Transcript of Columbia Sportswear Co.
Fourth Quarter 2017 Financial Results
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Participants

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Gert Boyle – Chairman of the Board
Tim Boyle – President and Chief Executive Officer
Jim Swanson – Senior Vice President and Chief Financial Officer

Analysts

Robert Drbul – Guggenheim Securities LLC
Katherine McShane – Citigroup Global Markets, Inc.
Mitch Kummetz – Pivotal Research Group LLC
Lindsey Drucker Mann – Goldman Sachs
Jim Duffy – Stifel
Laurent Vasilescu – Macquarie
Andrew Burns – D.A. Davidson & Company
Camille Lyon – Canaccord Genuity
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Ray D. – Bank of America Merrill Lynch
Jonathan Com – Robert W. Baird
Susan Anderson – B. Riley

Presentation

Operator
Greetings, and welcome to the Columbia Sportswear Fourth Quarter and Fiscal Year 2017 Financial Results. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. [Operator instructions]. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Christian Buss, Director of Investor Relations.

Christian Buss – Director of Invester Relations
Good afternoon. Thank you for joining us to discuss Columbia Sportswear Company's Fourth Quarter Results and 2018 Outlook. In addition to the earnings released, we furnished an 8-K containing a detailed CFO commentary, explaining our result, and the assumptions behind our full year 2018 outlook. The CFO commentary is also available on our investor relations website, investor.columbia.com.

With me today on this call are Chairman of the Board, Gert Boyle; President and Chief Executive Officer, Tim Boyle; Executive Vice President and Chief Operating Officer, Tom Cusick; Senior Vice President and Chief Financial Officer, Jim Swanson; and Executive Vice President and Chief Administrative Officer, Peter Bragdon.

Gert will start us off by covering the Safe Harbor reminder.

Gert Boyle – Chairman of the Board
Good afternoon. This conference call will contain forward-looking statements regarding Columbia's business opportunities and anticipated result of operation. Please bear in mind this forward-looking information is subject to many risks and uncertainties, and actual results may differ materially from what is projected. Many of these risks and uncertainties are described in Columbia's annual report on Form 10-K and subsequent filing with the SEC. Forward-looking statements in this conference calls are based on our current expectations and beliefs, and we do not undertake any duty to update any of the forward-looking statements after the date of this conference call to conform the forward-looking statement to actual results or to change our expectations.

Christian Buss – Director of Invester Relations
Thanks, Gert. I'd also like to point out that during the call, we may reference certain non-GAAP financial measures including non-GAAP results, which exclude program expenses and discrete costs associated with Project CONNECT, changes in revenue recognition and income tax charges associated with the Tax Cuts and Jobs Acts, as well as constant currency net sales growth. You'll find the reconciliation of these non-GAAP financial measures to comparable measures reported under US GAAP in the supplemental financial tables that accompany our earnings release, along with an explanation of management's rationale for referencing these non-GAAP financial measures.

Following our prepared remarks, we'll host a Q&A period during which time we will limit each caller to two questions, so that we can get to everyone by the end of the hour.

Now we'll turn the call over to Tim.

Tim Boyle – President and Chief Executive Officer
Thanks, Christian. Welcome everyone, and thanks for joining us this afternoon. We're pleased to report better than expected fourth quarter and 2017 results with revenue, gross margin, operating income and cash generation all at record levels in 2017. Exceptional execution in a rapidly changing consumer landscape remains the foundation of Columbia's business, as we celebrate our 80th anniversary this year and our 20th year as a public company this March.

It is this legacy that's reflected in everything we do. We're honored to have our global strengths recognized with our Chairman of the Board, Gert Boyle, receiving the ISPO Cup Award in January at the world's largest sporting goods trade show in Germany. The award has been given annually since 1971 to the global sports personality of the year. She's the first non-athlete to win the award and joins an illustrious group of athletes, including Pelé, Jean-Claude Killy and Max Schmeling.

We're also incredibly proud of our 7,000 global employees who have sustained our performance in 2017 with a relentless focus on sustainable high-quality sales and operating income growth. It's with this discipline that we're executing on our strategic priorities, which will accelerate market share capture across our geographies and brands.

As a reminder, our four strategic priorities are drive global brand awareness and sales growth through increased, focused demand creation investments, enhance consumer experience and digital capabilities in all of our channels and geographies, expand and improve global direct-to-consumer operations with supporting processes and systems, and invest in our people and optimize our organization across our portfolio of brands. We see clear evidence of the power of these strategies in our 2017 results, which also serve as the basis for our plans in 2018.

In the US business, we continue to experience challenges related to wholesale customers' bankruptcies and store closures leading to a mid-single digit percent sales decline in the US wholesale channel for 2017, with nearly two-thirds of the decrease resulting from the impact of retail bankruptcies. However, in the fourth quarter, the US wholesale channel played a significant role contributing to our top line beat relative to our October outlook, aided by improved order conversion. Fourth quarter net sales within the US wholesale channel increased 6%, driven largely by a shift in the timing of wholesale shipments from the third quarter into the fourth quarter.

Looking forward to 2018, we anticipate that the US wholesale channel will return to growth, reflecting visibility into our spring and fall order book. Our US Columbia wholesale team is managing the industry's challenges proactively, with a particular focus being placed on key markets in the Midwest and South. We continue to believe that the Columbia brand is gaining US wholesale market share in a challenging environment and that wholesale channel inventories are generally healthy.

We've accelerated investment in our US direct-to-consumer business, which grew at a double-digit percentage rate in the fourth quarter and a high single-digit percent rate for 2017. The brick and mortar channel drove sales growth with improved productivity, while we made the strategic decision to reduce online promotional activity relative to last year, driving modest growth in our e-comm business.

