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HUGO BOSS Q1 2019 Analyst Conference Call

Transcript – Q&A Session

May 2, 2019

Please note that the transcript has been edited to enhance comprehensibility. Please also use the webcast replay to listen to the Q&A session on the day of earnings publication.

Andreas Inderst (Macquarie): My first question is on your full year outlook. After Q1, do you feel less or more confident to reach your full year earnings guidance given in March?

The second question is related to your EUR 5 - 6 million one-off costs in Q1 related to restructuring measures. Can you actually elaborate a bit more on that? What is behind the restructuring? Can you quantify the benefits for the rest of the year and in the medium term?

Yves Müller (CFO): I have the same confidence that I had like 6 weeks ago. I'm really confident that we will achieve our full year guidance.

Major effects were related to complexity reduction within our brand organization. Especially in sportswear, we reduced complexity within our brand management and operations teams. With this came some severance payments. This will give a relief in the cost base in the upcoming years as we reduced some headcounts.

Jürgen Kolb (Kepler Cheuvreux): On your online business and its growth of 26%. Could you please give us some details as to what drove that in terms of concession business, in terms of additional countries that you may have opened up? How is the status of your negotiations with pure-players in terms of switching to the online business?

On the U.S. business, obviously, a little bit weaker than what you expected. Would you expect to see a little bit of a turnaround here in the coming quarters? Or do you think that the U.S. business will probably stay rather weakish for the rest of the year?

Yves Müller (CFO): We improved our online sales performance by 26% in Q1, with clear double-digit growth on a like-for-like basis. In the respective markets, in which we are already operating, we clearly saw a good underlying momentum with double-digit growth – be it via our own website in those 12 countries or be it through online concessions. In addition to this, we added some concession partners in Q4 2018, and they really outperformed. We therefore more than doubled our sales via online concessions in Q1. We stay very optimistic, because in the course of the year, we will convert our BOSS business on Zalando completely from wholesale to online concession. Plus we have signed further agreements in Russia, in the Baltics and in France to convert former wholesale to concession partners. Therefore, we are fully on track.

Regarding the Americas, overall, we are guiding for low to mid-single-digit growth over the course of the year. Q1 has been really affected by a number of effects. Be aware that in Q1 2018, there were a lot of tax credits coming from the tax reform that boosted consumer discretionary spending. However, we saw a slight decline over the course of 2018. So the comparable base will get easier in the course of the year. Plus we saw a reverse effect of the negative impact from the Easter shift already this month in April.

Jürgen Kolb (Kepler Cheuvreux): Does tourism business represent a big share of your business in the U.S. market?

Yves Müller (CFO): No, it doesn’t.

Antoine Belge (HSBC): First, could you please elaborate a little bit on your performance in Mainland China – what are you seeing in terms of product mix, especially regarding formalwear vs. casualwear? Regarding pricing, do you already have the right pricing for that market?

Secondly, you had flagged many things when you published your full year 2018 results, yet there are some things that have evolved. Apparently, the U.S. market has been tougher in Q1, and also the dollar has strengthened. Yet you are still confident to achieve the high single-digit EBIT growth. So will the mitigating factor be more cost cutting in addition to the EUR 40 million that you already have to achieve for this year?

Yves Müller (CFO): Regarding Mainland China, where, on a like-for-like basis, we achieved double-digit sales growth in Q1. We were very pleased to see this growth in our strategic market China. We are convinced that we are very well positioned with a price premium of 30%-40%. We have a very good price value proposition in China, and we have clearly increased our customer base in the last year. Especially since we overtook the last franchise partners in 2015, we have clearly increased and improved our customer base.

So what’s the typical Chinese customer? One is the typical formalwear customer, who really is up to upper premium products. Just to give you an indication, as of today, roughly 8% of our Group sales are generated in Mainland China, but more than 50% of our global Made-to-Measure orders come from customers in Mainland China. So, we are very well perceived as an upper premium brand there. In addition to this, there is a customer, who is very much addicted to wearing logos in casualwear and athleisurewear. A business where we have gained many customers in China over the last years. So overall, we remain very bullish especially for Mainland China. Plus, since the VAT in China came down in April, we see that sales are developing further positively.

In comparison to last year, if the dollar remains stable, the impact from currency effects on our earnings should ease over the course of the year. We also have some positive effects from other currencies such as the Chinese renminbi or the British pound. This, overall, will ease the negative currency effect during the course of the year. That's the reason why we don't see the necessity to cut further costs.

Philipp Frey (M.M. Warburg): Firstly, could you please elaborate on the level of cost savings in terms of the EUR 160 million cost saving program? Is it fair to say that what you've realized in Q1 is well below what you expect for the full year?

Secondly, the IFRS 16 impact on net earnings looks much more dramatic than one would have expected. Can you elaborate a bit on that please? Should we annualize the Q1 impact?

