Fossil Group, Inc.
Q1 2025 Earnings Call Prepared Remarks
Wednesday, May 14, 2025

Christine Greany, Investor Relations:

Hello, everyone, and thank you for joining us. With me on the call today is Franco Fogliato, Chief Executive Officer and Randy Greben, Chief Financial Officer.

Before we begin, 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, as well as certain non-GAAP financial measures. 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:

Thank you, Christine. Good afternoon everyone and thank you for joining us today. I would like to start by welcoming Randy, who joined us in March and has been a tremendous asset in his first two months with Fossil Group. As you've heard me say on recent earnings calls, we are moving fast and furious over here and Randy has jumped right in. He has ramped quickly, developing sharp proficiency across the operating and financial models in just a matter of weeks – and his high energy and strong desire to win are an ideal fit with our culture. After my remarks, I'll turn the call to Randy to provide a detailed review of the financial results and discuss our outlook.

We recognize the global trade environment is top of mind for everyone. Our world class teams have been doing excellent work on scenario planning, balancing near-term cost management with long-term supply chain optimization. Both Randy and I will address this during our remarks today. First, I will discuss our Q1 performance and provide an update on our turnaround initiatives, which are generating strong business momentum.

We are pleased to report another quarter of exceptional progress under our turnaround plan. Our teams delivered results ahead of our expectations both operationally and financially. We recorded a significant improvement in sales performance on a sequential basis, drove another quarter of meaningful gross margin expansion and generated a second consecutive quarter of profitability. Specifically, we narrowed our core sales decline to just 8%. That represents a sequential improvement of 400 basis points compared to the fourth quarter. Gross margin exceeded 61 percent, up nearly nine points from the prior year and we delivered positive adjusted operating margins of 4.3%.

Despite the dynamic macro backdrop, we are not currently seeing any softening in our demand trends and continue to have confidence in our ability to drive growth through our turnaround plan. Our confidence is underpinned by several factors. First and foremost is the immediate traction and positive results we're seeing from our turnaround efforts over the past two quarters. Additionally, we have a number of tailwinds to propel the business forward: A leading market position, favorable industry dynamics and core underlying strengths, including Iconic brands, innovative design, talented teams and broad global reach.

We are incredibly proud of our teams for delivering strong execution under our turnaround plan. As a reminder, the plan is centered on three primary pillars:

- Refocusing on our core
- Rightsizing our cost structure and
- Strengthening our balance sheet

I'll take you through a progress update for each of these areas.

Starting with our first pillar, **refocusing on our core**. Our teams are fully aligned on our new brand-led and consumer-focused operating model which is translating to positive results across the business. Our primary focus under this pillar is two-fold: Traditional watches on our major brand platforms and go-to market execution. We're advancing quickly on several fronts.

First, we're delivering a robust pipeline of product innovation with core Fossil icons such as our award-winning Raquel line for women and our classic Machine series for men. Raquel continues to be among our top sellers, capturing attention from influencer talent and style editors globally. On the Men's side, our Machine Chronograph has been a standout among celebrity stylists, generating social media buzz and press coverage worldwide. In 2025 we're elevating storytelling around major product and brand moments to strengthen engagement and prioritize winning with Men's, while continuing to maximize the momentum we're seeing in our Women's business.

Collaborations remain core to the Fossil brand as we continue to build a foundation of storytelling that connects our rich heritage with today's culture. Among our most high profile collaborations this year is the Fossil x Minecraft collection. Just two weeks after launch, the watches were sold out on Fossil.com. Organic social performance was also exceptional, with a total reach of 5.5 million. More recently, we held a preview event for our upcoming Fossil x Shelby collection. This is our most elevated, performance driven chronograph to date, which was built to capture the thrilling legacy of Shelby American racing. Additionally, this week we introduced a limited edition Superman collection featuring a full range of products from watches and wallets to bracelets and cufflinks, timed to coincide with Father's Day.