Outside the US, our results for 2017 demonstrates the power of our global business with total international sales growing at 8.5% year-over-year. This business generated 38% of total revenue in 2017, led by the Columbia brand.

Our EMEA business remains a standout in our international markets with constant currency sales growth of 14% for both the quarter and for 2017, the third year in a row of double-digit percent constant currency sales growth in that region. We saw high-teens percent sales growth in our Europe direct business and mid-single digit percent growth in our EMEA distributor partners for both the quarter and the year. We're particularly pleased with the performance of our Russian distributor who has navigated the challenges of that market effectively, returning to significant growth in 2017.

After achieving break-even profitability in 2016, our Europe direct business returned to a meaningful level of profitability in 2017. Our team in Europe has done an outstanding job over the last three years, and we have plenty of opportunity to drive continued growth and expand profitability in that important market in the years ahead.

Fourth quarter gross margin performance highlights the discipline executed by our team with 80 basis points of improvement driven by contributions from our DTC business, as well as a higher proportion of higher margin whole price sales. For the full year, gross margins expanded 30 basis points to a record 47%. We remain intensely focused on cross-discipline while investing in growth areas of our business.

In the fourth quarter, excluding Project CONNECT program and discrete costs, we maintained our SG&A rate helping drive non-GAAP operating margin up to 14.9% from 14% in the prior year. For the full year, excluding Project CONNECT program and discrete costs, SG&A expenses grew in line with sales in spite of significant investment to support our strategic priorities and the growth of our business. Together, we expanded our non-GAAP operating margin to 11.3% from 10.8% in the prior year.

I did want to take a moment and talk about our income tax expense in 2017. In connection with the company's analysis of the impact of the Tax Cut and Jobs Act, we recorded provisional expenses of $95.6 million during the fourth quarter of 2017. While there remains significant uncertainty on a long-term basis, excluding further refinement of our provisional tax expense, the lower US corporate tax rate should result in a global effective tax rate of around 22%. Our current intent is to repatriate approximately $200 million in cash currently held overseas. For more details on our tax expense and our capital allocation priorities, please see Jim's CFO commentary available on our website.

We edged out the year with inventories down 6% on 8% sales growth. Our inventories are clean, including a year-over-year decline in excess and closeout inventory. Our balance sheet remains extremely strong, with record cash from operations helping drive cash balances to a record $768 million. We continue to have no long-term debt. In light of rising cash balances and strong cash flow generation, we've chosen to provide additional insight into our priorities for the use of cash.

First and foremost, the company remains committed to maintaining a strong balance sheet, while utilizing cash to invest in growth opportunities for the business. We continue to believe that the lowest risk, highest return for the company is to continue to focus on improving the results in the assets we already own. We will also look to return 40% to 60% of free cash flow to shareholders by increasing our dividend when appropriate, and repurchase shares in the market place. Finally, we have demonstrated the capacity to make and integrate acquisitions as opportunities arise.

To this end, the board has approved the 16% increase in the company's quarterly dividend to $0.22 a share, up from $0.19 a share. This comes in addition to the 6% increase in the quarterly dividend that we announced in October.

Looking in more detail on how our brand-led, consumer-centric approach is allowing us to execute on our strategic priorities, impressively in the fourth quarter, our Columbia brand created over 1.8 billion engagements with our consumers and over 3 billion in 2017. Over the past year, our Columbia brand team has installed and refurbished over 300 Columbia shopping shops and elevated brand presentations at key partner stores around the world. We're also working with our retailers to directly engage with our consumers through collaborative marketing with notable campaigns in the fourth quarter with both Dick's Sporting Goods and the newly combined Bass Pro & Cabela's, for our Directors of Toughness and Columbia Warm Campaigns, which together generated over 50 million impressions with consumers. Our investment in this rollout reflects our commitment to enhance the consumer experience within our global wholesale business, and also speaks in the confidence that our wholesale partners have in us, as one of their most reliable partners and in the Columbia brand, as one of their most consistent performers.

In the fall of 2017, we launched the new seasonal campaign titled, Columbia Warm, that sits on top of our existing Tested Tough brand platform. It exposed consumers to a consistent global story across TV, digital, print, out-of-home, email and social media and includes new micro campaigns across digital channels that were updated regularly to maintain an always on marketing presence. The effort kicked off in September, with the campaign focused on our partnership and outfitting deal with the UK National Parks System and was followed by a partnership featuring actor and celebrity, Zac Efron and his brother, Dylan that has already driven over 400 million impressions.

Our marketing campaigns are also being increasingly tied directly to calls to action. The launch of the *Star Wars: Empire Strikes Back* collection in December is an example of how we can effectively activate our brand with consumers. The collection launched on December 8th and sold out in stores and online in minutes in the United States. While driving traffic to our stores and our website, the campaign also generated significant coverage in the media, resulting in more than 650 million impressions. In addition, pieces from the Columbia collaboration with the New York-based fashion retailer Opening Ceremony, continued to earn attention and were included in multiple print and holiday gift guides.

Our success has not been limited to our product collaborations. PGA athlete, Brian Harman, was wearing Columbia golf product in his thrilling PGA Tour win at the Wells Fargo Championship over the summer. Our athlete, Patton Kizzire, has also started 2018 off very strong, taking home wins at both the Sony Open in Hawaii and the OHL Classic in Mexico. Finally, Ryan Palmer was tested tough at Torrey Pines, holding the lead through three rounds and finishing in second place. These engagements help drive 9% sales growth for the Columbia brand in the fourth quarter, bringing total growth for 2017 to 4%.