Yves Müller (CFO): We are well on track with our efficiency program. We achieved what we have planned so far. Gradually, cost savings will come from the efficiency program, mainly when it comes to rental contracts, rent-to-sales, pay-to-sales and CapEx-to-sales. On the other hand, in Q1 we had some restructuring expenses. But we will see the corresponding positive cost effects in the upcoming years.

Let me remind you that our financial outlook for the full year excludes the impact from the first time adoption of IFRS16. Regarding the anticipated FY effects, we still refer to our statements in the annual report 2018. We are continuously reassessing the anticipated effects, as it's a complicated accounting issue. We will provide an update on IFRS 16 FY guide when needed. Therefore, you should not just annualize the implications of IFRS 16 on our Q1 results.

Thomas Chauvet (Citigroup): Firstly, a follow-up on e-commerce. Within the 26% online growth in Q1, what has been the exact underlying growth versus the impact of e-concessions? As you mentioned new e-concessions, can you confirm these e-concessions are captured in space contribution, i.e. non-like-for-like?

Secondly, in your earlier comments on April trend, you said LFL sales growth improved in the Americas on Easter timing. How about the Group overall? Could we get a flavor of China and Western Europe LFL and how that has held up against Q1?

One follow-up on the reporting of restructuring charges: in the past, you booked redundancy payments within your special items P&L line. Any reason why it was different this time?

Yves Müller (CFO): Let me start with the last one: As we said back in March during our full year 2018 earnings release, there will be no special items line in our P&L going forward. We abandoned it. However, just for your information, if in Q1 we had booked special items as in the past, we would have seen a mid-single-digit million-euro amount in our special items P&L line.

On current trading, regarding Easter, I already made a qualitative statement regarding the U.S. But, as you know, we usually don't comment on current trading on a quarterly basis. However, I can say that we are very confident to achieve our full year guidance.

Regarding your question on online growth: in Q1, we clearly saw positive double-digit like-for-like growth and an even higher growth in our online concessions. In FY 2018, sales generated via online concessions contributed around 10% to our own online business. Because of the conversion of our BOSS business on Zalando during the course of the year, we expect to double this to around 20% until end of 2019.

Piral Dadhania (RBC): On the phasing of marketing, as we progress through 2019: Obviously, there was a big change in Q1, up double-digit relative to a base period, which was down double-digit. How should we think about the phasing of marketing as we progress through the year, please?

Yves Müller (CFO): The strong increase in marketing expenses in Q1 was clearly a timing effect, as the Q1 2018 comp base was particularly low. So the timing effect in Q1 will mean under proportionate development for the upcoming quarters. Overall, our guidance remains the same, i.e. that marketing expenses will grow in line with our top-line.

Piral Dadhania (RBC): Let me move on to admin costs. Obviously, there were some one-offs in your admin expenses, which totaled EUR 80 million in Q1. Should we expect any further one-offs as we progress through the year or is it fair to say that most of the restructuring charges have now been taken in Q1?

Yves Müller (CFO): Yes, the restructuring expenses, especially those coming in course of the efficiency program, were done now in Q1.

Volker Bosse (Baader Bank): I would like to start with Asia/Pacific. It showed 4% of sales growth, which looks a bit shy. Mainland China was up double-digit on a comp store basis and you reported strong momentum in Japan and South Korea. So which countries have been negative and possibly not fulfilled your expectations?

Secondly, do you include your own online sales into your comp store sales figure? What would have been the figure for like-for-like excluding online sales?

Yves Müller (CFO): Starting with your first question: we include own online businesses into LFL once it is really like-for-like. In our like-for-like growth of 4% in Q1, the like-for-like online growth is therefore included. Secondly, if you would then exclude the online portion within the 4% like-for-like growth, the "physical" like-for-like of our brick-and-mortar business would have been 3%. So around 1 percentage point is the effect of online.

Regarding Asia/Pacific, yes, you are right: Japan and South Korea were good. Mainland China was good. Actually there were some store renovations and some closures in Hong Kong. Although Hong Kong overall showed low single-digit growth on a comp store basis, it was in total negative because of the store closures. For example, we closed our store in the IFC mall in 2019. And the same is true for Macau, where we see kind of a slowdown in traffic and in the quality of consumers that are coming to Macau. Plus, we are about to renovate two stores in this market as well. Therefore, both markets weighed on our performance in Asia in Q1. Australia was more or less flat.

Melanie Flouquet (JP Morgan): Could you share with us what has been the growth in the outlets compared to your full price sales? How do you see this developing over time?

My second question is on your e-concession contribution. It's very clear that you're saying, last year 10% of your online sales were based on e-concessions and they are going to contribute 20% by the end of this year. What will be the contribution in H1 2019 versus H2 2019, as I expect an acceleration in H2 2019, as you will convert the casual portion of your BOSS business on Zalando?

Yves Müller (CFO): Regarding online concessions and the respective phasing: yes, it's true, in summer, we will convert our BOSS casualwear and athleisurewear business on Zalando towards e-consession business. This is expected to drive growth strongly in H2. So, yes, there will be a phasing effect.

