Fossil Group, Inc.
Q3 2024 Earnings Call Prepared Remarks
Thursday, November 8, 2024

Christine Greany, Investor Relations:

Hello everyone, and thank you for joining us. On September 4th, Fossil Group announced the appointment of Franco Fogliato as Chief Executive Officer effective September 18th and he will be joined on today's call by Andrew Skobe, Interim Chief Financial Officer.

I would like to remind you that information made available during this conference call contains forward-looking information and actual results could differ materially from those that will be discussed during this call. Fossil Group's policy on forward-looking statements, and additional information concerning a number of factors that could cause actual results to differ materially from such statements, is readily available in the Company's Form 8-K, 10-Q and 10-K reports filed with the SEC. In addition, Fossil assumes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law.

During today's call, we will refer to constant currency results. Please note that you can find a reconciliation of actual results to constant currency results and other information regarding non-GAAP financial measures discussed on this call in Fossil's earnings release, which was filed today on Form 8-K and is available in the Investors section on FossilGroup.com.

With that, I'll now turn the call over to Franco.

Franco Fogliato, CEO:

Good afternoon everyone, and thank you for joining us. I am thrilled to be here for my first earnings call as Fossil Group CEO and look forward to getting to know our shareholders in the coming months.

First of all, I would like to take the opportunity to thank our teams globally, particularly Jeff, for leading the company during the transition and for the warm welcome I have received.

In my first weeks with the Company, I have immersed myself in the business, spending time with employees throughout the organization and meeting customers, partners, and vendors. I'm conducting this deep dive across all of our key geographies – the Americas, Europe and Asia as well as our channels and our incredible portfolio of brands. It's been exciting and empowering to hear universal support for Fossil Group and a strong desire to see us win. It's also been incredibly helpful to learn the biggest issues facing the company. Importantly, in my first 60 days, I've gained conviction about the opportunities we have and the actions we need to take.

Before I talk about the future, let me tell you why I am here. I have great admiration for the Fossil brand and the role this company has played in shaping the watch industry. The heritage of our core Fossil brand runs deep. We're recognized around the world and this year, Time Magazine ranked us as the #4 watch brand overall, just behind world-class brands like Apple and Rolex.

Over the past 27 years, I have been fortunate to lead iconic, global brands, gaining valuable experience running business portfolios with omnichannel operations in multiple geographies. Fossil Group has 14 brands in three channels across 120 countries – a level of complexity that my background is well suited for. I honed my skills in product, operations and strategy over decades and orchestrated successful turnarounds at Salomon and Columbia Sportswear. Most recently at Salomon, I started with building a competitive and execution-oriented team and culture. During my two and half year tenure, we reignited the top line and drove double digit sales growth. We achieved this by creating a new brand platform, streamlining our product offering, building joint business plans with our vendors and partners, and refocusing our distribution and pricing models.

At Fossil Group, we have incredible brands, talented people, and the power to unlock greater potential for the future. I have full confidence in our capabilities to return this business to growth and value creation. We can achieve this through discipline, simplification, and focus.

Our core strength is creating great, innovative watches and marketing them with compelling storytelling. We provide a seamless shopping experience for our customers, primarily in the wholesale channel, with our Direct to Consumer business serving as an important expression of our brands and emotional connection to consumers.

As we build the game plan to turn around the business, we will be developing a brand led and consumer focused model to execute our plan. There are three key areas we're prioritizing in the immediate term.

<u>Number one is redefining and focusing on our core</u>.

- First and foremost, we believe there is an opportunity to reassess the core business and simplify our operating model. Anything that is not core is a distraction, and we will evaluate options for these non-core assets.
- We see significant potential to drive change across category, distribution, and geography. This includes traditional watches, wholesale, digital, and key markets globally. Focus and simplification will again be key drivers of strategic choices.
- In short - you can expect to see us make bold moves to reignite growth in our Fossil brand. As we speak, we are working on:
    - A new brand platform;
    - A new pricing architecture; and
    - A new go-to-market approach to prioritize our profitable channels and regions and reduce penetration in the unprofitable ones.
- Some of the specific actions we're taking in the near term to reignite sales include the following:
    - First, we are bringing in a global brand ambassador for the Fossil brand, which we expect to announce next week.
    - A second action we're taking is the return to a more normalized level and cadence on promotions, which may create a headwind to sales

    but is expected to drive further improvement in gross margin while also strengthening our overall brand profile.
  - Third, we are leveraging the success of our women's Raquel line and our leadership position in watch rings with design and materials updates.
  - And lastly, we have the relaunch of our popular Machine platform coming to market in early 2025 as part of our effort to strengthen our men's offering.
- Ultimately, we need outstanding product offerings at the right price points with stronger upper funnel marketing and less promotional intensity.
- Our new Fossil brand platform will be aimed at reigniting our connection with consumers and deepening Fossil's cultural relevance. This will be supported with a strong innovation pipeline and compelling marketing. In fact, we are preparing to launch a major global campaign in 2025 featuring our new brand ambassador.
- As we focus on these initiatives to grow the Fossil brand, we are also taking actions to stabilize sales in our major licensed brands. We expect to revitalize our key partnerships under new and more realistic scenarios.
- From a distribution perspective, we see a clear opportunity to rebuild our relationships with our wholesale partners and return to our roots in this important channel. This means prioritizing our partners from a product, merchandising, and promotional perspective.
- We also see a significant opportunity to strengthen our digital business and operate this channel more profitably.
- We are moving as quickly as possible to execute against these plans - the majority of which are already underway.