With the opening of the Winter Olympics less than 24 hours away, we look forward to seeing Columbia uniforms on athletes from the US, Canada, Belarus, Kazakhstan, Brazil, and the Ukraine. We also know that the staff of NBC Sports and the Today's Show are staying warm, dry and protected as they've chosen to wear Columbia product on air during the Super Bowl in Minnesota and throughout the Olympics. With the [indiscernible] Ethan Pochman as the Vice President of Marketing for the Columbia brand in January, we expect to build on our momentum in 2018.

Our successes were not limited to the Columbia brand, with the SOREL brand team executing on the limited-edition boot collaboration with renowned Paris-based luxury design house, Chloé. The product launched on November 15th at 14 of Chloé's premium global wholesale partners, including Nordstrom, Galeries Lafayette, Barney's and Holt Renfrew. The collaboration is a perfect fit with SOREL's fashion-forward female consumer and sold out within two weeks on chloe.com.

SOREL's fall 2017 line was supported by the brand's new Defy marketing campaign that reinforces SOREL's position as the most fashionable brand in outdoor and the most outdoor brand in fashion. The campaign was anchored by street level window executions across New York City, as well as by extensive social media campaign that featured eight up and coming fashion influencers. SOREL net sales was 7% in 2017, and the brand is positioned for continued growth in 2018.

At prAna, during the third quarter, we promoted Russ Hopcus, Columbia's former SVP of North American sales to prAna Brand President. I'm confident in Russ and his team's ability to magnify prAna's message of sustainability and healthy, active free-spirited lifestyle to drive growth. prAna grew 8% in the fourth quarter, driven by an acceleration in e-commerce. The business grew 1% in 2017 and is poised for higher growth in 2018.

At Mountain Hardwear, new Brand President, Joe Vernachio, continues to build out the new product team that's working to create a compelling, high-performance product line. While we do expect continued pressure on the Mountain Hardwear business in 2018, we are encouraged by a return to growth in the brand's fall 2018 order book. Response to new product has been favorable, with the brand recapturing floor space in several key accounts.

In summary, we're pleased with our 2017 solid performance and how we've positioned our brands and regions for accelerated growth in 2018. It's from this position of strength and confidence that we're investing in our strategic priorities. Our increased focus on the consumer has led us to invest in a consumer-first technology initiative, which includes our global retail ERP platform. The project includes the IT systems infrastructure to support the growth and continued development of our omni-channel capabilities. As consumers continue to change the way they engage with brands, we're working to deliver a more personalized, seamless experience for consumers across our retail operations.

The multi-year global initiative is currently in the design phase, with Microsoft as our key partner. We are targeting regional implementation beginning in the first half of 2019. The platform will be integrated with our global SAP enterprise resource planning system, which has been implemented in the majority of our operations to date. We launched the SAP system in our China joint venture in 2017 and plan to transition our Europe direct business onto the system in mid-2018. With this, we will have completed the major components of our global SAP rollout.

Onto Project CONNECT, which I described during our July and October conference calls. In 2017, we completed the operational assessment phase of Project CONNECT, which included a shift in the company's operating model, executive organization structure and decision rights to enable a brand-led and consumer- focused organization. During the second half of 2017, the company began the implementation of operational improvements throughout the business. Project CONNECT includes initiatives to drive revenue, capture cost of sales efficiencies through design and assortment optimization, generate SG&A savings and improve our marketing effectiveness. As these improvements begin to be realized, we intend to reallocate resources to our strategic priorities. Our 2018 financial outlook contemplates modest financial benefits from these initiatives, while we anticipate more meaningful financial value capture in 2019.

Before I move to your questions, I wanted to provide a little more color about our expectations for 2018. We're in the midst of the fall advanced order picking process with our global wholesale partners. Although we no longer report specific backlog figures, I want to share that based on the visibility we have today, we're optimistic that we will continue to generate global growth, and that our US wholesale business will return to growth in the first half of 2018 with our spring business and carry that growth into the fall season. When combined with the continued growth that we expect from our DTC businesses, both the first half and second half of 2018 should show solid growth.

Our 2018 non-GAAP outlook anticipates 4% to 6% revenue growth, up to 20 basis points of operating margin expansion, and up to 7% to 10% non-GAAP net income growth, driven by the Columbia, SOREL and prAna brands and in all four of our geographic regions. We believe that the combination of our global, multi-brand, multi-channel business, our sound strategic plan and our teammates around the world form a solid foundation that will continue to drive growth, expand our profitability and increase our total return to shareholders in the years ahead.

You can find more detail on our Q-4 and full year results and our 2018 outlook in Jim's CFO commentary available on our website. Finally, I want to thank our team members for their hard work and discipline over the last year. I could not be more proud of the people who are at the heart of our global organization.

That concludes my prepared remarks. We are happy to take questions for the reminder of the hour. Operator, can you help us with that?

Operator
Our first question comes from the line of Bob Drbul with Guggenheim.

Q: Gert, I just have quick question for you before my other questions. Did Tim do an acceptable job accepting that cup honor in your name?

Gert Boyle – Chairman of the Board
He has and loved every minute of the day.

Q: Good. I'm glad. You're going to keep a close reign on him, okay?

Gert Boyle – Chairman of the Board
I'm trying as hard.

Q: All right. Congratulations on that honor, Gert. Very well deserved. Tim, the commentary that you made around your order books spring/fall, from your perspective on the channel, there's been a lot of door closure, but on the channel inventory levels, how clean do you think it is now? Can you talk about some of the geographic opportunities, especially in North America? When you look at that visibility, first half, second half, should it be consistent growth as you return to your wholesale growth? Can you give us a little bit more commentary around that please?

