Kellwood Co.

Moderator: Lee Capps

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Operator: Welcome to the Post View.

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Kellwood Company's Fiscal 2003 Q2 Results Conference Call. During the presentation, all participants will be in a listen only mode. Afterwards, we will conduct the question and answer session. At that time if you have a question, please press the "1" followed by the "4" on your telephone. As a reminder, this conference is being recorded Thursday August 28, 2003. I would now like to turn the conference over to Lee Capps, Chief Financial Officer. Please go ahead, Sir.

Lee Capps: This is Lee Capps. Welcome to the Kellwood Company's second quarter conference call. The other participants are Hal Upbin and Roger Joseph as well as two corporate vice-presidents, Bob Skinner and Steve Ruzow. Steve Ruzow is president of womenswear and Bob Skinner oversees menswear, lingerie and childrenswear.

As a reminder to the participants, statements in this conference call that are not strictly historical are "forward looking" statements within the meaning of the Safe Harbor provisions of the Federal Securities laws. Actual results may differ materially due to risks and uncertainties that are described in the company's Form 10-K and other filings with the SEC.

I will begin the meeting with a review of the 2nd quarter, covering sales and net earnings along with an analysis of year-to-year changes in each major line item on the income statement and a review of Kellwood's financial position as of August 2nd, 2003. Hal will then provide you with his assessment of the second quarter of each of our three business segments along with an update on the growing number of new and exciting growth initiatives in place to help drive organic sales growth and earnings next year. Hal and I will conclude our formal comments with an outlook for the third quarter and the outlook for the total fiscal year.

Sales for the second quarter were $527 million, increasing $64 million or 14% versus last year. Acquisitions contributed $68 million or all of the year-to-year increase in sales. Net earnings for the second quarter were strong, increasing $2.3 million or 53% to $6.7 million or $0.25 per diluted share versus $4.4 million or $0.18 per share before facilities and realignment costs. The improvement in net earnings came from increased sales and an improvement in gross profit as a percentage of sales.

Gross profit in the second quarter increased $16.2 million to 20.5% of sales versus 19.8% of sales reported last year. This is the fifth consecutive quarter in which Kellwood has been able to post a year-to-year improvement in its gross profit percentage. This is especially noteworthy given the current economic conditions, the climate at retail and continued price deflation at both wholesale and retail. The 0.7 percentage point year-to-year improvement in Kellwood's gross margin rate resulted from more competitive sourcing due to moving more of Kellwood's contract production from the western to the eastern hemisphere, running more contractor production through Kellwood's newly established trading company in Hong Kong, having less surplus and obsolete inventory to liquidate and the elimination of several non-competitive and costly manufacturing facilities in Mexico, Canada, El Salvador and Honduras as a result of taking a $15 million pre-tax facilities realignment charge last year.

SG&A expense in the second quarter increased $10.9 million or 0.1 points as a percentage of sales from last year to 16.8% of sales. Included in the $10.9 million increase was $7.0 million of SG&A expense from the acquisitions of Gerber Childrenswear and Briggs. On a comparable basis, SG&A expense increased $3.9 million or 5% due entirely to investment spending to launch new brands and marketing programs which will provide relatively little sales volume in the second quarter, but will provide growth later in the year and next year. Average shares outstanding for the second quarter were 27.0 million, up 2.3 million from last year. Acquisitions accounted for the majority of the increase. The remaining increase represents the impact of Kellwood's higher stock price on the number of stock option shares to be included in the calculation of fully diluted shares.

Turning now to the balance sheet. At the end of the second quarter, Kellwood's debt-to-capital ratio reached another record low at 33.5%, down 4.0 percentage points from last year. During this period, Kellwood invested a $140 million, of that a $128 million in cash and $12 million in stocks for the acquisition of Briggs. Kellwood's strong free cash flow and continued improvement in working capital management were the primary sources of these acquisition funds and also enabled the company to reduce total debt by $19 million.

