 50 bps year to date. So could you help us to unpack what's driving those adjustments, and should we expect those adjustments to continue in 4Q?

Joe Alkire

Yeah, I'll take that. So there have been some adjustments on the gross margin side really related to the ongoing supply chain transition that's further supporting the gross margin expansion that we see. Adjustments from here will primarily be project Jeanius related, which we'll lay out in the full context of our forward outlook.

Lia Yang

Got you. Thank you. And then on Project Jeanius, could you provide us with some preliminary thoughts on how much the Project Jeanius will cost and how much do you expect to reinvest?

Joe Alkire

Yeah, sure. So, we'll provide those specifics in February. We've said previously that we do expect some one-time adjustments as we transition. The returns we see on the overall program are a multiple of the costs that will require to achieve those, but we'll get into the specifics in February.

Lia Yang

Very helpful. Thank you.

Operator

Thank you. As there are no further questions, I would now like to hand the conference over to Scott Baxter, President, CEO, and Chair of the Board, for closing comments.

Scott Baxter

So before I say goodbye and thank everybody for being on the call, I wanted to make sure that everyone has had a chance to see our new campaign. We kicked off a global Wrangler campaign that Holly and her team have done, and real proud of the group because they did the entire campaign almost entirely in-house so that we could use more funds to go ahead and get the word out, as you can imagine. But it's really a terrific spot.

We're going to see a lot more of it now as the election winds down and then we can go ahead and be out there. We wanted to make sure that we got it at a point where we had more visibility.

But if you have a chance, please go ahead and take a look or look it up or get with one of us, get with Mike, and we can send it to you, too, if that would even be easier for you, but it's just a terrific spot. And I think it has a lot to do with the fact that the brand has so much momentum. The company has momentum. But I think there's also another piece here from a cultural standpoint.

I think our organization is real proud about how this company is doing, real proud about how the brands are performing. And when the entire company sees something like this in a global

ad campaign, our first one as Kontoor Brands, there's a lot of pride in this and a lot of pride from all of us in the entire organization about how well we're doing and how hard we're working to make things really good for our shareholders. So wanted to make sure that everyone had a chance to see that.

So with that, thank you for your participation today. We'll look forward to hearing from you again in February. Wishing everybody a happy and wonderful holiday season, and we'll talk to you all soon. Thanks, everybody. Take care.

Operator

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