Nine Months Results
Analyst Conference Call
Metzingen, November 4, 2014
Mark Langer, CFO

- The spoken word shall prevail –

Good afternoon, Ladies and Gentlemen, and welcome to the presentation of our Nine Months Results 2014.

In the period, HUGO BOSS recorded solid growth in an increasingly challenging market environment. But before we dive deeper into the financials,…

…let's start with a quick recap of the undisputed highlight in the past quarter – our BOSS Womenswear fashion show in New York.

The 54th floor of the new World Trade Center offered a spectacular setting for our second appearance at the Fashion Week following the successful show in February. LED columns lit with green trees formed an effective contrast with the modernist building to pick up the theme of 'architecture meets nature' introduced with the first show.

The presentation of the Spring/Summer 2015 collection focused on elegant yet very light and fresh looks fusing the BOSS brand's strong tailoring heritage and craftsmanship with Jason Wu's sense of femininity. The collection received strong feedback from the press and relevant fashion bloggers, translating in a very satisfying order book development as well.

Previewing the show, we launched the second part of Jason Wu's film project #thisisboss. Directed by video artist Marco Brambilla, the sequence featured model Suvi Koponen in a surrealistic forest setting. Showcasing the many facets of the BOSS Woman, the film got more than half a million clicks on YouTube and helped communicating Jason's artistic vision for BOSS Womenswear very effectively.

All these activities supported brand recognition and a strong reception of the Fall/Winter 2014 collection offered in our stores and at retail partners from July onwards. Representing the first collection designed under the creative leadership of Jason Wu, it contributed to an overall currency-adjusted sales increase of 14% in our womenswear activities in the first nine months. Revenues increased at double-digit rates across own retail and wholesale.

In Europe, strong momentum in womenswear was one of the factors driving sales growth of 9% in the first nine months.

Germany and the UK were up at double-digit rates, growing by 12% and 17% respectively. In France, revenues increased by 4%, whereas sales in the Benelux markets were down 5%, primarily as a consequence of wholesale account rationalization. Among the smaller markets, Iberia and the Eastern European countries performed particularly well. While our local business in Russia grew by more than 20% currency-adjusted year-to-date, demand from Russian tourists in other parts of the region suffered from ongoing political tensions and the devaluation of the Russian ruble.

In the third quarter, the region continued to grow solidly. The overall sales increase of 8% was supported by a pick-up in wholesale as expected. However, growth momentum in retail moderated as a consequence of lower contribution from new space as well as a deceleration in like-for-likes, in particular towards the end of the period.

In the Americas, momentum improved steadily over the course the year. In the first nine months, revenues were up 6% on a currency-adjusted basis with Q3 even seeing an 11% improvement.

In the third quarter, we benefitted from an acceleration of wholesale sales development supported by a better order book as well as a strong replenishment business. In own retail, we made progress in driving performance in our Saks concession business in particular. Helped by upgrades in store design and visual merchandising in several key locations, sales were up at a double-digit rate compared to the first few months after the takeover last year.

Across retail partners, however, the market environment continues to be very promotional. Our strict stance on further limiting markdowns therefore remains a drag on top line development – something we have deliberately chosen to accept.

Let me also update you on our organizational setup in the region: Effective January 1 next year, Gerrit Rützel, currently in charge of our Asian operations, will assume leadership of the Americas. He will succeed Mark Brashear, who left the Group in May. In the meantime, CEO Claus-Dietrich Lahrs will continue to oversee the region on an interim basis.

Only fourty years old, Gerrit already looks back at a long career at HUGO BOSS. Over the last thirteen years, he held various roles in business development, sales and brand management at headquarters as well as in Central and Latin America before moving to Asia in 2011. The experience he gained in steering this region through a challenging environment as well as his excellent network throughout the Group make him the perfect choice for the position in New York.