Net working capital as of August 2, 2003 was $393 million, down $26 million from last year. Excluding acquisitions, net working capital declined $48 million or 11%. Net working capital as a percentage of sales appears to have settled into the 16.5% to 17% range. This compares favorably to the 18.1% average in 2002 and the 26.3% average in 2001.

Accounts receivable were $315 million or 48 days at the end of the quarter versus 49 days last year. Kellwood's collection effectiveness (invoices current to 30 days past due) was 97.8 percent.

Inventory at August 2, 2003 was $356 million or 63 days versus $404 million or 70 days last year. Excluding acquisitions, inventories were down $57 million or 14% from last year.

I will now turn the meeting over to Hal who will discuss each of our business segments and bring you up to date on all of the new marketing initiatives we have been working on.

Hal Upbin: Thanks Lee, and thanks to all of you folks participating in our conference call. Obviously I am very pleased with the results for the second quarter. Sales growth from acquisitions, new marketing initiatives and our core brands, continued improvement in our gross margins, working capital management and leverage and a strong increase in net earnings and earnings per share in spite of investment spending for the future. What else could a CEO ask for? More compensation probably, but we won't go into that.

With that said, sales of women's sportswear in the second quarter increased $25 million or 9%. $45 million of the year-to-year growth came from the acquisition of Briggs on February 4, 03. Sales of our core popular-to-moderately priced brands (Sag Harbor®, Koret® and My Michelle®), which represents 55% of Kellwood's women's sportswear volume in the second quarter were up $7 million or 5%.

The new brands launched earlier this year and new distribution into Canada including DLG™ updated women's sportswear, Sangria™ and Napa Valley® dresses and sales of Melrose® sportswear in Canada contributed about $8 million of growth in the second quarter. These increases were offset by an $18 million drop in the private labeled volume, including sales of Kathie Lee® sportswear and dresses to Wal-Mart. Additionally, our better-to-bridge priced brands which are sold principally to specialty stores were down about $8 million or 33% from last year. Finally, the dress category continued to be somewhat weak with sales down $6 million or 9%. However as we look ahead to Spring 04, which is the strongest season for dresses, we are very confident that we have hit the bottom in the dress cycle this year.

Finally, the new marketing initiatives, which I have already mentioned, along with Calvin Klein® and IZOD® women's sportswear, XOXO® junior sportswear, Liz Claiborne® dresses and suits, Dockers® tops for women and Lucy Pereda™ sportswear for the Hispanic market are setting the stage for very strong organic sales growth later this year and more importantly in fiscal 04.

Sales of the men's sportswear for the second quarter increased $24 million or 25%. The acquisition of Gerber Hosiery in June of last year contributed $5 million of the increase. The year-to-year organic growth of $18 million or 21% was broad based across every major product category including our branded business and private label programs.

The major drivers of growth in the branded business include Nautica®, Claiborne® and Dockers® dress shirts. The private label growth came from major programs with L.L. Bean, Sears, Land's End, Polo, Abecrombie, May Company and Nordstorms.

On August 4th, Kellwood announced the signing of a license with Russell Simmons of Phat Farm® fame. Under terms of the agreement, Kellwood will produce and market a Def Jam University™ sportswear collection for young men and women for delivery in the spring of '04. The better-priced collection of warm-up suits, T-shirts, woven shirts, denim jeans, loungewear, sweaters and dresses will be distributed through specialty and department stores. Earlier this year, we had announced our first foray into urban streetwear by partnering with Reverend Run, Russell Simmons' brother to launch Run Athletics™ men's activewear which will be sold to Sears, Penney's and specialty stores. We are very pleased to be in partnership with Russell Simmons, as we enter this new and exciting and rapidly growing market.