We're supporting our robust pipeline of innovation and brand revitalization efforts with full funnel marketing initiatives. In 2025 we will be investing more strategically, deploying our spend toward a higher mix of brand marketing versus performance tactics. Beginning in Q2, we will be doubling down on media, influencers and PR to drive brand heat, build awareness and fuel demand. This includes the upcoming introduction of our global Fossil brand campaign featuring Nick Jonas. As our global brand ambassador, Nick has been a fantastic partner to us as we collaborate in preparation for the launch. In March, Fossil was a lead sponsor of JonasCon, a Jonas Brothers fan convention created in celebration of the group's 20th anniversary. Nick wore our Machine Chronograph throughout the event, providing Fossil with exposure to his most engaged audience, while also generating significant press coverage and social engagement. He has tremendous reach as a musician, actor and philanthropist who is known worldwide, and we believe Nick will help us build increased awareness of the Fossil brand and drive resonance among both new and existing customers. At the same time, we will be investing in point of sale marketing, rolling out new fixtures and improved storytelling collateral that beacon the Fossil brand at wholesale.

Turning now to our core licensed brands, Armani, Kors and Diesel. We are investing in point of sale and in-store presentation in the wholesale channel to reinvigorate our positioning among these brands. These initiatives are already generating improved performance. The Kors brand returned to growth, posting double-digit gains in the first quarter. Armani Exchange was also up in double-digits while the Armani brand remains pressured by the difficult macro environment in China.

We're particularly pleased with our ability to achieve minimum royalty reductions with our key partners, which speaks to the strength of our long-term relationships and demonstrates their confidence in our turnaround plan and current trajectory. Importantly, these agreements position us to drive profitable growth among our portfolio of licensed brands going forward.

Another key initiative is the work we're doing to optimize our global wholesale footprint by prioritizing key geographies. Most notably, in the US, our Q1 wholesale business for our core brands grew in the double digits on a year-over-year basis. We also saw continued momentum in other highly scalable markets such as India, where traditional watch performance across brands remains strong.

After transitioning five of our smaller international geographies to a distributor model earlier this year, we are continuing to evaluate additional opportunities where we can drive efficient growth and scale through the distributor model. This go-to-market strategy can be very powerful in smaller markets. It simplifies our operating model, allows us to leverage the regional expertise of local partners to fuel top line growth and lowers our in-region costs to drive increased profitability.

Moving to our initiatives around channel profitability, our actions are generating meaningful results across both wholesale and DTC. This is clearly reflected in the strength of our gross margins and improved bottom line results. The wholesale channel continues to perform ahead of our expectations led by fewer promotions as well as Fossil brand innovation. In the ecommerce channel, operating results continue to strengthen. After delivering better than expected results in Q4, we saw ongoing momentum in Q1, which has not slowed down thus far in Q2. The strategic decision to reduce our promotional activity is paying clear dividends - higher gross margins, higher quality traffic to our website and increased average unit retail.

In our retail stores, we're seeing a strengthening trend in our full price locations, led by improved performance in traditional watches. During the quarter, we continued to optimize the store portfolio through the closure of 28 additional stores.

As we continue to make great progress across these strategic areas of the business, we're also taking action to transform our operating model by **rightsizing Fossil Group's cost structure.** In fact, we have already taken the steps necessary to align our cost structure to our newly defined strategy, scope and scale. This includes a reduction in force in February, moving some of our international markets to a more profitable distributor model and closing unproductive retail stores. These actions are expected to drive $100 million of SG&A savings in 2025 versus 2024. We are also continuing to evaluate other opportunities, including the potential sale of non-core assets.

Looking at the third key pillar under our turnaround plan, **strengthening the balance sheet**. We ended the quarter with $100 million of liquidity – and we're actively pursuing initiatives to improve working capital and manage liquidity. Just a few days ago, we signed an agreement for the sale-leaseback of our European Distribution Center in a transaction that's expected to close later in Q2. At the same time, we are working with our advisors to address our upcoming debt maturities. Importantly, our better than expected financial performance in Q1 provides us with added flexibility to execute our plans and navigate the dynamic macro environment.
I am tremendously grateful to our teams across the organization for their dedication to Fossil Group. They are putting in the hard work and we are seeing the results in the early stages of our turnaround. This is inspiring and highly motivating. Including Randy, we have three new executives who joined the Company during the first quarter. All of them have hit the ground running.

