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PRESENTATION

Operator

Welcome to the Fourth Quarter 2019 Fossil Group Incorporated Earnings Conference Call. My name is Hilda, and I will be your operator for today. (Operator Instructions) Please note that this conference is being recorded.

I will now turn the call over to Ms. Christine Greany. Ms. Greany, you may begin.

Christine Greany ***The Blueshirt Group, LLC - MD***

Hello, everyone, and thank you for joining us. With us today on the call are Kosta Kartsotis, Chairman and CEO; Jeff Boyer, Chief Financial Officer; and Greg McKelvey, Chief Commercial 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 and 10-Q 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.

Please note that you can find a reconciliation 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 of fossilgroup.com.

Now I'd like to turn the call over to the company's Chairman and CEO, Kosta Kartsotis.

Kosta N. Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Hello, everyone, and thank you for joining us today. I'll begin my remarks today with a discussion of Q4 and recap the highlights from 2019. Then I'll provide our perspective on the current operating environment, how we plan to navigate our challenges and where we see opportunities to drive growth as we continue to transform Fossil's business model.

Before turning to my formal remarks, I would like to briefly comment on the coronavirus. First and foremost, we want to express the collective concern of our management and Board for the well-being of our Fossil team members, partners and their local communities that are being impacted by the crisis. As it relates to our business, the 2020 outlook that Jeff will take you through reflects our current assumptions based on what we know today. As the situation unfolds, we will continue to monitor events closely and update our guidance if needed.

Turning back to last year, while there were a number of strategic and operational accomplishments in 2019, we are disappointed to close the year with a particularly challenging quarter. The underperformance primarily reflects lower-than-expected sales of our older generation connected product as well as ongoing softness in traditional wholesale, principally in the United States.

Going into the holiday season, we anticipated that our previous generation connected product would be a significant growth driver as a strong value offering with a lower price point. However, consumer response was negatively impacted by the combination of competitive pricing in the marketplace for value-oriented product and to the strong response to our Gen 5 offering, which has much improved functionality.

To that end, Gen 5, our latest generation display product, and our new Hybrid HR product, both performed very well in the quarter. In fact, we are pleased to note that we're seeing a great deal of enthusiasm for our latest technology and fashion designs.

Positive consumer reviews and strong response to our offerings in Q4 are further evidence that high-performance technology, combined with the latest fashion designs will drive consumer interest and purchases. Our business in Asia delivered another quarter of double-digit growth, with strong performance in key markets, including China and India, which grew 60% and 10%, respectively. While Asia and Gen 5 were bright spots in the quarter, the softness in older generation smartwatches pressured margins due to the promotional intensity and the $38 million write-down of that inventory. These factors drove operating profit significantly below our expectations.

Although we faced considerable headwinds in 2019, our teams worked diligently to execute against our strategic priorities throughout the year. First, we completed our first New World Fossil program 1.0, which over the last 3 years delivered $200 million of run rate improvement across gross margin and operating expense. We also launched our New World Fossil 2.0 - Transform to Grow Program, which is designed to drive operational efficiency and improve profitability, while also providing us with the ability to invest in top line growth opportunities.

In 2019, we achieved our plan to capture total benefits of $50 million, primarily through operating expense reductions.

From a product perspective, we delivered world-class technology upgrades in connected watches and exciting new innovations across our traditional categories. And our accelerated product class technology upgrades in connected watches and exciting new innovations across our traditional categories. And our accelerated product drop strategy, combined with a digital-first marketing approach drove more consumer engagement than ever before. We made big strides in Asia, we broadened our reach in key markets and delivered double-digit growth. We advanced our DTC and online marketplace businesses by optimizing our segment and assortment strategy. We offset significant profit pressure from tariffs through adjustments to our sourcing base and to our product costing. And we ended the year in solid financial condition with $200 million of cash and virtually no net debt.

As you know, we have been operating in an extremely challenging environment for a number of years now as consumer interest in shopping patterns in the watch and accessory categories evolve. From a channel perspective, wholesale in the U.S. and Europe remains difficult, primarily in traditional watches. This is largely reflective of 2 major dynamics: one, the ongoing consumer transition from brick-and-mortar to online shopping; and two, the continued momentum behind the fashion cycle that is driving strength in connected watches in place of women's accessories and watches.