Sales of other soft good in the second quarter increased $15 million or 15%. The acquisition of Gerber Apparel on June 25th, '02 contributed $18 million or all of the year-to-year growth. The other soft good segment consists of three business units, Intimate Apparel, Gerber Apparel and American Recreation Products. The story for this segment is fairly simple. Gerber Apparel is doing well in tracking our original financial plan. Intimate Apparel and American Recreation Products, while quite dissimilar businesses, were both down from last year in the range of 5% to 6%. The reason both businesses were down is the same, namely the decision to withdraw from unprofitable products and markets, and loss of some private label programs due to being underbid in reverse auctions.

Before I turn the call back to Lee, who will give you our forecast for the third quarter and total year. I want to comment on what we have accomplished thus far this year to lay the foundation for strong organic sales growth and the strong growth in net earnings in fiscal 04.

I know we have commented on many of the growth initiatives already, but bear with me while I quickly summarize them for you.
For women, we have

- The Calvin Klein® license for sportswear
- IZOD® women's sportswear, intimate apparel and swimwear
- XOXO® junior sportswear, dresses and intimate apparel
- Liz Claiborne® suits and dresses for department stores, and Access™ by Liz Claiborne® for Kohl's and Mervyn's
- Lucy Pereda™ women's sportswear and intimate apparel for the Hispanic market
- Dockers® tops for women
- DLG™ updated women's sportswear, and
- Sag Harbor® robes and loungewear.

For the men's category, we have

- Claiborne® dress shirts
- Dockers® dress shirts for Sears and the new license for Dockers Green Label™ for other retailers
- Crazy Horse® dress shirts for JC Penney
- Run Athletics™ urban activewear, and
- Def Jam University™ urban sportswear

There are several other initiatives that are in place as well.

At the same time, we have been adding meaningful brands, new markets and new consumers to our portfolio. We have also been doing some pruning. The shortfall from our original plan for the year has largely occurred in the private label area including women's sportswear and dresses, intimate apparel and camping products. Because we have a growing portfolio of new brands and markets, we can be more selective in going after low margin private label business. Over time, this should enhance Kellwood's growth margin and working capital efficiency.

Finally, we have made the decision to discontinue our European hosiery, which is really men's athletic socks business, by the end of the year. The sales for this business have fallen to only $10 million and the operating loss is considerably over plan and higher than it was last year. The European hosiery business came along with our acquisition of Gerber Childrenswear. We tried to fix the business but the European economy, competition and a growing operating loss have tipped the risk/reward scale the wrong way and most importantly, the European hosiery business does not complement our strategic plans for men's sportswear.

I tell you all this so you can share in my vision of a very strong 04. I hate the old cliché, "you have to spend money in order to make money", but unfortunately it's true.

At the beginning of this year, we provided you with a forecast of $2.70 to $2.80 per share. But since the beginning of the year, we were able to add several new licensed brands which were not included in our original plan or guidance and the operating loss from the European hosiery business has significantly increased versus plan. All these factors add up to approximately $0.20 per share of expense. However, this investment spending for future growth and elimination of non strategic business provides Kellwood with a much stronger foundation for growth in sales and net earnings in 04 and beyond. With that said, I am very comfortable in forecasting organic sales growth in 04 of 7% to 9%. This is before any new acquisitions, and we are looking at several, and we hope to close on at least one, well, within the next six months. I will now turn the conference call back to Lee, who will provide you with the outlook for the third quarter and total year.

Lee Capps: Thank you Hal for that background. We expect sales in the third quarter in the range of $670 to $680 million, up 7% from $633 million reported last year due to the acquisition of Briggs. Organic sales are expected to be down 2% due to lower open-to-buy for the fall and loss of some low margin private label programs. Additionally, JC Penney and Kohl's are not going forward with key item promotional programs which performed poorly last year.

The increase in sales is expected to be driven by $20 million or 5% growth in the Women's Sportswear segment, $27 million or 22% growth in Men's Sportswear segment and a $5 million or 5% drop in sales in Other Soft Goods.