Tim Boyle – President and Chief Executive Officer
Let me give you my take on the inventory levels at retail and then, maybe Jim can comment on the specifics around where we expect the growth to be from the calendar perspective. This year, we try not to rely on weather to help us and frankly, our business has improved. It's always good to see weather. We had appropriate weather actually in North America and in Europe this year, which helped to clean up inventories that otherwise may have been a problem from prior periods. In my opinion, the winter merchandise is very clean across North America and Europe, and for that matter, China.

I think we've probably seen the bulk of the financial embarrassment in the retail trade today, so I'm hoping that we don't have any more significant bankruptcies or store closures. I would think that our visibility in our order book shows that we're A: taking some share, and B: that the inventories are clean, and there's some replenishment going on.

Jim Swanson – Senior Vice President and Chief Financial Officer
Yes, Bob. Just to jump in, if you look at the outlook that we're providing on the year for the US wholesale business, that plan [indiscernible] low single-digit basis. I'd anticipate based on our visibility in the order book today and we're not providing a quarterly outlook that should be relatively balanced over the year.

Q: The second question that I have— sort of my third. The second one is, on the demand creation, in your commitment to increasing that, where did you end 2017? When you think about the plans for '18 and sort of longer term, can you just give us an update where you think you are now on that aspect of the business please?

Tim Boyle – President and Chief Executive Officer
Yes. In total, we ended up with a growth in the nominal dollars, but the percentage rate was about the same as it had been last year, which was about 5%. We've budgeted the year to be about the same for 2018, although as a portion of Project CONNECT, we've actually been able to analyze the efficiency levels in terms of our spend, so we expect that if we have a nominal increase, which we will likely have in the spend, it will be more efficient. Any savings as a result of Project CONNECT or increased performance from an operating income standpoint, we plan to reinvest that in our marketing efforts. That's going to be the number one focus of our reinvestment.

Operator
Our next question comes from the line of Kate McShane with Citi.

Q: I was wondering if you've seen a meaningful pickup with millennial customers, given some of your new marketing campaigns. Is there any data you can give us with how you're resonating within that demographic and what the potential might be?

Tim Boyle – President and Chief Executive Officer
Certainly. I think, if I look across the North American continent as it relates to our various product categories, the youngest consumer we have is our PFG consumer. That's an extremely popular apparel product on college campuses, especially in the southern part of the United States. That's where we've seen the most tractions

specifically from the millennial consumer, although I know that we're getting pickup in some our outerwear categories as well. If we look for very specific, it's going to be in that PFG category.

Jim Swanson – Senior Vice President and Chief Financial Officer
Then maybe adding to that, Tim, certainly in the SOREL brand, we've seen much more pickup as we've changed that brand more to a kind of a fashion-forward product in the spring season as well. We've seen a younger demographic that we're selling to with the SOREL brand. I also indicate that to be the case with prAna.

Q: If I just can ask one more question, switching gears a little bit about outerwear versus sportswear, and how that composition has changed over time. Can you talk a little bit more about how you're managing ready-to-wear and the flow of product onto the floor of the retailers? Has the percentage of your categories changed as a result?

Tim Boyle – President and Chief Executive Officer
Certainly. Our sportswear business is actually larger on the unit basis by quite a bit in sportswear versus outerwear. Obviously, the units tend to skew towards the back half of the year in outerwear. We also have the particular to around the average unit price of outerwear in this vexing holiday that ends up being in the end of the year, called Christmas. While we really try and keep our stores fresh and our retailer stores fresh year-round with the sportswear, from a dollar standpoint, we're still fairly heavily involved in outerwear.

Operator
Our next question comes from the line of Mitch Kummetz with Pivotal Research.

Q: Tim, you mentioned that in the quarter, you saw improved order conversion, I assume that's just different language for a lower cancellation rate. Then, you also talked about better full priced selling. I know last year wasn't good. Was this year more normal, and when we think about 2018, kind of the guidance assumes something similar to this year, or was this year really great and next year, you wouldn't anticipate it to be quite as good on those sort of two assumptions?

Tim Boyle – President and Chief Executive Officer
No, this year was, I guess, a return to what we had seen historically, from not only a lack of cancels but reorder rate. As an example, our European reorder rates were probably at a historical high this year. I think that bodes well for the brand's acceptance, not only from a categorical standpoint, but from a brand perspective. I don't think that we've actually assumed a cancel reorder rate as healthy for 2018, but we certainly have the potential to be there.

Jim Swanson – Senior Vice President and Chief Financial Officer
Yes, and Mitch, just to jump in, as it relates to our outlook and as we have historically— the order conversion between the cancellations and reorders, those are planned on a normalized basis as we see it. Specifically as it relates to the fourth quarter, you're right, in terms of the balance between that being much more a function of less cancellations, and really seeing the benefit of that, particularly in our US wholesale business, as well as our European wholesale business. Nice performance in each of those on the quarter.

Q: Then just from a housekeeping standpoint on 2018, maybe just two quick questions. One, what are you expecting for FX? I would imagine that's a tailwind in 2018, at least on the top line. Help me understand the difference between kind of the GAAP and non-GAAP guides, particularly on the sales side? What is this $40 million that comes out of the sales line and it goes to the SG&A line? Help me understand kind of what's going on with this change in accounting standard.

Jim Swanson – Senior Vice President and Chief Financial Officer
Yes, Mitch. Let me take you to those. First as it relates to foreign currency, you're right. We should see naturally a tailwind from an earnings standpoint in 2018, that by and large, being a function of the hedging that we've done on our production for the year and to a lesser degree that the translation benefit. Although, as outlined in the outlook that we've provided, the translation benefit to a top line perspective is less than a point, about 75 to 80 basis points of benefit and then, the flow through down to the earnings line maybe a little bit less. The net effect is currency as a benefit to earnings on the year and that's reflected in our outlook, as wells as if you look at the gross margin outlook we've provided on the year at plus 60 basis points, some of the hedging currency benefit is reflected in that.