<u>Returning now to our key focus areas. Number two is right-sizing the business</u>. In tandem with reassessing and simplifying our core, we plan to right-size our infrastructure to ensure that we're optimized for profitability from a smaller, more focused base. This work will begin next year and will be incremental to our current TAG Plan, which Andy will talk more about during his remarks.

Our third priority is a commitment to strengthening the balance sheet and improving liquidity. We are moving quickly here and aggressively pursuing options which may include actions to monetize assets as we redefine our core and simplify our operations.

The Board and I are fully aligned on the opportunities at hand and the change that needs to occur to execute this turnaround and create value for shareholders. We have a strong sense of urgency and you can expect to see us moving swiftly. When we hold our year-end earnings call, I will have had another few months at the helm. At that time, I will provide an update on the actions we've taken thus far and share our comprehensive strategy and game plan for Fossil Group's next chapter.

Now, I'll turn the call to Andy to discuss the financials.

Andy Skobe, Interim CFO:

Thank you, Franco. We are excited to welcome you and to work together to lead the company in focusing on our key strategic priorities. Good afternoon, everyone.

As expected, our third-quarter performance reflects continued pressure on the top line, while initiatives under our Transformation and Growth Plan continue to drive improvement across gross margin, SG&A, and adjusted operating profit.

Third-quarter net sales totaled $288 million, down 16% in constant currency. 600 basis points of the decline is attributable to our smartwatch exit and store closures.

We continue to see stabilization trends in Fossil traditional watches, which declined 4% globally on a comp basis in Q3, as well as India, which was up about 10% excluding connected. We also see strength in select licensed brands such as Armani Exchange, Skechers, and Tory Burch. The most challenging area of our business continues to be our larger licensed watch brands, as some of our partners work through their respective repositioning efforts. We are working closely with them to adapt our plans and programs accordingly.

Gross margin expanded 240 basis points versus last year, at 49.4%. This can be traced primarily to the exit of Connected and TAG benefits from retail pricing, promotional initiatives, and account renegotiations. Incremental royalties for several brands with contractual minimums partially offset these margin benefits.

SG&A expenses were down $31 million to $161 million compared to last year, representing a 16% decrease as we focus on cost takeout. The year-over-year reductions are attributable to:

- Lower store operating costs on fewer stores;
- Lower compensation and administrative expenses resulting from our TAG initiatives; and
- Decreased marketing spend versus the prior year.

These ongoing cost actions are expected to drive continued reductions in SG&A dollars in the fourth quarter, with Q4 comparisons expected to be similar to Q3.

During Q3, we closed 7 stores, ending the quarter with 251 stores, a 17% reduction compared to a year ago. We have exited 53 locations year-to-date and expect to close up to 58 by year-end. As a reminder, these closures occur at natural lease expiration with very minimal closing costs.

Our focus on gross margin expansion and cost reduction allowed us to significantly improve adjusted operating loss in the third quarter. On a year-over-year basis, we narrowed our Q3 adjusted operating loss to $19 million, reflecting an improvement of 39% compared to the adjusted operating loss of $31 million last year.

We remain on track to achieve continued benefits across gross margin and operating expenses from our TAG Plan in the coming quarters. Our initiatives include SKU rationalization, pricing, promotional actions, workforce reductions, procurement and indirect cost savings, and store closures.

We expect to capture annualized adjusted operating income benefits of $100 million in full-year 2024 and $300 million of annualized total plan benefits by the end of 2025.

Turning to the balance sheet, we ended the quarter with total liquidity of $130 million, including $106 million in cash and cash equivalents and $24 million available under our revolving credit facility. Inventory levels decreased by 30% compared to a year ago, which aligns with our expectations. Operating cash use was $23 million, reflecting expected inventory investment in the quarter.

We made progress against our asset monetization opportunities in Q3, completing the sale of our building in France, which generated approximately $8 million in net proceeds. Additionally, we are making further progress toward the sale-leaseback of our distribution center located in Germany, which we expect to close in the first quarter of next year.

We continue working with our advisors on our strategic review as we focus on reassessing our core and simplifying our operating model. This includes an ongoing analysis of our business model, development of strategic initiatives, refinement of our financial plans, and comprehensive reviews of our capital structure and financing alternatives. As Franco mentioned, we are reviewing options for our smaller, owned, non-core assets or brands, to improve focus and execution on our major businesses.

Moving to guidance, we are revising our outlook for the full year to reflect current business trends and our assertive actions to stabilize the business, which Franco discussed. Worldwide net sales are expected to be approximately $1.1 billion, while the adjusted operating margin loss is expected to range from -6% to -8%. We expect the business to have positive cash flow in 2024, with sufficient liquidity for the foreseeable future.

We remain on track to achieve at least $100 million of annualized P&L benefits in 2024 across gross margin and SG&A under our TAG Plan. Restructuring costs related to TAG are estimated to be approximately $40 million for the full year 2024.

Now, I'll turn the call back to Franco for closing comments.

Franco:

Thank you to everyone for listening in today. I am incredibly grateful to be here and we are committed to turning around this business and creating value for our shareholders. We recognize there is a lot of heavy lifting to do. We're up to the task. We look forward to talking to you on our year-end earnings call when we outline our new strategic plan for the future.