Annual Shareholders' Meeting 2018 – Speech

Metzingen, March 8, 2018
Mark Langer (CEO)

- The spoken word shall prevail -

Ladies and Gentlemen, as you know, the past year has been an eventful one. With that in mind, I warmly welcome you to this year's Annual Shareholders' Meeting on behalf of my fellow members of the Managing Board and the employees of HUGO BOSS. I would also like to extend an equally warm welcome to the ladies and gentlemen who are following my speech via the Internet.

When we met here a year ago, I characterized 2017 as a "year of stabilization". Our goal was to stabilize sales and profits and to implement important strategic alignments. We wanted to lay the foundation to return to sustainable and profitable growth.

Today I can tell you that we succeeded. We met our financial targets and even exceeded some of them. We also made good progress in the core areas of our strategy.

We achieved these successes in a market environment that has improved somewhat overall, but remains very challenging in some regions.

The upper premium apparel segment grew globally by around 4% in 2017. The industry development was, however, marked by substantial regional differences. Important European markets such as Great Britain, Spain and France benefited from a good business with tourists. Germany, on the other hand, experienced weak local demand. In North America, the decline in business in large department stores and the continued heavy discounting weighed on the performance of the sector. In Asia, on the other hand, the industry benefited in particular from a recovery in local demand. In China, consumer confidence has increased. This, along with the depreciation of the local currency, which shifted consumer demand towards the domestic market, had a positive impact on industry sales. The market environment in Hong Kong and Macau also improved over the course of the year.

We benefited from this slight upturn in the market, but above all from the progress made in implementing our strategy. Thus, our growth in the own retail business accelerated significantly over the course of last year. While comp store sales decreased by 3% in the first quarter of 2017, we closed the fourth quarter with growth of 7%. This was the strongest growth in a single quarter for five years.

Several factors contributed to this performance:

- We brought our online business back on track.
- We significantly changed the merchandising in our stores.
- In addition to our businesswear offering, we strengthened our focus on sporty casualwear.
- And we expanded the entry price point offering and thus refined our positioning in the premium segment.

These measures have strengthened our position in key markets.

We held up well in a challenging domestic market. Year-on-year sales remained stable. Given the general decline in the apparel retail sector, this is a remarkable performance.

We continue to be very successful in Great Britain, our second-largest European market, where, adjusted for currency effects, sales rose by 9%. As a result, it was the eighth year in a row that we saw growth in the high single-digit percentage range. Solid demand from tourists, whose willingness to buy has risen as a result of the weakness of the pound sterling, plays a role here. Even more important is the very robust local demand.

We were able to achieve a real comeback in the U.S. during the fiscal year. There was a significant increase in demand in our own stores, particularly in the second half of the year. In a difficult market environment, we achieved a better performance in our full-price business, both instore and online, than in the outlet channel. This demonstrates that we have successfully optimized processes in our own retail business. It is also proof of the resurgent strength of our brand. Total sales in the U.S. were down 1% year-on-year due to the decline in wholesale.

In China, our largest market in Asia, we were able to sustain the improvements we achieved at the end of 2016. The new pricing architecture and the strong digital focus generated further momentum in our business: Overall sales in this market were up by 8%.

Our success in the U.S. and China, two markets in which we previously faced considerable pressure, emphasizes the effectiveness of the change of course we initiated in 2016. Painful as it was, withdrawing BOSS from off-price selling in the U.S. wholesale business was the right decision. Adjusting regional pricing differences and aligning Asia closely with global price levels was also the right thing to do.

Adjusted for currency effects, consolidated sales increased by 3% overall in the past year. As a result, we outperformed our original expectations at the beginning of the year. Taking the appreciation of the euro against most other major currencies into consideration, sales in our reporting currency increased by 1% to more than EUR 2.7 billion.