Historically, Fossil's largest share of market existed in mid-tier priced female fashion watches sold in the traditional department store channel. The factors I just mentioned around channel shift and consumer preference for technology have been disrupted to the mid-priced fashion watch segment as a whole, and have certainly had a profound impact on our core female fashion customer. In fact, over the past 4 years, women's watches sold through the wholesale channel in our Americas and Europe regions have contracted substantially. In contrast, our Fossil brand watch business in Americas and Europe over the same time frame has remained relatively stable due to 3 major factors: a healthier mix of men's and women's product; a stronger direct business, including third-party marketplaces; and our robust connected business.

Given the structural changes occurring across the industry and within our business, in particular, we've been pivoting our model accordingly: First, we are deploying greater resources to the direct channel for both our owned and licensed businesses; second, we are accelerating our connected product offerings; and third, we are successfully driving growth in key APAC markets, including China and India, where the developing middle class has an increasing desire for fashion watches.

Equally are important, we are taking actions to strengthen our operations and build scale as we evolve our model in tandem with industry dynamics. As I just mentioned, the contraction in the wholesale channel has had a substantial impact on our business. Looking back to just 4 years ago, our U.S. and European wholesale channels represented over half of our worldwide net sales. In 2019, this segment of wholesale made up roughly 1/3 of the sales mix. Over time, we anticipate that we'll shift even further with the U.S. and European wholesale channels ultimately representing less than 20% of worldwide sales.

Because we expect these secular trends will persist, our mandate is to maximize top line growth opportunities outside of the traditional wholesale, while at the same time, transforming our financial model to improve profitability over the long term.

We expect to accomplish this by pulling levers across product, channel and geography and capturing efficiencies through New World Fossil 2.0. Let me provide some color.

This year, we are focusing on 4 strategic priorities that are expected to improve operational efficiency in 2020 and position the company to begin reversing our top line trend and building scale in 2021. Priority #1 is delivering exceptional storytelling and innovation. The path forward to changing our sales trajectory will come first and foremost from great product and unmatched creativity. Although we'll have fewer product stories in the market in 2020, we're going to tell them in bolder ways through focused digital marketing programs.

We've expanded our use of data and analytics, which is improving our ability to understand consumer trends and preferences and how to more effectively interact with the customer digitally. We have significant opportunities in our traditional and connected watch categories, and we're also refocusing our efforts on the jewelry category.

In 2020, we'll be refining our assortment levels and distribution strategy in connected watches to more closely reflect consumer preferences across channel and assortment. Consumers are telling us that the shopping experience for connected product in traditional wholesale channels is not compelling. To address this, we will be launching connected LTE product this year and aggressively expanding in the CE and telecom channels while reducing our connected presence in select wholesale accounts and brands.

We anticipate that the reduced assortment and distribution will be partially offset by expanded CE and telecom channels in 2020, with growth in 2021 and beyond.

Priority #2 is driving commercial transformation. The consumer is increasingly gravitating to all things digital, and we're moving quickly to improve our digital capabilities across the company. This encompasses everything from multi-brand omnichannel capabilities, digital marketing and CRM to analysis, targeting and retention. The implementation of our new e-commerce platform is in process now and brings us a robust set of tools to support a larger direct-to-consumer business in the coming years. Importantly, the nature of our high dollar value, small cute proposition will enable us to increase our DTC business without pressuring margins, as often happens in other categories.

Our third strategic priority is to expand on our opportunity in China and India, which, as I mentioned earlier, both grew double digits in 2019. The emerging middle class in these countries loves our categories and brands. We've had great success with our localized marketing and segment and assortment approach, and we see even more runway to accelerate growth in these markets going forward.

In China specifically, our ability to combine great brands and marketing content, while partnering closely with the largest online marketplaces has proved to be a winning strategy with select brands. We expect to see continued momentum and growth as we bring this formula to an increasing number of our brands going forward.

Our fourth priority is continuing to implement New World Fossil 2.0. In 2019, we conducted a comprehensive review of our operating model and our leadership team has been working with a sense of urgency to drive greater efficiency in our processes and work streams throughout the organization.

Notably, we see a significant opportunity to reengineer our supply chain. We plan to drive improvement in our end-to-end manufacturing and distribution capabilities, which will allow us to reduce lead times, lower cost and enhance our overall competitiveness.

