

2019 Third Quarter Results

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- The spoken word shall prevail -

Good afternoon ladies and gentlemen.

My name is Christian Stöhr, I am heading up the Investor Relations activities at HUGO BOSS and I would like to welcome you to our 2019 third quarter financial results presentation.

Today's conference call will be hosted by Mark Langer, CEO, and Yves Müller, CFO, of HUGO BOSS. As always, during the Q&A session, I kindly ask you to limit your questions to a maximum number of two, so everybody gets a chance to ask his or her questions.

And with that, let's get started and over to you, Mark.

Thank you, Christian and good afternoon ladies and gentlemen. Welcome to our third quarter results conference call. In the next 20 to 25 minutes, Yves and I will present to you our Q3 operational and financial performance before taking a closer look at our updated outlook for the full year 2019. After that, we will open the floor to your questions.

As announced already back in October, our Q3 top- and bottom-line performance came in below our own expectations. In particular, the persistent macroeconomic uncertainties increasingly weighed on consumer demand in some of our core markets, something we were not able to compensate elsewhere.

Not only did our business in the Americas experience a further deterioration in the third quarter – with a particular weakness in U.S. wholesale – also our business in Asia/Pacific saw a significant slowdown in Q3, as the turmoil in Hong Kong had a severe impact on the market and the region alike.

Consequently, the top-line performance in Q3 did not show the expected acceleration, with currency-adjusted Group sales in Q3 at the prior-year level. In euro terms, sales grew 1% to 720 million euros as currency effects continued to provide a slight tailwind to revenues.

So, let's take a closer look at the regions, starting with the Americas, where sales declined 8% on a currency-adjusted basis. As already highlighted last month, and against our expectations, the market environment in North America saw a further deterioration in the third quarter. This can be attributed to a number of challenges that all weigh on consumer sentiment in this market.

First and foremost, in the important U.S. market, where currency-adjusted sales were down 10%, the tourism spend was significantly lower as a result of the ongoing trade tensions as well as the appreciation of the U.S. dollar. Besides that, a general softness in local demand put a strain on our business. This is particularly true for the wholesale channel, for which Q3 was marked by weaker than expected order business as well as ongoing promotional activity, especially for the formalwear part of our business. Consequently, U.S. wholesale sales were down by a double-digit rate in the third quarter.

The aforementioned decline in the tourist spend also put a strain on our business in Canada, where sales were down 7% in the third quarter, reflecting declines in both channels. Finally, sales in Latin America decreased slightly in Q3, as the strong performance in Brazil was more than offset by lower sales in Mexico.

Coming to Asia/Pacific, where sales grew 2% currency-adjusted in Q3, thus below the level witnessed during the second quarter. While Mainland China once again drove regional sales growth with yet another quarter of double-digit comp store sales improvements, our business in Hong Kong has been significantly disrupted since the beginning of the demonstrations. This became particularly visible during the course of the third quarter, as we were confronted with a sharp decline in tourism, which under normal circumstances represents between 70% and 75% of our Hong Kong business. Consequently, sales in this market – which usually account for approximately 25% of Greater China revenues – were down around 50% in the third quarter.

In Macau, the store renovations we flagged earlier this year have been largely completed. In the meantime, however, the Hong Kong protests also affected our business in this

market, as the usual tourist travel pattern is a combined Hong Kong/Macau trip. In contrast, other markets of the Asia/Pacific region posted healthy growth in the third quarter – in particular Japan, where sales were up in the high single-digits in Q3.

Coming to our largest region, Europe, where sales increased 2% on a currency-adjusted and reported basis in Q3. With sales growth of 5%, the UK stood out once again, driven by strong momentum in own retail, despite ongoing uncertainties around Brexit. While our business in France continued to record positive comp store sales increases in Q3, a number of larger store optimization projects during the quarter, including the renovation of our BOSS flagship store on the Champs-Élysées, weighed on the market's overall performance.

This brings me to Germany, where currency-adjusted sales declined 5% in Q3. Both channels – wholesale and own retail – ended the quarter below the prior-year level. The latter was also affected by the transition to our new flagship outlet near our Metzingen headquarters towards the end of September, as we had to wind down the previous outlet over several weeks during Q3.

Allow me to say a few words about our biggest outlet worldwide in terms of both selling space and commercial relevance. Located in the heart of one of Europe's largest outlet cities, this new outlet offers our customers a unique shopping experience. While the product offering is clearly centered on apparel, covering all the different wearing occasions, from formalwear to casualwear and athleisure, it is also offering a broad selection of shoes and accessories. Without doubt, and starting with Q4, the new outlet will contribute to improvements in our overall retail business in Germany, and to be more precise, the non like-for-like part of it.