Then, specifically as it relates to the GAAP versus non-GAAP in the $40 million, so the part of revenue recognition accounting standards change goes in effect January 1 of '18. This impacts predominantly from a P&L standpoint, our businesses in Asia, our Korea business and our Japan business. As you recall, much of those businesses are concentrated with shopping shops. The rental cost and the labor cost associated with operating those rental shops to date have been a deduction to our gross sales and netted. Going forward, we're going to move those concession fees, and those will be recorded in SG&A.

Effectively, revenue gets grossed up $40 million, SG&A gets grossed up $40 million, and the net effect to the operating income is neutral. However, obviously our operating margin at sales will be impacted a little bit as a result of the higher top line on a neutral earnings impact.

Q: So when we grow this year we're not growing off the— if we go up 4% to 6%, it's not necessarily off the reported number. It's that reported number for 2017 plus the 40 million?

Jim Swanson – Senior Vice President and Chief Financial Officer
Well we've tried to keep this as comparable as we can. So the 4% to 6% is a comparable number to the way we had reported in 2017

Operator
Our next question comes from the line of Lindsay Drucker Mann with Goldman Sachs.

Q: I wanted to ask about the 2018 outlook, the 4% to 6% including currency or something a little more than 3 to a little more than 5 ex-currency. How does that compare with what you believe the long-term revenue growth potential is for the business?

Tim Boyle – President and Chief Executive Officer
Well I think I've been pretty clear that my own personal goals for the business are much greater in minimum double-digit sales growth. But what we found with Project CONNECT is that the business has been operating well efficiently and now getting ourselves back to just slightly north of average operating margin. We're doing it by really starving our marketing spend.

So what we're going to be doing is focusing our time and effort on reinvigorating the brand, telling our stories at a much louder voice and really growing the business from a sound financial base, and frankly the cash for those activities and for the other activities we delineated in my script are going to come from efficiently run the business. When you've been running a business for 80 years and you have some activities which are no longer as productive as they should be, so Project CONNECT has helped us to focus our time and efforts on those areas of the business that can really move us forward to create a greater opportunity for marketing spend and telling our story. So once we get a louder voice, I believe that the opportunity for sales growth at high-teens is even possible.

Q: You talked about looking for China to grow mid-single digits in FY '18. Can you just remind us what the run rate for Chinese growth has been since you've brought that JV in-house?

Jim Swanson – Senior Vice President and Chief Financial Officer
I don't have all that data in front of me, but I think if you look at each of the last couple of years, we've been growing at a mid-single digit level, and within that mid-single digit level to start kind of breaking it down by channel in its entirely of the Colombia brand that we're currently transacting and doing business with in China. But we're really where we're seeing the strength in the ecommerce business, and so we feel like there's a lot of opportunity to get other parts of that business growing at an equal rate and potential [indiscernible] in the market place.

Operator
Our next question comes from the line of Jim Duffy with Stifel.

Q: A couple of questions from me. Tim, now that you're through the assessment phase, number of quarters into implementation of Project CONNECT are you prepared to put some shape around the longer-term financial targets, margin objectives or even baseline objectives for annual improvement in margin that we should think about over a multiple-year period?

Tim Boyle – President and Chief Executive Officer
Well so we've basically broken the Project CONNECT into a few parts. Two-thousand-seventeen was really an analysis space looking for the opportunities that we found, and 2018 is going to be really implementation of those findings. We haven't put a finite amount of savings and reinvestment that we expect to find. Although I can tell you it is going to be significant and I think we'll have a meaningful improvement not only in the profitability of the business, but also the size of our voice as it relates to telling our story on product.

Jim Swanson – Senior Vice President and Chief Financial Officer
And, Jim, just to add on there as well, our 2018 outlook does contemplate some modest benefit flow through related to Project CONNECT coming through both the gross margin line and SG&A. But to Tim's point, we really see the more meaningful side of those benefits begin to flow through in 2019. We'll see it in a variety of ways looking at both the topline contributions in our business from a commercial standpoint, improvement in the gross margin and also SG&A efficiency. Then I think what remains to be told is to what degree that flows to the bottom line versus reinvestment that we would make back into these strategic priorities. So we'll look forward to providing further updates as we get further down the road.

Q: That's a good segue to my next question. I wanted to try to understand as it relates to the marketing spend, I get it. You guys want to increase marketing spend to drive growth. Do you have a figure in mind for marketing spend? Is it target percent of revenue or revenue growth rate at which you would expect you could leverage the marketing spend?

Tim Boyle – President and Chief Executive Officer
Well I think first of all, with Project CONNECT we've realized that we can spend what we're spending more efficiently and that's underway. There's been small amount of improvement in the spend in '17, more in '18. When I look across the landscape of publicly-held companies in our business, the ad rate runs from 13%, 10%, 12% of sales. I don't think we need to spend that much, but we need to spend more and we need to spend it more efficiently. The addition of a new marketing head for the company for the Colombia brand is going to help us unify our spend across the geographies that we currently have in disparate spend and less efficient.

Operator

Our next question comes from the line Laurent Vasilescu with Macquarie.

Q: I wanted to follow up on the ecommerce revenues. I think it was called out that it's about 9% of FY '17 revenue, so I think that would be $220 million. Maybe my math is wrong, but I think last year's fourth quarter earnings call quantified ecommerce revenues for Fiscal Year '16 at $220 million. So essentially maybe— am I wrong but was it flat for the year or just maybe you can [indiscernible] that numbers?