Net earnings in the third quarter are forecasted to be in the range of $28 to $29 million or $1.05 to $1.10 per diluted share, up $4.7 million or over 20% from last year. We will begin reporting the European hosiery operation and the cost of discontinuance as a discontinued operation beginning in the third quarter. Last year, net earnings were

$23.3 million or $0.90 per diluted share before costs for business and facilities realignment. Net earnings as reported last year were $21.1 million or $0.82 per diluted share.

The improvement in net earnings for the third quarter will be driven by the acquisition of Briggs, continued improvement in gross profit as a percentage of sales, partially offset by a modest increase in SG&A spending, as ongoing consolidation efforts are largely offset by the investment spending from new marketing initiatives. Finally, interest expense should be down in the range of $1.0 million from last year due to the company's strong free cash flow and continued improvements in the management of working capital.

Finally, the outlook for the total year. Now that we have substantially completed bookings for our Fall business which largely ships in the third quarter, orders came in $30 million below our expectations in May. Approximately, one half of the drop in the volume is due to the JC Penney's and Kohl's, the fact that they did not repeat the two promotional item programs serviced by the Sag Harbor and Koret, which turned out to be very disappointing for our customers and Kellwood. The other half of the drop in volume was largely due to the loss of some low margin private label programs. With that said, we now expect sales for the year to be in the range of $2.525 billion, increasing $320 million or 15% from $2.205 billion last year.

Since May, as Hal discussed, Kellwood entered into two new major licensing arrangements which will provide additional foundation for growth in 2004 on top of the several exciting new brands and growth initiatives announced earlier in the year. Theses new initiatives will add very little volume in the second half of the year, but do involve startup spending. Obviously, when we provided earnings guidance for the year in May, the Calvin Klein® and Def Jam University™ marketing initiatives were not included in our forecast. Additionally, the increased operating loss from the European Hosiery operation should be largely offset by the Kasper breakup fee less our out-of-pocket expenses.

With that said, let me summarize the three factors impacting the outlook for the balance of the year. First, sales are forecasted to be lower than we expected in May. Secondly, we will incur significant startup costs attendant with the two new marketing initiatives previously discussed, and finally, the increasing operating loss from our European Hosiery business should be largely offset by the net proceeds from the Kasper breakup fee.

Therefore, we now expect net earnings for the year, before discontinuance costs, but including the operating loss from the European Hosiery business, to be in the range of $70 to $72 million or $2.60 to $2.65 per diluted share versus $51.7 million or $2.08 per share before the business and facilities realignment cost that we reported last year. Net earnings as reported last year were $42 million or $1.69 per share.

We are now in the process of identifying the costs to discontinue the European Hosiery business. At this time, we estimate that the after tax discontinuance cost will not exceed $7.5 million and will be booked during the third and fourth quarters.

We now open up the meeting for questions.

Operator: Thank you. Ladies and gentleman, if you would like to register a question, please press the "1" followed by the "4" on your telephone. You will hear a three-tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the "1" followed by the "3". If you are using a speaker phone, please lift your handset before entering your request. One moment please for the first question. Once again ladies and gentleman to register a question, please press the "1" followed by the "4" on your telephone. Mr. Capps, at this time, I am showing no further questions, please continue with your presentation or any closing remarks.

Hal Upbin: Are you out there? This is Hal. This is the first time in our history of conference calls, nobody had a question. We are so excited about what we are doing and you don't have any questions and we even shortened our comments, so we can have more time for questions.

Lee Capps: Operator, is there a way to verify that the participants are still on the line?

Operator: They are still on the line, Sir.

Hal Upbin: Okay. Fine. Okay, we really thank you all for attending the conference call and we are looking for good things when we next talk to you again. Thank you.

Lee Capps: Have a great holiday weekend.

Operator: Ladies and gentleman, that does conclude your conference call for today. We thank you for your participation and ask that you please disconnect your lines.