With this, let's move on to our channels, starting with own retail, where sales grew 3% on a currency-adjusted basis, reflecting a 2% increase in comp store sales as well as a contribution from space of around 1 percentage point. Comp store sales were up at a low single-digit rate in Europe and remained stable in the Americas, hence broadly in line with the performance seen during the second quarter. In Asia/Pacific, however, comp store sales growth slowed down to a mid-single-digit range in Q3, reflecting the aforementioned sales declines in Hong Kong. Importantly, both our brick-and-mortar business as well as our own online business contributed to comp store sales growth in the third quarter.

Momentum was particularly strong in online, where currency-adjusted sales growth re-accelerated to 36% in Q3. The performance in the quarter benefitted from robust sales increases via hugoboss.com as well as the further expansion of the concession business. The latter saw an important milestone in the third quarter as we successfully converted the vast majority of our BOSS casualwear and athleisurewear business on Zalando from wholesale to retail. The intensification of our successful partnership under the Zalando Partner Program enables us to serve customer requirements even better than before, while at the same time taking more control over the distribution of our BOSS brand in the online space. Finally, to conclude on online, the successful rollout of hugoboss.com to Scandinavia and Ireland in mid-August made initial contributions to online sales growth in Q3, albeit to a lesser extent.

Allow me to once again point out that the further expansion of our online concession business as well as the rollout of hugoboss.com to new markets will contribute first and foremost to growth of our non like-for-like business, particularly in the short term. The same is true with regard to our ongoing store optimization initiatives, which include store renovations, relocations, or rightsizings.

In particular, the rollout of our new BOSS store concept continues to play an important role when it comes to the persistent modernization of our brick and mortar store network. In the third quarter, we renovated and upgraded 10 BOSS stores, bringing the total number of stores offering the new shopping experience to a total of 68 BOSS stores worldwide. The re-opening of our BOSS flagship store on the Champs-Élysées on October 5 represents an important milestone in this regard.

Turning to the wholesale channel, where sales were down 5% on a currency-adjusted basis. While currency-adjusted revenues in Europe decreased 1% and were hence in line with expectations, sales in the Americas were down 20% on the prior year, primarily reflecting the previously mentioned weakness of the U.S. wholesale market in Q3.

From a global perspective, and similar to previous quarters, Q3 saw ongoing strong momentum with either online marketplaces or online platforms of leading department stores, up at a double-digit rate in total, while stationary retailers continued to suffer from ongoing traffic declines.

Finally, our license business grew a strong 14% in Q3, driven by improvements across all product groups. The important fragrance business particularly benefitted from the launch of “BOSS The Scent Absolute”, which was accompanied by a global marketing campaign starring model Birgit Kos and actor Jamie Dornan. In addition, our eyewear business saw strong growth in the past quarter, supported by the recent renewal of our license agreement with Safilo.

Let’s conclude on the top line with a brief review of the performance by brand. Starting with BOSS, where formalwear performed broadly in line with casualwear in Q3. However, it is important to note that the slight decline in total sales for our BOSS brand is purely attributable to the challenges experienced in North America in Q3. Elsewhere, our BOSS brand continued to enjoy robust momentum, with sales increases in both Europe and Asia/Pacific.

On the marketing side, over the last several weeks, BOSS took center stage twice in two of the world’s most important fashion metropolises: Milan and Shanghai. In September, BOSS showcased its upcoming Spring/Summer 2020 collection in Milan. Only a few weeks later, BOSS underpinned the strategic relevance of the Chinese market by presenting its Pre-Fall 2020 collection in Shanghai for the first time in seven years. The feedback on both shows and on the accompanying social media campaigns was overall very positive – thanks also to the close involvement of international bloggers and influencers.

Moving over to HUGO, where the positive trend from previous quarters continued in Q3. Currency-adjusted sales growth accelerated to 6%, representing the strongest quarterly performance for HUGO in more than two years. In line with the brand’s positioning in the contemporary fashion segment, sales in casualwear continued to grow disproportionately and were up at a strong double-digit rate. Besides ongoing strong momentum around HUGO’s logo-inspired product offering, various events as well as product and marketing campaigns focused on HUGO’s new brand ambassador – British singer Liam Payne – supported brand heat in Q3.

Ladies and gentlemen, this concludes my discussion on the top line. Let me now hand you over to Yves to guide you through the remaining P&L and balance sheet items, before I will provide you with an update on our expectations for the remainder of 2019. Yves, over to you!

Thank you Mark, and good afternoon ladies and gentlemen.

As always, let's start with the gross margin development, which increased by 80 basis points to 63.3%, mainly due to the reversal of negative inventory valuation effects. With retail growing stronger than wholesale, we also recorded a slightly positive channel mix effect in Q3. This however, was largely offset by negative currency effects. While all other factors were broadly neutral in the quarter, I would also like to highlight that markdowns have not turned into a tailwind in Q3, reflecting the ongoing promotional environment that we continue to see in some of our markets, first and foremost the U.S. All in all, the gross margin development in Q3 was thus not able to deliver the improvement we had initially expected for the quarter.