Jim Swanson – Senior Vice President and Chief Financial Officer
No, we've continued to see nice growth in our ecommerce business worldwide. Our US business, pleased with the growth that we've seen in that. I think in the fourth quarter in particular as we've noted, a little bit more modest growth in the fourth quarter, that in part being related to the strategic decision that we've made in not being quite as promotional as we had been in the prior year quarter. But collectively when we look across the business, our ecommerce channels worldwide, we've continued to see nice growth in resonating with the consumer. I'd also note that earlier in the year you may recall that our European business, which we previously operated through a third party that supported that, and we took our ecommerce business in-house so continue to see nice growth from a European standpoint as well.

Q: Yes, obviously these are percentage points, so there might be some variance there. And then for your direct-to-consumer business, it's very helpful that you guys quantified that it was 40% of Fiscal Year '17 of revenues. How do we think about that rate going forward? I think it increased by 300 [indiscernible] in Fiscal Year '17. Should we think about that similar rate for Fiscal Year '18?

Jim Swanson – Senior Vice President and Chief Financial Officer
I think as it relates to '18 in particular, we'll anticipate the DTC business. We'll outpace the growth of our wholesale business. And I think in terms of what you're looking at growing from 38% of total in 2016 to 40% in 2017, we're probably seeing a like shift as we move forward out to '18. But we're also excited, as Tim had mentioned, about the wholesale order book that we have in-hand, and that we're able to grow that important part of our business as well.

Tim Boyle – President and Chief Executive Officer
Yes, it's really going to be critical in terms of not only the categorical sales growth as an example. If our footwear business continues to grow at the rate we expect, that's almost exclusively a wholesale channel business. Then from a geographic perspective, our European business we expect to expand significantly and really at the wholesale level.

Q: Just to kind of follow up on this question if I may, any expectations? Any kind of high-level thoughts about how many stores you want to open for the year?

Jim Swanson – Senior Vice President and Chief Financial Officer
Yes, I can provide a bit of that detail. It's a shade [ph] lower than what we've done in 2017, but if we look at the US as an example, we've got 8 outlets planned and a branded store. And then across much of the remaining markets, Laurent, it's really on par with what we've done, each of the last couple years— a couple stores in Canada, a handful, four or five in Europe, and then Asia obviously the capital investment and so forth of those stores given the shopping shop model that's there, various rates of growth, but that gives you a little bit of an idea.

Operator
Our next question comes from the line of Andrew Burns with DA Davidson & Company.

Q: Just a follow up on Laurent's ecommerce question. I thought perhaps the reduced online promotional activity online might be just a function of inventory, but it sounds like it was more of a strategic decision. Could you elaborate on how you view your ecommerce side as a clearance platform going forward?

Tim Boyle – President and Chief Executive Officer
Yes, certainly. Well we still want to make sure that the investors understood that we're primarily a wholesale business. That means we have lots of retailers with inventory that they purchase from us on their shelves and we don't want to be competing with them on price through our own website. So we strategically decided to forestall promotions that we were comping against in prior years to make sure that our wholesale customers had an opportunity to liquidate their inventories at a high margin rate.

Jim Swanson – President and Chief Financial Officer
Yes. And, Andrew, you may recall coming into the Black Friday/Cyber Monday period last year, it was a bit warmer across North America. And so in light of that we were a bit heavier promoted during that period and coming into the fall and some of the favorability we'd seen in our business, we didn't feel it was necessary and we're less promotional.

Q: And then I noticed that Colombia was largely not present at the OR Show in January. As I recall within US wholesale, that outdoor specialty was up to a third of the total distribution. Is there any change in the go-to-market process servicing those retailers or was that just more of a one-off?

Tim Boyle – President and Chief Executive Officer
No. Again, as a function of Project CONNECT we looked at all the expenses that we have basically dealing with our retailers and with consumers. And we need to be frankly brutal about how we allocate those expenses and the costs associated with going to a trade show where— it's basically an opportunity to say hello to retailers and not really much business has done. The business has been concluded within North American retailers for all intense and purposes much prior to show. We just weren't getting the kinds of return that we wanted and that we should expect. We still attend trade shows in Europe and we still had a presence with the smaller brands in outdoor retailer. But when we look at where we need to be focusing our time and effort for a higher return, our marketing spend really didn't include the outdoor retailer show.

Operator
Thank you. Our next question comes from the line of Camille Lyon [ph] with Canaccord Genuity.

Q: Tim, you talked about in the prior question ultimately getting back to double-digit topline growth and maybe mid-high-teens growth. As you see this vision unfold and Project CONNECT kind of at the root of it all, is that driven by bringing in a new customer into the business, extending categories, going further down the DTC road? Like, if you just can put some shape around that comment, I think that'd be helpful because that's maybe a far different story from what we've been accustomed to over the past few years. So I think any context of it would be greatly appreciated.

Tim Boyle – President and Chief Executive Officer
Certainly. Well, depending on the geography, we're really selling to every retailer that we want to be selling to. We're just not selling enough and we see competitors with larger share in some markets in some retailers and we want to be actively focused on growing our share in those stores. We believe there's an opportunity for us to grow double-digit if we execute properly and we have the kinds of demand creation and focus on having the consumers pull our merchandise off the shelves the way we want them to. So I think the opportunity exists.

The US, we're more mature certainly than we are in Europe where there's an enormous opportunity for us. So I just think there's a tremendous opportunity. Additionally, we have the DTC business, which has been growing nicely, but certainly the focus for rapid growth and for highly probably growth is going to be with our wholesale partners.