On the cost side, sales and marketing expenses increased by 2%. We benefit from the fact that we now invest significantly more in renovating existing stores than in new openings and that we have successfully renegotiated lease agreements. In addition, as announced in the summer of 2016, we closed 15 loss-making stores at the end of the 2017 fiscal year.

At EUR 491 million, our operating profit – EBITDA before special items – was virtually unchanged over the prior year.

Consolidated net income grew by 19%. This significant increase was largely due to the non-recurrence of the expenditures for store closures from 2016.

The increase in consolidated net income and the very healthy development of free cash flow makes it possible for us to propose a dividend increase of 5 cents to EUR 2.65 per share today. This results in a payout ratio of 79%, a return to our dividend policy, which provides for a corridor of between 60% and 80% of consolidated net income.

We exceeded this corridor last year, as the result was significantly impacted by the closure of unprofitable stores. These were one-off effects that did not recur in fiscal year 2017.

We will continue to aim for the corridor of 60% to 80% for future dividend payments. We are convinced that dividends must be primarily based on the development of the consolidated net income.

In addition to the dividend, we naturally also want to increase value for our shareholders though increases in the share price. The HUGO BOSS share increased by 22% in 2017. It therefore outperformed the DAX and MDAX benchmark indices, which closed the year up 13% and 18%, respectively.

Investors seem to reward our operational progress and also our improved medium-term growth prospects.

Our strategy aims to return the Group to long-term profitable growth. We strive to be the most desirable fashion and lifestyle brand in the premium segment. This is our vision. In order to turn this vision into reality we have defined four strategic fields of action:

- We are realigning our brand portfolio and the positioning of our BOSS and HUGO brands.
- Based on this two brand strategy, we are further developing our distribution strategy.
- We are driving forward the digital transformation of our business model.
- Finally, we want to make important business processes faster and more agile. Moreover, we want to promote entrepreneurial thinking and actions of our employees. So it is also about a change in corporate culture.

We made great progress last year in this strategic realignment process. Let me show you how things look in each area.

The core element of our new brand strategy is the clear focus on two strong brands, BOSS and HUGO. As part of this, we have integrated the BOSS Green and BOSS Orange brand lines into the BOSS core brand and, in doing so, have simplified our brand portfolio.

Both brands – BOSS and HUGO – share core HUGO BOSS attributes, such as premium quality, perfect fit, innovation and sustainability. Nonetheless, both brands are characterized by individual attributes and each targets a clearly defined customer group.

With our BOSS brand, we are targeting status-oriented, rationally-minded customers who wish to dress in a classic yet modern and high-quality style. The BOSS customer has exacting standards when it comes to quality and attaches great importance to an advantageous value-for-money proposition.

In contrast to BOSS, HUGO is targeting a customer who is significantly more fashion-conscious and considers his style of dress to be an important element in expressing his personality. The HUGO customer is open-minded, individual and likes to shop, doing so via online and mobile channels.

The first collections designed in accordance with the new brand strategy have been in stores since the end of 2017. We are very satisfied with the sales of the collections, as the first quarter results published yesterday underline. The feedback on the collections that will be released later in the year is also very positive.

We presented the Fall/Winter 2018 collection of BOSS Menswear, entitled “sports tailoring” at the New York Fashion Week at the beginning of February. The collection was very well received by the fashion press. In particular, it highlighted the clear statement made by the collection, which skillfully combines the formal core brand with a sporty, casual look.

Only a few days later, we presented the BOSS womenswear collection also as part of the New York Fashion Week. The audience were expecting a scaled-back presentation that put more emphasis on the looks.

The event also marked the end of Jason Wu’s role as artistic director of BOSS Womenswear. Under his responsibility, BOSS Womenswear has made significant progress over the past years. Above all, the runway collections, representing the high fashion end of the collections, attracted more attention because of him. The creative team will continue its work under the direction of Ingo Wilts, our Managing Board member responsible for creative and brand management. In the future, the focus will be on making the commercial retail collections more fashionable. We will align the statement of these collections more closely with our menswear to express the unique DNA of the BOSS brand also in our womenswear collections.