Major initiatives in 2020 include implementing advanced demand planning and a more sophisticated open-to-buy process.

Cost reduction is also a critical component of New World Fossil 2.0. In 2020, we expect to capture benefits totaling $65 million, with $15 million coming from gross margin improvement and $50 million coming from operating expense reduction.

There's no question that the headwinds in traditional wholesale will continue for some time. Our direct-to-consumer business is stable, and with our expanded digital capabilities, we expect to see solid growth in this channel in 2020. Our work on segmented assortments is paying off, with growth expected to significantly accelerate globally in third-party marketplaces. And we anticipate that Asia will continue growing at double digits. Given this backdrop, we are working urgently to optimize and rightsize our cost structure. These actions are important not only to improving profitability, but they will also provide more capacity to invest in our biggest areas of growth going forward.

As I close, I want to thank our teams for their hard work and strong commitment to the company. The entire organization is working diligently on the priorities I outlined earlier. We believe the innovation we're bringing to market across our categories and our increasing focus on digital will generate improvements in sales trends over time. We know that transformation does not happen overnight. We are fortunate to have great brands, products and people to help us accomplish our goal of stabilizing the top line as quickly as possible.

Additionally, our strong balance sheet and cash flow provides us with the financial flexibility and runway we need to pivot our business model and work towards restoring growth and profitability.

Now I'll turn the call over to Jeff to discuss our Q4 financials and our 2020 outlook.

Jeffrey N. Boyer ***Fossil Group, Inc. - Executive VP, CFO & Treasurer***

Thanks, Kosta. At a high level, sales came in at the low end of our expectations, principally due to ongoing challenges in U.S. wholesale as well as soft performance of our older generation connected product. We continued to improve our cost structure. But gross margin was impacted by promotional intensity and charges related to the write-down of inventory, which put substantial pressure on profitability in the quarter.

Q4 sales came in at $712 million. That's down 10% versus a year ago and 9% in constant currency. The top line was negatively impacted by continued challenges in traditional wholesale, store closures, licensed brand exits and weaker-than-expected performance in older generation connected product. Excluding store closures and business exits, which were roughly a 160 basis point headwind, underlying core sales declined high single digits, consistent with performance in both the second and third quarters.

Looking at performance by region, strong growth in Asia was more than offset by double-digit declines in the Americas and EMEA. On a constant currency basis, net sales in Asia increased 11%, reflecting growth of 61% in Mainland China and double-digit increases in India and Korea.

Our exceptional growth rate in China is attributable to ongoing strength in the Emporio Armani brand and the success of our integrated wholesale and e-commerce marketplace approach. In the Americas, sales declined 16%, driven primarily by the wholesale channel. Within wholesale, department stores have been the most challenged, with sell-in and sell-out performance declining more than 20% in Q4. We were able to partially offset these declines with strong growth in e-commerce marketplaces in the U.S. In Europe, sales declined 9% in constant currency, reflecting softness in the wholesale channel.

Similar to the U.S., department stores independent within EMEA continued to face headwinds, while our e-commerce marketplace business is stable.

Moving now to our direct-to-consumer business, retail comp sales decreased 3%. While full price comps were down high single digits in the quarter, outlet comps were positive, driven by more effective promotions. Within e-commerce, international strength was offset by softness in the Americas, primarily resulting from underperformance in older generation connected product.

Turning to category performance in Q4. Watches declined 8% in constant currency, with traditional watch sales declining low single digits, similar to our third quarter trend. Connected watch sales, which represented 18% of total watch sales in the quarter, decreased double digits. This is largely due to underperformance in older generation display watch sales and reduced liquidation levels versus a year ago.

Fourth quarter gross margin came in at 43.3%, reflecting a decline of 970 basis points from last year. Of that amount, approximately 530 basis points is attributable to a onetime noncash charge of $38 million related to the write-down of older generation connected inventory. We had anticipated that our lower-priced older generation product represented a strong value offering and would account for nearly 70% of our connected sales volume in the quarter. However, Gen 4 product sales were lower than anticipated as consumer opted for the much improved tech functionality in Gen 5 and we faced more aggressive competitive pricing in the marketplace for value-oriented connected product. This led to an inventory imbalance with a much higher level of older generation inventory, a portion of which we now anticipate will need to be liquidated.