Q: So that's to say that is that a product focus then to create more product that is then more innovation as desired by the consumer or is to really— you've mentioned having a louder voice a few times on this call, just focus really on your core demographic but speaking to them more frequently or expanding your core demographic profile so that you're speaking to a broader base?

Tim Boyle – President and Chief Executive Officer
Well I think for the Colombia brand it means just creating additional voices and a larger voice from the Colombia brand, which is already very well-known. But it also includes the other brand, SOREL, prAna and Mountain Hardwear, which are very under-penetrated and much less-known than the Colombia brand. So we're going to be using the capital that we are able to pull from Project CONNECT not only to focus on the Colombia brand but to also focus on the other brands and getting them to the level that they deserve.

Q: And then just switching gears a little bit, you mentioned Russia had returned to significant growth. I know South Korea's been a tougher market. Could you just update us on those two markets with a little bit more detail [audio disruption] headwinds? It sounds like Russia's on track. Is that the case for certain in South Korea, or is there more to be done there?

Tim Boyle – President and Chief Executive Officer
Certainly. Well specifically on Russia that's one of the longest relationships the company has with an international distributor. We have a very strong financial partner in Russia and one that's shown that the capability of having a sustainable business even in the face of really disastrous currency fluctuations. So as the business improves not only from a total economy improvement in Russia but also from an improvement in their operations, we're going to see great things I believe happen in Russia specifically with the Colombia brand.

South Korea, I believe we're in a trough [ph] position there. Our inventories are much better. There are some issues I believe in the general health of the inventory levels across other brands. But with our brand we've had great success in cleaning that inventory up and building for the future. So we don't expect significant growth in Korea for 2018, but I think the future bodes well for improved business there.

Operator
Our next question comes from the line of Chris Svezia with Wedbush Securities.

Q: I guess first question I have is— I got on a little late here but I'm just curious— of the 4% to 6% non-GAAP revenue growth that you talked about, I know you've reference that Colombia, SOREL and prAna were supposed to grow. Is there any way you can potentially add a little more color about rates of growth or where that falls in that context for that 4% to 6% growth rate?

Jim Swanson – Senior Vice President and Chief Financial Officer
Yes. I mean, obviously on an absolute basis, it's going to be more heavily-weighted in the Colombia brand and on a relative basis, if we were to provide a little more color on that, I think we're anticipating the prAna brand in particular coming off a year in which it's been a low-single-digit rate of growth that we would see more acceleration in that. That's probably the faster-growing of the brands. Then Colombia and SOREL would be kind of more approximate to each other from an overall growth standpoint.

Then with the Mountain Hardwear brand being lower, as Tim commented in the prepared remarks, we've come through a year in which we've been cleaning up inventory. So we've had some excess close out inventory and so forth, but we are pleased with the fall of '18 order books that's come together and seeing the full price side of that business within US wholesales returning to growth.

Q: With regard to— in Europe, the subsidiary portion of Europe, can you just maybe talk to— I know the profitability's improved, just sort of where you are right now on that? And any thoughts about how we think about 2018 in sort of the profitability improvement in the subsidiary of western European piece to the business?

Tim Boyle – President and Chief Executive Officer
Yes. I think Jim can maybe be more granular, but the improvement of profitability was significant in 2017 over 2016 where we were, for all intense and purposes, break even. The business is going to continue to improve. Our expectation is for that lead-in to growth. We may even have the potential to approximate the company average in '18.

Jim Swanson – Senior Vice President and Chief Financial Officer
Yes. And just to jump in there a little bit, with 2016, that was the year in which we finally got back to a breakeven point after several years on the European direct business performing at an operating loss, and as noted, saw meaningful improvement in the profits in Europe. We feel like there's a lot of room to grow here. The business is on a trajectory to continue to grow, and we'd anticipate that as it does that, there's a fixed cost structure in Europe that we're able to continue to leverage and we should see continued improvement in the operating profits. There's a ways to go yet for [indiscernible] before we get back up to corporate levels or levels that we see within other parts of our business regionally.

Q: One last question, and I apologize I might have missed this. But when you talked about spring for the Colombia brand, North America US wholesale having [indiscernible] growth, how is it that changes if you think about the back half for US wholesale given how strong fourth quarter was and potentially retailers' appetite for pre-booking and things of that nature? Maybe if you could just walk through that a little bit, that'd be great.

Jim Swanson – Senior Vice President and Chief Financial Officer
I can lightly touch on the order book as a part of this. Based upon the combination of visibility we had to our spring book, which obviously we've had that in hand for quite a while and we've got confidence in driving growth through the first half of the year with the spring book, and then with the early visibility that we have as we've got much of the order book in to clean on the Colombia brand through the fall season anticipating, again, a low-single-digit rate of growth. From an overall, reorder, cancel perspective and replenishment, again, just planning those more on a normalized cycle.

Operator
Our next question comes from the line of Ray [indiscernible] with Bank of America Merrill Lynch.

Q: On the US wholesale improvement for 2018, are there any channels or categories that are outperforming or is the improvement balanced?

Tim Boyle – President and Chief Executive Officer
Yes, it's fairly balanced, but I mean, we've been excited about the increase in our footwear business. It's a smaller base obviously than the apparel business, but it's gratifying to see that part of the business improve with some significance.

Q: Is that Colombia footwear or SOREL or both?

Tim Boyle – President and Chief Executive Officer
SOREL, yes and we called that out, but I'm talking about the Colombia footwear business.

Q: And then you've opened I think 300 shopping shops in 2017. What is the outlook for 2018?