Joe Martin, our Chief Commercial Officer, is overseeing all of our global revenue-generating activities. Joe is already implementing a robust commercial strategy designed to drive growth within our global wholesale business. During Q1, Joe and I spent time meeting with our partners around the globe and we are working in close collaboration on future planning, reinforcing the opportunity in front of us.

Another key leader new to our team is Antonio Carriero, our Chief Digital Information Officer and General Manager of EMEA. Antonio is leading our global technology strategy and driving our commercial business in the EMEA region. He is focused on optimizing our existing tech stack while accelerating our use of AI across the organization to drive efficiency and unlock potential growth drivers.

And while I've already talked about the value Randy has brought to the table, I'll add that he has been instrumental in our tariff war room as we assess, plan and model the business amidst a fluid situation.

As we announced today, we also added two new Board members to complement the strength of our executive team and bring additional thought leadership to Fossil Group.

While the year has started differently than we expected, we are seeing continued business momentum and we are addressing the global tariff environment from a position of strength. First and foremost, we are fortunate to have a team with extensive experience navigating complexity across global markets. Equally important, our diverse global footprint limits our tariff exposure and we have multiple levers we can pull to protect our strong gross margin profile. We have long-term relationships with our vendor partners, we have the ability to lean into highly scalable markets outside the US where our brands already have a strong presence, and we have pricing power.

While evolving policy changes and market moves make it challenging to predict consumer sentiment for the remainder of the year, we have not seen any slowdown in our business trends year-to-date. We are reiterating our full year guidance, which contemplates a range of outcomes for China tariffs. We also remain confident in the three-year financial framework we outlined during our March earnings call. Our outlook assumes there is no material change in macroeconomic conditions and broader consumer demand trends.

Although we're operating in a tumultuous environment, our turnaround plan is working and results are moving in the right direction. We look forward to continuing on our path to restoring growth, delivering long-term profitability and creating durable shareholder value. Now I'll turn the call over to Randy to review the first quarter financials and discuss our outlook.

Randy Greben, CFO:

Thank you, Franco and good afternoon everyone. It's great to be here and be a part of this incredible team. I am excited about the opportunity we have in front of us and look forward to getting to know our shareholders.

We started the year with strong first quarter performance that exceeded our expectations across the P&L.

First quarter net sales totaled $239 million, down just 6% in constant currency. Core sales declined 8% on a year over year basis, excluding the benefit of 700 basis points from the additional week in this year's retail calendar, partially offset by 500 basis points of impact from our smartwatch exit and retail store closures. This represents notable sequential improvement from a core sales decline of 12% in Q4. Performance in our Fossil traditional watch business also improved sequentially, posting growth of 7% globally versus the prior year, excluding the 53rd week and store closures. That's up from low single digit growth in Q4 of 2024.

First quarter gross margin expanded 880 basis points compared to last year, coming in at 61.1%. The year-over-year increase primarily reflects higher product margins in our core categories driven by improved product costing, reduced promotional activity in our e-commerce business and our exit from Connected watches. Looking at the balance of the year, we expect gross margins to remain strong as we continue to reduce our promotional levels and focus on a full price selling model.

Looking at expenses, we brought down SG&A by $17 million to $136 million. This represents a decrease of 11% versus prior year, which can be traced to lower store operating costs on fewer stores, lower compensation and administrative expenses, and a planned decrease in digital marketing spend versus the prior year. Our teams have done a great job of prioritizing cost control and we will continue to identify additional expense levers in 2025.

During Q1, we closed 28 stores, ending the quarter with 220 stores. All of these closures occurred at natural lease expiration with very minimal closing costs.

Looking at the bottom line, our focus on gross margin expansion and cost reduction enabled us to deliver a second consecutive quarter of profitability. First quarter adjusted operating income swung from a loss of $20 million last year to $10 million of profit this year. This strength drove a Q1 adjusted operating margin of 4.3%.

Moving to the balance sheet, we ended the quarter with total liquidity of $100 million, including $78 million in cash and cash equivalents and $21 million of availability under our revolving credit facility. Inventory levels totaled $182 million. That's down 19% compared to a year ago and in line with our expectations.