Fourth quarter margins also reflect the following factors: increased markdown activity to move older generation connected product; higher inventory costs, largely due to increased tariffs and freight; softness in retail margins, driven by promotions; and the unfavorable impact of currency. These pressures were partially offset by margin optimization efforts through our New World Fossil programs as well as favorable regional and product mix.

Selling, general and administrative expenses were $304 million in the fourth quarter, reflecting a decline of $41 million versus a year ago. We continue to make solid progress against our cost reduction targets in the quarter and delivered full year operating expense reduction of $45 million from our New World Fossil 2.0 program. As a reminder, key areas of expense focus include corporate and regional overhead, stores and indirect spend.

In 2019, we closed a total of 45 stores ending the year with 451 Fossil locations. Income tax expenses in the fourth quarter were approximately $1 million. The negative effective tax rate was driven mainly by the recognition of deferred tax asset valuation allowances and an unfavorable impact from the GILTI revision of the Tax Cuts and Jobs Act. Income tax expense in the prior year was $14 million on pretax income of $62 million.

For the fourth quarter, we reported a net loss of $0.14 per diluted share, which included New World Fossil restructuring charges of $0.08 per diluted share. Last year, our fourth quarter EPS was $0.94 and included restructuring charges of $0.07. Currencies, including both the translation impact on operating earnings and the impact of foreign currency on hedging contracts had an unfavorable $0.01 impact on our EPS in the fourth quarter.

Moving to the balance sheet and cash flow. We ended 2019 with $200 million of cash and cash equivalents. Year-end inventory levels were up 20% versus 2018, primarily reflecting the underperformance in older generation connected watches. Additionally, you may recall that we had lower levels of connected inventory exiting last year due to the timing of 2018 product launches. We ended the year with net debt of $5 million as compared to net cash of $7 million last year. The increase in our net debt position was largely driven by our higher inventory levels. We continue to maintain a low net leverage ratio of 0.8x.

Our adjusted EBITDA for the quarter was $62 million, resulting in a trailing 12-month adjusted EBITDA of $169 million. We recently reached an agreement with our primary term Loan B creditor to revise our quarterly net debt leverage covenant metrics for 2020 and for the first 3 quarters of fiscal 2021. This adjustment takes into consideration our expectation for higher revolving debt requirements to support ongoing and seasonal inventory levels through this time period.

Now let me turn to our 2020 outlook. As Kosta mentioned, we recognize the significant disruption underway in the traditional wholesale channel and in our categories. We're pivoting quickly to accelerate major growth areas, such as Asia, direct-to-consumer and connected. Importantly, we're taking actions that will allow us to appropriately control margin, cost and inventory, while transforming our business for future growth.

We expect full year sales to decline in the range of 11.5% to 4.5%. This includes headwinds of approximately 130 basis points related to store closures and 50 basis points from currency as our guidance is based on prevailing rates for the euro and the pound at $1.10 and $1.30, respectively.

Our sales guidance anticipates continued double-digit core sales growth in Asia and modest growth in the global direct-to-consumer channel, while wholesale declines in the Americas and EMEA are expected to persist. From a category lens, we expect to return to growth in jewelry in 2020 with moderated declines in leathers and watches. Within watches, we anticipate that connected will be down modestly given the refinements to assortment and distribution that Kosta mentioned.

Turning to gross margin. Excluding the inventory write-down in Q4 of 2019, we expect to see modest year-over-year expansion in 2020. This will be driven by higher connected margins, beneficial channel mix and improvements from New World Fossil 2.0, partially offset by increased promotional activity and the negative impact of tariffs.

For full year 2020, we expect to capture gross margin benefit under New World Fossil of approximately $15 million.

Gross margins are expected to be relatively consistent on a sequential basis throughout 2020 with some year-over-year pressure in the first half and improvement in the second half.

Moving now to operating expenses. We expect our New World Fossil initiatives to deliver approximately $50 million of operating expense reduction in 2020. Cost savings are expected to be driven by organizational efficiencies as well as lower spending levels. The anticipated reductions will be partially offset by incentive compensation included in our 2020 plan. We expect to incur $35 million of charges related to restructuring efforts in 2020, including severance and related costs.