Tim Boyle – President and Chief Executive Officer
I don't know that we've given a specific number to that yet. We're still analyzing where the order book falls and we're talking about how to best utilize those assets, but there will be likely more of those. And the number we quoted was ones that we'd opened as well as ones that we'd refurbished.

Q: And then last question. Can you talk about key innovation or product launches that you have for 2018 that we should be looking out for?

Tim Boyle – President and Chief Executive Officer
Yes. We have a product category. You're definitely familiar with Omni-Heat and we have an improvement to our Omni-Heat product. So Omni-Heath will still continue to lead the business, but we found a process to improve the performance on that. We're calling it Omni-Heat 3D, and that's likely to be among the most exciting things we've launched. So that's going to be the focusing of our marketing efforts for 2018 as it relates the winter and the expectation is for solid growth there.

Operator
Our next question comes from the line of Jonathan Com with Robert W. Baird.

Q: I wanted to ask a little bit more about the overall trajectory of your business throughout the quarter and then into early 2018. Here I noticed in the CFO commentary towards the back, you mentioned specifically that the Q1 growth rate for sales and income should be higher than the full year. So I'm just wondering is that DTC strength you're seeing in early 2018 or is that more based on the spring commentary you've provided?

Jim Swanson – Senior Vice President and Chief Financial Officer
Jonathan, I don't have the specific details in front of me, but I think it's going to be a combination of looking at as we're shipping in the spring '18 order book currently and then the expectations that we have around the performance of the direct-to-consumer business.

Q: And then when you look to the balance of the year going back to the US wholesale projection for being up in low single-digits, I just want to ask. I know for a couple of years we've heard from a lot of the vendors that retailer are shifting some of the inventory risk back to the brand and vendors. I'm just wondering if you think that dynamic is changed at all this year relative to the past few, or just any color on the dynamic there.

Tim Boyle – President and Chief Executive Officer
Well I think there's no question that that's a pressure point for retailers, but it's been frankly ongoing for as long as I've been in the business in terms of where the inventory risk lies. That's one of the reasons we have such a strong balance sheet, is our capacity to take risks when it's appropriate— when retailers have to balance that risk with the potential of not having inventory when it's cold. So I'm not frankly seeing a tremendously changed attitude on retailers' part this year versus prior periods, but over time, that's always been a point of contention. If a retailer doesn't buy the merchandise and expects us to hold it, we're going to sell it to the retailer who wants it first. So if there's nothing left for somebody, then that's a problem with them.

Q: Last one if I could, just looking at your dividend height, pretty sizable. And I think even with that for the year you'll be less than 40% of the projected free cash flow in terms of the payout just for the dividend alone. So just wondering if your capital allocation commentary, does that imply that you will be in the market repurchasing? Or just wanted to clarify that.

Jim Swanson – Senior Vice President and CFO
Yes, Jonathan. So the dividend increase that was made, the 16% increase from $0.19 to $0.22, and then certainly the target that we've provided in terms of return of capital of 40% to 60% on a free cash flow basis, that would assume at some level that there's a share repurchase assumption built in to how we're thinking about the year. And you'll note as well as part of tax reform obviously we've got [indiscernible] flexibility around our foreign cash, and if you look at year end about half of our foreign cash was held overseas and we've made some comments with regard to bringing back a good chunk of that, approximately 200 million in the first half of the year. So share repurchases would be among the considerations that we have if we bring that cash back to the US.

Operator
Our next question comes from the line of Susan Anderson with B. Riley.

Q: So I wanted to ask a little bit about SOREL and the new spring product. I think last year was the first year that you had the new product out. How much more product do you think you'll have this year or is it going to be much bigger at all?

Tim Boyle – President and Chief Executive Officer
Yes. Actually, last year was the second year for the spring product line and it's increased fairly significantly from a dollar standpoint, but a fairly small basis. I don't believe that the line itself or the number of styles offered is significantly different. But the revenues are better improved and we expect to have a more impactful spring line, which at the end of the day is what our retailers are asking us for is the opportunity to have that product in the store year round.

In an ongoing attempt to de-winterize the brand, we've added more fall weight or winter light product in addition to the heavyweight product that SOREL's so famous for to the line. We believe that we're well on our way to making it a less winter brand than it had been in the past.

Q: Then one last question on Mountain Hardwear. Nice to hear that you feel good about the new fall '18 product. Maybe if you could give any more color on just kind of the space gains or what channel they're coming in for fall of '18. Then just the newness in the product that gives you confidence in some better performance in fall.

Tim Boyle – President and Chief Executive Officer
Certainly. Well, Joe Vernachio, who's joined the company sometime during the last nine months (I don't have the dates in front of me exactly), his vision for the brand which we completely concur in is to take it back to its roots as a truly high-end [indiscernible] brand led by really the climbing community. And he's been building out his team. I think we're very close to the final members of the team being added now— and where we have an excited singular-vision for the brand where we think that we can really launch it back to its former glory days.

The product that I've seen and that's been so exciting is a combination of the Ghost Whisperer Ultra-Light Down Jackets that they've been so famous for as well as the newer stretch-down product, which performed extremely well at retail over the last several seasons. It's a matter of just getting that product finely-tuned and getting the brand's energy back in excitement in the community. So I think we're very comfortable with Joe's leadership and we're looking forward to great things with that brand. We've seen some nice, healthy reacceptance by specialty retailers in 2018 fall.

Operator
Ladies and gentlemen, I'd like the floor back to Tim Boyle for closing comments.

Tim Boyle – President and Chief Executive Officer
Well, thank you very much for listening in. We're very excited about the potential for the business as we continue our journey on Project CONNECT. We're anxious to be talking about the great successes we'll have in the future. So thank you.

Operator
Thank you. That does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.