2017 was also a milestone for HUGO.

HUGO appeals to customers who pursue a very individual lifestyle. HUGO celebrates this lifestyle – cosmopolitan, always curious and authentic in style.

The collection we presented in Florence in June 2017 expressed this message powerfully. A former factory building was the perfect venue to showcase the Spring/Summer 2018 collection. It features a progressive, unconventional brand look that combines our core competencies with respect to quality, innovation and fit with the non-conformity that characterizes the HUGO brand.

We will build upon this consistent alignment of HUGO this summer. At the beginning of July, we will showcase HUGO with a big show during the Berlin Fashion Week. With its creative, vibrant scene, Berlin is the perfect fit for HUGO. The city is therefore the ideal stage on which to make a statement in our domestic market.

The realignment of our brands has given us the best prerequisites to further improve the performance of our own retail business. In the past year, we increased sales productivity, i.e. the turnover we generate per square meter of retail space each year, by 2% to EUR 11,100. Our target remains EUR 13,000 per square meter by 2021.

How do we intend to achieve this ambitious goal?

First, we will be expanding the BOSS casualwear offerings in our stores over the next twelve months, thereby benefiting from the significant enhancement of the previous BOSS Orange offering. We have significantly increased the quality of the materials used and also invested in the finishing. That means that we can now boast of a first-class price-performance ratio. The Spring/Summer 2018 collection reflects these changes for the first time and has been available for sale since January.

We are convinced that the expansion of the casualwear offering will have a positive impact on customer footfall in our stores.

Second, we are introducing a new store concept for BOSS. The stores will be much lighter and inviting. They will also be more functional. Styles and sizes not on display are instantly available in drawers and hidden shelves. In addition, the store is connected to the online world via various digital elements. This will enable our sales staff to offer customers products that are not available in the store.

In the past year, we tested this concept in three pilot stores. The results were very positive. The new concept will hence be introduced in all stores that we will open or renovate this year.

We will also use the new store concept for the new construction of our flagship outlet in Metzingen. This outlet will act as the benchmark for the future design of this kind of stores globally. We will take customers on a journey, offering them a unique brand and shopping experience with over 5,000 m^2 of sales space. The structure of the building facilitates the rapid supply of goods. Over 100 staff will be employed here in future.

With an investment well into the double-digit million euro range, the new building is also a clear commitment to Metzingen. I am also pleased that the future address of our outlet will be HUGO BOSS Square. The groundbreaking ceremony took place at the beginning of April and the opening is scheduled for fall 2019.

Third, we have invested in our service. My fellow board members and I met with some of our long-time customers for fireside chats in Hamburg and London. Many of them emphasized that their relationship with individual members of our sales staff plays a key role in choosing our brand. That’s why we invest in the intensive training of our sales staff, as well as in the personalization of our customers’ entire shopping experience.

This starts with communication. We will strongly align our newsletters to our customers based on their personal preferences. Our website hugoboss.com is also being personalized. For example, it adapts the selected product highlights on the start page to visitors’ navigation history.

Finally, we will be introducing the full range of omnichannel services in all of our European online markets by the middle of this year.

These services include “Click & Collect”, the in-store collection of goods ordered online, “Order from Store”, the online ordering of items in the store, and “Return in Store”, the in-store return of goods ordered online. These services will be introduced with the new store concept, which includes the installation of digital tables and mirrors that can also be used as screens. This gives our sales staff and customers access to the complete online offering. All of our stores in the U.S. already offer “Click & Collect”. The remaining omnichannel services will be available there latest by the end of the year.

The purchasing behavior of our customers will continue to change. They will increasingly use digital services to find out about fashion trends, experience our collections and engage in dialog with our brands. This won’t, however, make bricks-and mortar retail superfluous. On the contrary, our stores will continue to be the most important point of contact with our customers, the place where we offer them the chance to get to know our collections and receive expert advice, and also to try on our products. In other words, online and offline are complementary. The services we have discussed will link these two worlds ever more closely together.