On a sequential basis, first quarter operating expense is expected to be down slightly to last year, including restructuring expenses of approximately $12 million. Moving beyond the first quarter, expenses are expected to decline at roughly the rate of sales as the impact of New World Fossil benefits is realized. Therefore, for the full year, we expect operating margin to range between negative 1.5% and positive 1.5%, which includes $35 million of expense or roughly 150 basis points related to restructuring charges.

First quarter operating margin is expected to range from negative 14% to negative 10% inclusive of $12 million of restructuring charges or roughly 300 basis points.

For the full year, we expect interest expense of approximately $32 million, and we're planning CapEx at $25 million. We expect to carry elevated levels of inventory through the first half of the year as we work through the higher levels of Gen 4 connected product.

Before we open the call to questions, I want to echo Kosta's sentiment regarding the coronavirus and reiterate that because this is such a dynamic situation, the guidance we're providing today may need to be revised if the crisis extends beyond Q1.

Now I'll ask the operator to open the call to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have a question from Ike Boruchow from Wells Fargo.

Irwin Bernard Boruchow ***Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst***

I guess my first question just to start with the first quarter. Could you elaborate on -- I know your Asia guide for the year, I think, is double digits, you said, Jeff. What are you planning in Asia in Q1, given the headwinds from the virus? I was curious.

Jeffrey N. Boyer ***Fossil Group, Inc. - Executive VP, CFO & Treasurer***

Yes, Ike, we are expecting the APAC region to be down double digit, just low double digits overall. We got off to a very good start in January and had anticipated the typical slowdown during Chinese New Year. Obviously, the virus situation has had an impact on the business. So for the remainder of the quarter, we forecasted that down fairly significantly and it puts us down low double digits in the first quarter for APAC.

Irwin Bernard Boruchow ***Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst***

Got it. And a few more, if that's okay. I think you gave some color, but can you give a little bit more explicit guidance on the wearables outlook? I know it's declined in the last 2 quarters. But what are you planning wearables in Q1? And then how do you expect that to progress through the year?

Jeffrey N. Boyer ***Fossil Group, Inc. - Executive VP, CFO & Treasurer***

Yes, we are expecting it to be down on the full year overall. And there is a minor contraction, both in assortment rationalization as we focus on some of the key brands and SKUs and also on a distribution rationalization as well, really focused on channels of our business that can drive the business overall. I don't have the specifics right in front of me on the Q1, I'll call on it. But I'd tell you it'll be down probably for the year roughly about 10% on it. So some contraction -- further contraction...

Kosta N. Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Yes, the one thing I would add, Ike, on the wearables, just -- as we mentioned, we're seeing very strong reviews and sell-throughs on Gen 5. And when you stand back and look at where we are in wearables right now, especially with a new product out there, we obviously had a product issue last year, but our capabilities, our software, our programs, our road map just our overall capability is much greater than it was the last couple of years. And the reviews and the sell-throughs we're getting just lead us to believe that we have a much bigger opportunity going forward. So that's something for us to be excited about.

Irwin Bernard Boruchow ***Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst***

Yes. I mean -- to stick with that, I mean, it sounds like the new generation product keeps working and I think this is the second inventory write-down you've had, I think, in the last -- in as many years. Just is there anything you guys are working on to do better at kind of managing the life cycle of your wearable business? I'm just trying to understand, like at what point do you kind of get more comfortable with managing the inventory in that category?

Kosta N. Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Absolutely. We've -- go ahead. Go ahead, Jeff and Greg.

Gregory A. McKelvey ***Fossil Group, Inc. - Executive VP & Chief Commercial Officer***

This is Greg. Let me provide a little bit more color. As we position the business for Q4, it was clear that the market was developing into 2 distinct tiers of product. The first is just the latest tech, which is largely full priced with a high consumer willingness to pay, and then the older generation or less featured products at sharper price points. And what we're hearing from a lot of our channel partners was the focus on the opening price point, sharp price point, business to be able to drive unit volume and traffic to the stores. So we actually positioned our inventory as such. So we had 70% of our inventory roughly in Gen 4 and Sport, and only 30% on our latest tech offering, which was Gen 5 and our Hybrid HR, thinking that, that mix represented the channel's desire.