Regarding the development of our outlet and full-price business, both developed positively in Q1 on a like-for-like basis.

Melanie Flouquet (JP Morgan): For H1 2019, what is the percentage of online concessions within your own online business, compared to the 10% in 2018?

Yves Müller (CFO): There will be a slight improvement from 10% to “low teens”.

Melanie Flouquet (JP Morgan): So a big acceleration in H2, which means that in full year 2020, you will be on an even bigger share annualized than the 20%?

Yves Müller (CFO): Yes.

Elena Mariani (Morgan Stanley): Firstly, on your full-year guidance on EBIT. I understand that you're no longer splitting up the non-recurring items within your P&L, but you did in the past. In 2018, you had approximately EUR 13 million of non-recurring items within your OpEx. What you've said so far suggests that we're going to have only around EUR 5 million of exceptionals in 2019, which is what you've booked in Q1. So is it fair to say that there is a EUR 8 million difference that we should take into account between 2018 and 2019, when we calculate our EBIT margin progression? If this is the case, then quite a lot of your improvement in your EBIT margin is going to come from this reduction in extraordinary items. So I just wanted to clarify that we are not going to see any additional non-recurring items through the rest of the year.

Secondly, your space contribution in retail seems to be negative in Q1. Can you help me to understand why that's the case, given that you already have some benefits from these conversions? Is it the closure of the stores?

Yves Müller (CFO): Regarding space contribution: yes, we slightly decreased our selling space in Q1, because we were rightsizing stores, especially in Europe and in the U.S. This is clearly one big measure in order to improve retail sales productivity, and of course, retail efficiency as a whole to really drive profit in retail.

Regarding EBIT in 2019, we are clearly committed to show an increase in the high single-digit percentage range, coming from operational performance.

Elena Mariani (Morgan Stanley): So the high single-digit improvement would be underlying, and so we're not factoring in these non-recurring items?

Yves Müller (CFO): Yes.

Elena Mariani (Morgan Stanley): Okay, so we shouldn't take into account this potential benefit from this EUR 8 million of difference in extraordinary items that you would have between 2018 and 2019. Okay, that's very clear.

One small follow-up, please: when you gave your guidance for full year and you talked about this reacceleration in organic growth, you've mentioned three components: one is like-for-like, which should probably reaccelerate from the 4% you've had in Q1. The second is the benefit from the conversion into e-concessions, which you've kindly quantified. And the third one would be the store renovations. So these three components would allow you to get from the 1% constant currency growth you reported in Q1 to the mid-single-digit for the full year. Is it fair to say – based on what you've just disclosed – that the biggest component of this acceleration is going to be this conversion into e-concessions? Or would you say that it would be broadly balanced between like-for-like improvement, renovation of stores and e-concessions?

Yves Müller (CFO): Overall, it will be well-balanced. I think there is a little bit more improvement coming from the online concession conversion. But overall, don't over estimate different effects coming from these three components. Like-for-like performance is one big thing. Be aware that we have an easing comparison base as well in the upcoming quarters. And of course, we will have tailwind of this conversion from wholesale to online concessions. Thirdly, we have a big fall/winter and Christmas business. So in September we stop renovating stores and want them to be open. So these are the three major effects. If I would rank them, they are all very important, of course, but like-for-like is the most crucial.

John Guy (MainFirst): Firstly, when we think about trade net working capital up 8% and inventory up 9% in Q1. From an inventory perspective, that's better than what we saw in 2018, but obviously it is still high. Could you – within your guidance framework – give us some sort of indication as to where inventories need to be by the end of the year in order to reach the EUR 210 million to EUR 260 million free cash flow range that you have guided? Especially within the context of the minus EUR 60 million of free cash flow in Q1, pre-IFRS 16?

Secondly, on regional profitability, focusing on the U.S.: you've given that low to mid-single digit sales guidance for the year. I mean, you were barely break-even in profitability in the Americas in Q1. How should we read the opportunities from a profit perspective in that particular region?

Yves Müller (CFO): Clearly, we feel committed to generate free cash flow of between EUR 210 million to EUR 260 million in 2019, ex-IFRS 16. This is what we reconfirmed today. In addition, we want to sequentially bring the inventory level down. Therefore, for H1, we expect the inventory growth to further decrease. And clearly, for year-end 2019, we are aiming for an inventory decrease in comparison to 2018, as this will be clearly supportive for our free cash flow.

Regarding regional profitability: clearly, profitability especially in the U.S. has to improve. One big effect will come from store optimizations. We see tremendous potential in right-sizing our store network and in running the right business model, especially with wholesale partners, i.e. in terms of renegotiating trade terms and converting, in some cases, from wholesale to concession business. From a brand perspective, we have to upgrade our brand in the U.S. in particular, and to gradually

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reduce our outlet share in the U.S. to clearly underline our premium positioning in this market.

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