In our online business, we have carried the momentum that we unleashed in our online business at the end of last year into the new year.

In mid-March we upgraded the hugoboss.com website to reflect the two brand focus. Structure and layout of the website clearly differentiate the two brand worlds of BOSS and HUGO. Customers with a preference for one of the two brands can directly access the homepages of BOSS and HUGO via the links boss.com and hugo.com. We have, however, also ensured that customers without a clear brand preference can browse through the entire product offering and are able to easily jump from one brand world to the other.

Of course, we will also enhance the presentation of BOSS and HUGO on our partners’ websites. In the future, this could mean that we take control over these websites via concessions businesses. Where this is neither possible nor economical, we will ensure the greatest possible congruence with our own standards.

Digitization is, of course, not just about distribution. We will digitize key operational processes along the entire value chain and will hence increase our efficiency.

One example: we will present HUGO's first digitally designed collection in the late summer of this year. It is composed of a variety of casual wear styles and is being developed using virtual prototypes. We will make such collections a regular part of the HUGO offering. Thanks to the significantly shorter development process, we will be able to create new collections at regular intervals – a decisive competitive advantage in today's fashion world.

Such a collection is distributed primarily via the internet. This holds true even for HUGO's wholesale business. Our wholesale partners in Germany, France and the U.K. already have the opportunity to order the HUGO collections digitally. A table-sized touch screen, which digitally presents the entire collection, including all of the color and style options, increasingly replaces the traditional form of selling, where the collection is presented to trading partners in the form of expensively produced samples.

By the end of this year, we will have taken the first steps to implement the digital showroom for the BOSS brand as well.

My comments make it clear that the importance of the HUGO brand in our group exceeds its purely commercial significance. HUGO plays a pioneering role within our company in many areas, with digitization being just one example. HUGO benefits from its relatively small size and thus its greater flexibility and responsiveness. The brand offers us the ability to implement and test innovations quickly. If these innovations prove successful, we can carry them over to the much larger BOSS brand with a high probability of success.

We do not only want to become faster and more flexible. We also want to systematically enhance our sustainability activities in order to further increase confidence in the company and its brands.

We were included in the Dow Jones Sustainability Index for the first time last September. The Dow Jones is one of the best-known sustainability-related equity indices and comprises the world's leading companies in this field. We are one of only five companies in our segment to qualify for inclusion in the index.

We attach great importance to the dialog with our stakeholders. The dialog provides us with important input on how to further develop our sustainability strategy. That is why we held a second Bad Urach stakeholder dialog in 2017 and exchanged views with around 25 external participants. One of our stakeholders' requests was for us to disclose a list of all our finished goods suppliers and the associated manufacturing facilities. We have complied with this request and have published this information transparently on our website. Since last week, you also find our latest sustainability report on our website in which we report on our efforts, the achieved successes and the remaining challenges.

Our collaboration in alliances also fosters dialog with our stakeholders.. For example, HUGO BOSS has been a member of the Fair Labor Association (FLA) since February. The accreditation is the fruit of the company's commitment to fair working conditions in recent years. We will, of course, continue to engage in this area, both within the FLA and also in other formats, such as the Sustainable Textiles Alliance and its Tamil Nadu initiative, which seeks to improve the standards of textile production in India.

Our customers experience sustainability first and foremost in our products. That is why we work intensively on the development of sustainable materials. In doing so, we rely on innovation. For the first time ever we have been selling shoes made of exclusively vegan materials in selected stores and online since the beginning of May. A new production process uses pineapple leaves to produce a material that is an alternative to leather. Its laces are made of pure biological cotton and its sole consists of recycled plastic.