What we found out is the consumer responded very differently than channel expectations. So our Gen 5 and Hybrid HR products, both of which have 4.3, 4.4 stars, really, really well done by our engineering teams across the world, far exceeded expectations, and any channel that carried those was very happy with the results. But the price competition in the lower tier was much greater than we had expected or frankly any of the channel partners had expected. And that drove not only lower unit volume overall but lower margin than we expected. So that's why we took the charge.

So although we're disappointed, though, in the commercial outcome for Q4, we proved and our teams proved with the success and the seller reviews of Gen 5 and Hybrid HR that we belong in the category, we're a leader in the business, and we just need to keep pivoting with a focus on 3 things. The first, from a product perspective, we're going to stand for the latest technology. We're going to bring those to market with the best designs from the best brands in a focused way, focused on full price sales as opposed to the 70-30 split that we had in Q4. We're going to do that as well with our engineering teams that have proven that they can really take the lead end-to-end. And Gen 5 was the first product where they took the engineering lead end-to-end on both hardware and software, which is why we had a higher-quality product with features like iPhone compatibility and battery life modes that are really only found on our Wear OS watches. So the next 24 months of innovation that we've got an eyesight on are all built by this engineering team off of that platform. That's our product focus, latest tech, full price and best brands.

Second is, from a channel perspective, we're -- we went pretty broad in our distribution. So we're in direct-to-consumer, CE, traditional wholesale and online marketplaces. And there's just a clear segmentation that's starting to emerge, where there are certain channels that are set up to sell these products well where they can -- they have a better sales process, more customer engagement or more customer support. So that's CE channel, that online marketplace is largely in our own direct-to-consumer stores. Those are doing really well.

In traditional wholesale, we're going to have a top-door approach. We're going to focus on trying to get the pop-up environments that we can provide that engagement. But were that's not the case, we will dramatically pull back, so that we just are selling where these products sell well. That will also have a side benefit of getting our traditional wholesale teams refocused on high-margin traditional watches and jewelry, which are sold much better in that environment.

And then third, from a geographic perspective, while we'll continue competing in the U.S. market and see it as still a huge opportunity, the fact is that iOS is much more dominant here and internationally, Android is significantly more dominant. So we'll be doubling down our growth in international markets where Android has a much larger market share of the smartphone market, which will allow us to capture much larger -- go after a much larger addressable market.

So in summary, smartwatch market continues to grow. We're just now seeing our best products built from our exceptional internal engineering and supply chain teams. We're going to reposition the business this year with the right product and the right locations and the right geographies. We're confident that the best is yet to come here.

Irwin Bernard Boruchow ***Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst***

Got it. And just last on the balance sheet. If I can have one more. Jeff, can you help me understand a few things. Just the term loan amendment details that are there and also, I think in that 8-K, it said there was potential leverage covenant violation that would come up in Q2. I'm just kind of curious what exactly is going on with the amendment and what's going on there? And then just quickly, can you give us -- sorry, go ahead, Jeff.

Jeffrey N. Boyer ***Fossil Group, Inc. - Executive VP, CFO & Treasurer***

Yes. Ike, the amendment is complete, so we have that in place right now with a broader net leverage ratio metric. So it's 2.7x for the next 4 quarters, all of this year, net debt over EBITDA. And some of that is drawn by the inventory levels that we have. Also, we got into the conversation given some of the business issues out there right now with the coronavirus. I want to make sure we had some protection on that. It continues on into next year at 2.25 for the first 3 quarters of the year and reverts back to the 1.5x net debt leverage for Q4 of 2021 on it. So we're in a good position with that. So that's all done and behind us at this point, Ike. So there's not a leverage issue.

Irwin Bernard Boruchow ***Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst***

Got it. And then lastly, can you help us with CapEx, D&A? And then based on your guidance, I'm getting to sort of a negative free cash flow number for this year. Can you correct me there, help me out with the free cash number that you provided in your guidance?

Jeffrey N. Boyer ***Fossil Group, Inc. - Executive VP, CFO & Treasurer***

We should have some modest free cash flow overall on a CapEx of about $25 million overall on it. The depreciation number is roughly $50 million or so, $45 million, $50 million on depreciation. And as you can appreciate, with a bit of extra inventory ending fiscal '19, that will be reduced and will drive some working capital benefits.