Our teams are continuing to operate with financial rigor, exercising working capital discipline and careful inventory management as we work toward strengthening the balance sheet - a critical pillar under our turnaround plan.

The Company has been acting with urgency to address its liquidity position, and I can share that we're making meaningful progress toward refinancing our debt, selling non-core assets, and further reducing costs. I'm particularly pleased to report that in the last week we signed an agreement for the sale-leaseback of our Distribution Center in Eggstadt, Germany. The transaction is expected to close in Q2, and will bring in excess of $20 million to the balance sheet upon completion. The refinancing process has been a particular focus of mine during my first 60 days, and we look forward to sharing more with our investors over the coming months.

Turning now to guidance. Based on the results we're seeing from our turnaround initiatives, and ongoing momentum across the business, we're reiterating our full year outlook for 2025. With respect to the global tariff situation, our business has a number of factors that work in our favor, and I've been impressed at the speed at which my colleagues around the globe have mobilized to address this head-on. The Company is leading from the front with respect to addressing tariff mitigation and absorption. Even if tariff rates ultimately settle between 30% to 145% on goods from China and 10% on products from other countries, we're confident that we can mitigate the full impact of tariffs to our 2025 outlook. Let me unpack just why:

First and foremost, we are a global company, with more than 60% of our revenue generated outside of the US. This provides us with a level of insulation that we will leverage as we continue to lean into countries where we have a strong presence and growing business momentum, placing less reliance on our tariff-impacted domestic business.

In addition to having a large and diverse revenue stream, we have long, established vendor partner relationships, in many cases formed over decades, both in China and around the globe. We are leaning into those relationships, and have already seen partners willing to participate in sharing some of the cost impact of incremental tariffs.

We also have a supply chain that has built-in redundancy, providing us with the agility to reallocate manufacturing quickly and seamlessly, as needed.

While reducing costs and leveraging our global revenue stream are key advantages, they are not our only levers. We have also made the strategic decision to increase prices later in Q2 and into Q3. Our approach is highly surgical and will vary by brand and by category, providing us with another means to protect the gross margin progress we've demonstrated over the last two quarters.

The final mitigant is to further geo-diversify our production. We are evaluating opportunities to lessen, and in some categories completely remove, the portions of our production that occur in China. In fact, we've already begun to mobilize on this front in certain areas of the business.

Given the fluid trade situation, there are two key points I will make regarding our guidance: 1) our full year outlook assumes no material softening of the macroeconomic environment or broader consumer demand; and 2) the favorable dynamics Franco and I discussed make us confident that we can offset potential tariff impacts even if China rates settle as high as 145%. If the current rate of 30% holds through year end, we believe the guidance we're providing today could prove conservative.

- For full year 2025, we expect worldwide net sales to decline in the mid to high teens, which includes approximately $45 million of impact related to retail store closures and excludes impacts from foreign exchange and potential asset sales. Given the strong business momentum we're seeing, we expect to continue to narrow our year-over-year sales declines for the remaining quarters in 2025.

- As Franco mentioned, we are taking actions this year that are expected to generate approximately $100 million of SG&A expense savings in 2025 versus 2024. Three factors are driving the savings.

    - First, we implemented a corporate reduction in force in February,
    - Next, we expect to continue to rationalize the store portfolio, with plans to close approximately 50 stores in 2025, and
    - Third, we transitioned five international markets to a distributor model, which brings our operating costs in those markets to near zero. We are continuing to evaluate opportunities in additional regions.

- We expect the combination of expanding gross margins and aggressive cost actions to drive full-year adjusted operating margin in the negative low single digits.

As we position the business to achieve long-term profitable growth, we're acting with discipline, maintaining financial rigor and moving as quickly as possible on all fronts. We appreciate your time this afternoon and will be available for follow-up calls. Now, I'll turn the call back to Franco for closing comments.

Franco Fogliato, CEO:

Thank you, Randy.

I want to thank our teams for their tireless efforts and dedication to our turnaround plan. And I want to thank our shareholders for their ongoing support. We remain committed to restoring profitable growth and building long-term shareholder value, and look forward to updating everyone on our continued progress next quarter.