Operating expenses increased 7% or 24 million euros in Q3. While selling and distribution expenses were above the prior-year level, administration expenses declined slightly, despite some one-off expenses related to management changes. The muted top-line growth in the third quarter, together with the increase in operating expenses, resulted in a decline in EBIT and net income of 13% and 12%, respectively.

So let's take a closer look at the individual cost items, to explain what ultimately caused the increase in operating expenses.

In particular, there are four elements that resulted in the increase in operating expenses in Q3:

Firstly, higher retail costs, mainly associated with the ongoing modernization and sequential expansion of our brick-and-mortar store network over the past twelve months. This also includes higher depreciation and amortization as well as an increase in rental and payroll costs in Q3. In addition, expenses associated with the further expansion of the online concession business as well as the ongoing rollout of the hugoboss.com website globally also contributed to the increase in retail costs. Altogether, the increase amounted to a low-double-digit million euro amount.

Secondly, higher marketing expenses reflecting the various initiatives that took place in the third quarter to drive further brand momentum for both BOSS and HUGO. This includes large brand activation initiatives such as the BOSS fashion show in Milan or the HUGO brand event in Berlin, new collaborations we entered into with brand ambassadors such as

Mark Chao and Liam Payne, as well as various limited collections that were launched during the quarter, including the second edition of BOSS x Porsche. The increase related to these initiatives amounted to a mid-single-digit million euro amount. As we project brand and marketing investments to also grow in the final quarter, we now expect marketing expenses as a percentage of sales for the full year to be slightly above the prior-year level.

Thirdly, one-off expenses related to several management changes – on the executive board and regional level – amounted to a mid-single-digit million euro amount. This also includes a personnel change for our business in the Americas, where Stephan Born, currently Managing Director of our UK market, will take over responsibilities from November onwards.

Last but not least, negative currency effects due to the devaluation of the euro against major currencies also impacted operating expenses by a mid-single-digit million euro amount.

So, as you can see, ladies and gentlemen, the third quarter was, generally speaking, an opex-heavy quarter and we clearly took the decision not to cut down on brand and distribution expenses, despite the weaker than expected top-line performance in Q3. We decided to do so because we fundamentally believe that investing in our business is crucial in order to drive brand desirability in the long run.

This said, I would also like to point out that our tight overhead cost management approach in combination with our initiatives to optimize the organizational structure of our company, of which some have been implemented at the beginning of the year, have started to yield positive returns. The fact that general admin costs were kept stable in Q3, despite the already mentioned one-off costs related to management changes, is proof positive in this context.

Let's now turn to the balance sheet, starting with inventories, where we have been able to reduce inventory growth for the fourth consecutive quarter. At the end of September, currency-adjusted inventory growth amounted to 1%, despite the lower than expected sales growth in the quarter. However, let me point out that I am not satisfied yet with where we stand in terms of inventories! As we continue to put a strong emphasis on tightly managing inventories, we are confident that inventories will finish the year at around the

prior-year level. And be assured that inventory management will also remain a focus area for us in 2020, as it is our clear goal to reduce inventories in absolute terms over the coming months.

Turning quickly to trade net working capital, which – at the end of September – remained stable year on year. As a percentage of sales, trade net working capital grew 110 basis points to 20.5%.

Moving on to our free cash flow development in the first nine months. In line with our outlook for the full year, capital expenditure increased 37% to 131 million euros, reflecting the ongoing focus on optimizing our store network as well as further strengthening our IT and digital capabilities.

The increase in capital expenditure together with the decline in operating profit largely offset the improvements achieved during the course of the year when it comes to trade net working capital. As a result, free cash flow amounted to 12 million euros for the first nine months and was thus at around the prior-year level.

With this, ladies and gentlemen, let me hand you back over to Mark, who will discuss the adjusted outlook for 2019 in more detail.

Thank you, Yves. So let's change perspective and look ahead at our expectations for the remainder of the 2019 fiscal year. Against the backdrop of the persistently difficult market environment, – and as you are all aware of – we adjusted our financial outlook for 2019 on October 10.

We now expect currency-adjusted Group sales for the full year 2019 to increase at a low single-digit percentage rate. Before moving on to the bottom-line, let me give you some more color on our top-line expectations and what this means from a regional perspective.

For Europe, we forecast sales growth to accelerate in the fourth quarter. While we do not expect the underlying market environment in key European markets to change fundamentally versus most recent trends, we project that important growth stimuli will come from the non like-for-like part of our business. In particular, we expect positive effects from the successful conversion of online partners to the concession model as well as the

recent completion of large-scale retail projects. For the full year 2019, Europe is expected to deliver low to mid-single-digit growth.