In Asia, we will ensure management continuity by promoting Gareth Incledon, currently Head of China, to the position of President & CEO for Asia. His successor in Shanghai will be named shortly. Gareth has been with the Group now for almost ten years. Starting as a Finance Director in the UK, he had been in charge of the Scandinavian market before taking over China.

In the first nine months, Group sales in Asia increased 7% on a currency-adjusted basis. Supported by a better performance in China as well as ongoing strong momentum in Australia and Japan, the third quarter was even up 13%.

However, in China the improvement was largely due to some wholesale delivery shifts benefitting the third quarter at the expense of the second. In own retail, we saw very volatile and uneven trading patterns over the course of the quarter. After a period of several strong weeks, performance deteriorated again in September. A negative impact from the political protests in Hong Kong came on top of a broader slowdown affecting also the Mainland that had started some weeks earlier already. Again, traffic declines were the main reason behind this.

After the takeover of operations from our JV partner in China at the end of June, we have worked intensively on improving this business. While performance in the former JV operations continued to lag behind, we made important changes to the management team and achieved good progress in strengthening key operational processes.

Let’s go through the Group’s sales development by distribution channel.

In own retail, sales were up 16% on a currency-adjusted basis in the first nine months. On a comparable store basis, revenues grew 4% year-to-date and also in the third quarter. Europe was the best performing region also in this respect, recording increases above the Group average, despite a meaningful deceleration towards the end of the period. The American like-for-like was slightly positive, whereas Asia continued to suffer from a difficult trading environment in China offsetting double-digit increases in Japan and Australia.

In Asia and Europe particularly, traffic was a drag on performance. However, better conversion rates, and even more so, growing transaction sizes compensated for this. Generally, outlets performed noticeably better than full-price stores over the last few months. On the one hand, this reflects the store quality upgrades we have implemented in this channel. On the other hand, however, it also underlines the price-sensitivity of consumers in the current environment.

In the first nine months, we expanded our own retail store base by a net 18 locations.

Europe continued to be the regional focus of new openings. Out of a total of 66 openings also considering takeovers, 37 related to this region. In addition to several smaller shop-in-shop openings, including new spaces at Galeries Lafayette and Printemps in France, we opened a second own store in Russia. Located on the ground floor of the Metropolis Mall in the North Western part of Moscow, it adds to our flagship presence in Kusnetzky Most established in summer last year.

In the Americas, we strengthened our presence in the capital with a 570 square meter store in the CityCenter DC, a new neighborhood development in downtown Washington. In Asia, our store count remained stable as new additions were balanced by closures, predominantly in Australia and Japan. In the latter market, we exited eleven underperforming shop-in-shops at several department store partners. As also closures in Europe related predominantly to smaller shop-in-shops in various countries, the overall commercial impact remained limited.

In wholesale, revenues rebounded in the third quarter in line with our projections. Growth of 7% over the last three months means year-to-date sales are down 1%. The improvement was driven by several factors:

- Firstly, pre-orders were better for Fall/Winter than for Spring/Summer,
- Secondly, the short-term replenishment business, which represents around 20% of overall wholesale sales, accelerated in the third quarter,
- Thirdly, the shift of wholesale to retail sales resulting from shop-in-shop and franchise store takeovers has moderated significantly as a result of the anniversary of several bigger transactions.
- And finally, effects from a different timing of Fall collection deliveries compared to the prior year benefitted third quarter performance.

Last but not least, the license business was up 2% in the first nine months. Performance was driven by good growth in eyewear, watches and female fragrances. Here, the BOSS MA VIE scent has been off to a strong start. In the German market, for example, it was the best-selling female fragrance in September.

Moving below the top line, gross margin continued to improve. In line with our forecast, however, increases moderated recently compared to the first half year.

In the third quarter, gross margin was up 60 basis points. While channel mix effects remained supportive, the pick-up of wholesale and outlet sales just discussed meant this effect got smaller compared to previous quarters. Nonetheless, margin continued to benefit from lower markdowns as we shortened the length of the season end selling period in summer.