We also want to increase the use of sustainable materials in the breadth of our collection. We primarily focus on cotton, the most important textile fiber for HUGO BOSS. By 2020, we expect half of the cotton we use to come from sustainable sources. By 2025, this share should have increased to 80%.

In addition, we also pursue the idea of sustainability in our sponsoring activities. Since December we have been the first official clothing partner of the purely electric motor sport series Formula E. The Formula E races take place right in the centers of major cities such as Hong Kong, Rome and Paris. This means that they offer exceptional racing experiences and a perfect platform for presenting innovative and sustainable propulsion technologies.

Ladies and gentlemen, we take sustainability very seriously and are pleased that this is also perceived by the public.

In conclusion, let me address our expectations for the current financial year.

We expect our sales growth to accelerate as compared to 2017. On a currency-neutral basis, sales should grow in the low to mid single-digit percentage range. All regions and sales channels are expected to contribute to this growth. From a regional perspective, we expect the largest growth in Asia, while if we look at distribution channels, the increases in the Group's own retail business will exceed those of the wholesale business. We expect mid single-digit percentage growth in existing retail space. This includes the online business for which we anticipate double-digit growth.

Operating profit before special items is expected to develop within a range of -2% to +2% compared to the prior year. This forecast takes into account negative currency effects of some EUR 10 million.

The Group’s net income should increase in the low- to mid-single-digit percentage range. The consolidated net income will benefit from a normalization of the Group’s tax rate at 26%. The tax rate in the past year was 30%, due to the revaluation of deferred tax assets in the U.S.

The first quarter results published yesterday show that we are on track to reach these goals.

Currency-adjusted sales were up 5%. However, the appreciation of the euro meant that performance in the Group’s reporting currency was weaker. On this basis, sales remained stable at EUR 650 million. In the Group’s own retail business, the positive momentum of the fourth quarter continued. Adjusted for currency effects, sales in this distribution channel increased by 8% in the first three months. On a like-for-like basis, the currency-adjusted sales growth was 7%, unchanged from of the fourth quarter. Currency-adjusted sales in the wholesale business rose by 1%.

All regions contributed towards growth in sales. In Asia/Pacific, sales were up 12% on a currency-adjusted basis, primarily supported by continued growth in China. In the Americas, currency-adjusted sales were up 7% year on year. This was mainly due to the U.S. market, where we continued our recovery and were once again able to record double-digit growth rates in the Group’s own retail business. In Europe, the overall market environment remains difficult. Nonetheless, the region was up 3% on a currency-adjusted basis.

The gross margin declined by 40 basis points in the first quarter. Investments in the product quality were the main reason for this. This was only partially offset by positive effects from the increasing share in sales of the Group’s own retail business. Operating profit was up 1% and consolidated net income was up 3%.

Allow me to summarize.

We have made great strides in the strategic realignment of HUGO BOSS. The sales development during the past year has made us even more confident that the realignment of our two brands BOSS and HUGO is on the right track. Our confidence is affirmed by the initial sales data for the new collections and our wholesale partners' feedback regarding our Fall/Winter collection.

On behalf of the entire Managing Board, I would therefore like to use the review of what has been achieved with a sincere thanks to our employees. You all have every reason to be proud of yourselves and your work!

We won't be resting on our laurels, of course. We have identified further drivers of continued growth that will come to fruition in this year and beyond. This includes the further development of our collections in line with the brand strategy as well as the optimization of our retail processes, both online and offline.

These measures entail further investment, which, in tandem with negative currency effects, will limit earnings growth this year. However, I would like to stress here that these investments will enable our brands to make further progress. Nonetheless, it is plain that the financing of these investments must come from improvements in efficiency elsewhere. I am sure that we will achieve both and thus ensure sustained and profitable growth in the 2019 fiscal year and beyond.

Ladies and Gentlemen, I would like to thank you for your loyalty and would like to combine my thanks with the hope that you will continue to accompany us on our future journey. We will do our best to justify the trust that you have placed in us.

Thank you for your attention.