For the Americas, we expect recent weakness to persist also in the final months of the year. In particular, we project that the overall weak U.S. consumer sentiment will most likely continue to lead to traffic declines as well as ongoing high promotional activity and thus also weigh on our sales performance in the fourth quarter. For the year as a whole, we therefore expect sales in the Americas to decrease in the mid- to high single-digit percentage range.

Finally, Asia/Pacific is expected to grow at a mid-single-digit rate in the full year 2019. We expect Mainland China's dynamic momentum to continue in Q4, supported by various execution measures, both in brick-and-mortar retail as well as via our online partnerships with TMall and JD. At the same time, we are mindful of the ongoing weakness in the Hong Kong market, which is expected to remain a drag on our performance for the region as a whole.

From a channel perspective, we now expect to grow retail sales in 2019 at a low to mid-single-digit rate. This outlook is based on the assumption that comp store sales will grow by a low single-digit rate. This in turn means, that we do not expect an underlying improvement in comp store sales growth in Q4 compared to the first nine months. Instead, it will be our non like-for-like business that will see an acceleration in Q4.

Let me point out two factors that will be decisive for the anticipated acceleration in non like-for-like growth in the final quarter:

- Firstly, the expansion of the concession model within our online business will push sales growth in the remaining quarter. New e-concessions, and those we initiated back in 2018, will clearly contribute to strong double-digit growth in our own online business also in Q4. As you all know, our Zalando partnership will play a key role in this regard, as Q4 2019 represents the first full quarter in which we are running the BOSS business on Zalando by ourselves.
- Secondly, we will continue with our initiatives to modernize our global store network. In recent weeks, a number of strategically important BOSS stores have been

upgraded to the new store concept and reopened on time, as the important holiday season is just about to start. Besides our flagship store on the Champs-Élysées in Paris, we also successfully completed the renovation and relocation of our Macau store at the Galaxy Hotel and the renovation of our biggest store in Singapore at Ngee Ann City. We are right on track to also finish renovations at important stores in key U.S. cities, such as Chicago, San Francisco and Atlanta in the coming days.

With this, let's move further down the P&L to complete our expectations for fiscal year 2019. Starting with our gross margin, which we expect to remain broadly stable for the full year 2019 as well as for Q4. This implies that we expect the positive effects from a more favorable channel mix in Q4 to be broadly offset by slightly higher markdowns in the Americas. Operating expenses, however, are expected to slightly improve in Q4 as we expect some operating leverage, driven by the anticipated acceleration in top line growth and the non-recurrence of last year's one-offs in a magnitude of around a high single-digit million euro amount.

As a consequence, and excluding the effects of IFRS 16, EBIT is expected to come in at a range between 330 million and 340 million euros for the full year. For net income, we expect a decline at a mid- to high single-digit percentage rate. This includes our assumption of a tax rate of around 32% for the fiscal year 2019, as the ongoing tax field audit we highlighted earlier this year is just about to be completed.

In light of the anticipated decline in net income for fiscal year 2019, allow me to also say a few words about the dividend. While it is too early to talk about the detailed implications, I would like to point out that the Managing Board of HUGO BOSS is clearly committed when it comes to the absolute dividend for 2019, as we recognize the importance of a reliable dividend for our shareholder base. As always, we will lay out all details around that with the publication of our full year 2019 results in March next year.

Ok, ladies and gentlemen, before we start with the Q&A session, let me conclude by emphasizing that we are obviously not satisfied at all with regards to the financial performance in 2019. Clearly, we had planned a different start to our mid-term strategy, which we introduced to you almost exactly one year ago.

Nevertheless, we have to accept that the underlying macroeconomic trends have deteriorated in some of our core markets. As macroeconomic uncertainties will most likely remain high in the short term, it is absolutely crucial that we remain focused when it comes to successfully executing our strategic initiatives. I am absolutely convinced that we have the right strategy in place to ensure that we further increase brand desirability in the years to come, while at the same time also structurally improving the profitability of our company. In this context, I am encouraged by the fact that despite the various challenges in Q3, all our four strategic growth drivers – Online, China, HUGO, and store productivity – continued to grow disproportionately. This is particularly evident around our online business as well as at HUGO, where growth rates have clearly accelerated in the quarter. In addition, we continue to make strong strides when it comes to gaining further relevance vis-à-vis the Chinese consumer and increasing the productivity of our store network.

But of course there is more work ahead of us, and I can assure you that together with my Board colleagues, we will tackle each and every challenge that we are facing with highest discipline, strongest focus, and utmost passion in order to be successful in the long run and to live up to your and our expectations. We fundamentally believe in the strong, untapped potential that both BOSS and HUGO have to win the consumer and ultimately become the most desirable premium fashion and lifestyle brand.

And with this, ladies and gentlemen, Yves and I are now happy to take your questions.