Year-to-date, the Group's gross margin advanced by 180 basis points to 65.3%, almost equally driven by the two factors just mentioned.

Selling and distribution expenses increased 13% in the first nine months, driven by higher own retail expenditures as well as a step-up in brand communication. Relative to sales, marketing expenses are up 70 basis points as a result. In the logistics line, migration costs and the initiation of lease payments related to the new flat-packed goods distribution center in Filderstadt more than offset the first efficiency improvements realized in the third quarter.

Administrative expenses were up 10%, negatively affected by a different phasing of costs and provisions compared to the prior year.

Taking into account special items amounting to three million euro, first nine months EBITDA margin declined by 40 basis points to 22.4%. In absolute terms, EBITDA before special items grew 4% to 423 million euro. Group EBIT increased 2% as depreciation charges were 15% above the prior year level.

Profit growth benefitted from a better financial result compared to 2013, while the Group's tax rate remained stable at 23%. Supported by lower minorities following the takeover of our Chinese JV operations in June, net income attributable to shareholders improved 5% to 258 million euro, translating into earnings per share of 3.74 euro.

Region Europe recorded a strong operating margin increase thanks to good top line momentum and healthy gross margin improvements supporting operating leverage. In the Americas, a steep increase of marketing expenditures related to our fashion show activities in New York in particular weighed on quarterly profitability. As a result, operating margin was down 30 basis points year-to-date. In Asia, margin contracted 510 basis points. While gross margin was stable, the negative comp store sales development as well as marketing- and retail expansion-related cost increases drove an operating deleverage.

Let's turn to the balance sheet.

At the end of September, trade net working capital was up 23%. Inventories increased 19% or 15% excluding currency movements. Retail expansion including takeovers was the main driver behind the increase. The age structure of inventories, however, remained at healthy levels. Nonetheless, we are working on different measures to tighten inventory management again over the next few months.

Receivables were up 10%, primarily due to the sales acceleration in our wholesale business. Finally, trade payables decreased 1%.
Investments amounted to 86 million euro in the period. This reflects a significant decrease compared to the prior year primarily as a result of the non-recurrence of expenditures related to the construction of the flat-packed goods distribution center. Own retail investments declined as well. While this reflects lower investments in new projects following a significant number of flagship openings in the prior year, renovation-related expenditures increased.

Together with the profit increase, lower investments drove higher free cash flows translating into a 16% reduction of net debt.

Ladies and Gentlemen, the Group has coped well with the prevailing economic and industry challenges. HUGO BOSS grew very solidly in a decelerating European market. We regained momentum in the Americas. And we enjoy strong growth in many Asian markets despite ongoing challenges in China.

We will not deviate from our strategy of elevating the BOSS brand because of short-term challenges inherent in the current economic and industry environment. Instead, we will continue doing what is right for the brand and will secure long-term profitable growth. This means we will continue maintaining strict pricing discipline and we will continue investing in retail and brand communication to drive consumers to our stores.

In light of the last weeks of trading in the third quarter as well as in October, we adjust our financial outlook for the full year. While we do not expect the weakness seen in September and October to persist until the end of the year, we forecast own retail growth to be visibly lower in the fourth quarter than in the third quarter.

Based on this assumption, we now expect Group sales to increase at a rate of 6% to 8% on a currency-adjusted basis. Own retail revenues will grow at a double-digit rate, whereas wholesale is expected to be stable. As a result of weaker than expected top line momentum and in light of continued retail and brand investments, we now expect EBITDA before special items to grow by 5% to 7%.

Investments will amount to around 130 million euro, primarily focused on retail expansion and refurbishments including the opening of a good 50 new stores excluding takeovers. The decline of investments compared to last year will support free cash flow generation despite higher working capital needs. As a result, we remain confident in the achievement of a net debt position around zero at year-end.

Ladies and Gentlemen, I'll now be happy to take your questions.