Kosta N. Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Probably something we can work with you a little closer on to get the specifics on that EBITDA calculation.

Operator

(Operator Instructions) Our next question comes from Dana Telsey from Telsey Advisory.

Dana Lauren Telsey ***Telsey Advisory Group LLC - CEO & Chief Research Officer***

Can you unpack a little bit about the wholesale channel? What you're seeing there? How it's impacted globally? And what changes you foresee for your product assortment? And then can you give us any update on the licensed brand and any timing of exploration and particularly how -- what's happening with the Kors brand?

Jeffrey N. Boyer ***Fossil Group, Inc. - Executive VP, CFO & Treasurer***

On the channel discussion, I think we've commented that we're largely expecting the trend to continue in both Europe and Americas, which means we quoted the sell-through issue in Americas and sell-in and sell-out issues being down about 20%. So we're still forecasting that for most of this year in Americas wholesale. And then on EMEA, EMEA isn't impacted quite as much. That's more in the mid-teens contraction we have. So those are both still in our forecast in the underlying numbers. So those numbers largely are what's impacting our overall contraction as we make the change in the pivot to a more direct business model, both through third-party marketplaces as well as websites on it. So that's kind of the channel discussion, strength in those channels, the DTC channel as well as geographically, the strength in APAC we expect will rebound in the second half of the year.

On licensed brands, I would tell you, there's not a lot new report, continue to work closely with our licensed brands, have great relationships there. Continue to work with our Kors partners on the opportunity for watches and jewelry, both in the wholesale channel as well as in the boutiques, and that relationship continues to be very strong.

From an expiration standpoint, there's no major expirations coming up at this point in time. And no major issues that we see in our licensed brand portfolio as we move through some of these transformation efforts that we're going through.

Gregory A. McKelvey ***Fossil Group, Inc. - Executive VP & Chief Commercial Officer***

I would just add, Jeff, that we -- just like we have historically, we still have great relationships with both our wholesale accounts and our licensing partners. So -- and we're focused across the board with them on driving growth across channels. Within traditional wholesale, especially in the U.S., it's definitely more promotional and trends are challenging, but we do see a lot of opportunity to continue to stabilize the business with just better product and better storytelling. And so we've challenged our teams to create excitement for consumers in both brick-and-mortar and online. And then, especially online, we see tremendous growth opportunity globally in the marketplace businesses that we're in. And frankly, now with our digital transformation that's accelerating with our sales force platform.

So you're going to -- both in wholesale, online marketplaces and DTC, see digital bring to life the right product and the right storytelling this year, but also as we go into future years.

Kosta N. Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

And I would add also, we continue to look at the marketplace as it evolves and we probably, over the next couple of years will be adding additional licenses and change some of our portfolio as we continue to evolve the business.

Dana Lauren Telsey ***Telsey Advisory Group LLC - CEO & Chief Research Officer***

And then just on the coronavirus, how -- where are you in terms of factories, component parts, given diversification in manufacturing? How do you see that playing out as this very fluid situation is still underway?

Jeffrey N. Boyer ***Fossil Group, Inc. - Executive VP, CFO & Treasurer***

Actually, our factories are coming back online nicely, slower than we had anticipated. We estimate right now that the capacity right now is about 50%. Expect to have the factories and the underlying component suppliers up to full speed by the end of March on it. We've been prioritizing key products on it. As you can tell from our inventory position, we're actually in a very good inventory position to manage through this process. We pulled some inventory ahead because of Chinese New Year anyway and the inventory that we have is good quality. And we're prioritizing production for key products that continue to sell. So we feel pretty good about our factories coming up to speed in China and being at full speed by the end of the first quarter.

Operator

I would now like to turn the call back to the management for closing remarks.

Kosta N. Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Before we sign off, we wish to, again, express our concern for all those affected by the coronavirus. Despite this near-term issue, we want to emphasize that we have every confidence that our transformation initiative will be successful over the long term. We have innovative products, talented people and great partners. We have a capital-light business that generates good cash flow with no net debt at the year-end. We're planning 2020 based on current market trends, but we will be driving our 3 major growth engines of connected, Asia and DTC to achieve top line stabilization as quickly as possible. We appreciate your continued support and look forward to updating you in the next quarter. Thank you very much.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. We thank you for participating. You may now disconnect.