Half Year Results 2014
Analyst Conference Call
Metzingen, July 31, 2014

– The spoken word shall prevail –

Good afternoon, Ladies and Gentlemen,…

…and welcome to the presentation of our First Half Year Results 2014.

In the first part of our presentation, I'll go through our set of financial results, the trends we are seeing in the different regions and our financial outlook. Afterwards, I'll hand over the call to our CEO, Claus-Dietrich Lahrs. Although he is travelling at the moment, he'll be pleased to update you on the progress we are making with a number of strategic initiatives presented earlier this year.

But first, let's start with a recap of the first six months.

HUGO BOSS achieved a very solid financial performance year-to-date. Supported by accelerating top and bottom line growth in the second quarter, first half year Group sales increased 7% on a currency-adjusted basis. Currency translation effects, however, had a negative impact. In euro terms, revenues were up 4% and reached almost 1.2 billion euro. Operating profit advanced 3% to 242 million euro.

In the first half year, all regions contributed to revenue growth.

Europe was a clear area of strength. Sales were up 9%, driven by increases across almost all markets. The UK continued to develop particularly strong with an increase of 21%. We also recorded good growth in Germany and France, up 8% and 6%, respectively. The Benelux were down as a result of some account rationalization in wholesale as well as difficult trading in own retail. Among the smaller markets, Iberia was the standout performer, recording strong double-digit growth.

While an overall more positive economic climate and the industry's recovery from prior year losses supported our performance, our success is primarily explained by further improvements in the quality of our retail execution.

Let me give you a few examples in this respect:

- CRM activities have become more sophisticated and more effective as we cover an increasingly bigger share of our customer base.
- We have fine-tuned our offering in smaller shop-in-shops taken over from department store partners, strongly driving sales productivity in Spain, for example.
- We have enhanced the clarity of our offering in larger stores by focusing on our core BOSS brand even more strongly.
- We have established a model store concept to maximize the quality of the merchandise presentation.

- Finally, we have put a high focus on retail training, making sure service quality adheres to our brand promise.

As a result, we were able to offset declining traffic levels with better conversion rates and growing transaction values. We are confident Europe will be a strong region for HUGO BOSS also going forward, although the comparison base from the prior year is going to become somewhat more difficult in the second half year.

Performance in the Americas accelerated over the course of the period for a half year sales increase of 3%. While we are encouraged by this pickup, we acknowledge the market is not back to normal yet. Weaker than expected consumer demand since the end of last year has resulted in low sell-throughs and inventory pressure among many retail partners fuelling intense promotional activity. This is still visible at retail today.

In this environment, we have opted to maintain strict pricing discipline. The extension of brand control in particular also in multi-brand environments has been the key to this. At Saks, the concession business model introduced a year ago allows us to effectively communicate our overall brand proposition rather than to compete purely on price. Over the course of the second quarter, we improved performance in this business as we implemented a number of measures to optimize merchandise selection and availability. In the next two months, we will also refurbish another nine shop-in-shops for which renovation had been put on hold following the change of ownership at Saks.

In 2014 again, the Americas will be an important contributor to Group sales and profit growth. The recent change in leadership presents a chance for the entire regional team to bring in fresh new ideas to exploit HUGO BOSS' full strength. Until a new Regional Director has been named, CEO Claus-Dietrich Lahrs will continue to hold direct responsibility for the Americas.

Revenues in Asia were up 4% in currency-adjusted terms, driven by robust growth in Australia and the region's smaller markets. Our Japanese business grew 4% excluding currency effects despite a temporary slowdown post the VAT increase in April and the closure of several smaller shop-in-shops no longer in line with our overall brand proposition.

Sales in China, however, declined 2%. This primarily reflects a weaker performance on the Mainland, where in particular revenues of our joint venture operations were down at a double-digit rate. In Hong Kong, however, we recorded a positive sales development, in the second quarter as well as year-to-date.

We expect the overall Chinese market situation to remain challenging in the short and medium term. The public clampdown on corruption has not only resulted in a significant deterioration of our gifting business. It also has a profound influence on sentiment of our key target customer group of entrepreneurs and men working in senior management positions. Coupled with a visible oversupply of retail space not meeting sufficient demand at the moment, the impact on traffic continues to be severe. While declines are moderating compared to the prior year, the number of mall visitors and, as a result, also the number of customers visiting our stores continues to be down at a double-digit rate in many places.

Although there is no short-term change in market trends in sight, we are confident in our strategy. One important element is strengthening consumer perception in clothing. Our Art of Tailoring exhibition, which has started touring prime luxury malls such as Plaza 66 in Shanghai or Mix-C in Shenzhen, has already proven effective in sharpening our appeal as a fashionable, truly European suiting brand. This was reflected in an uptick of clothing sales in all exhibition locations so far.

The introduction of our Made-to-Measure offering available in Hong Kong, Shanghai and Beijing since April serves the same purpose. Supported by an integrated cross-channel campaign including a special event with British Formula One driver Jenson Button, we created good demand for this concept and an important halo effect for the overall brand.

Taking full control of the business in key markets is a cornerstone of our strategy. That's why it was a logical step to acquire the remaining 40% equity stake in the joint venture with our long-standing franchise partner Rainbow Group in China and Macau, effective June 30.

As a reminder, we founded the joint venture in 2010, replacing the franchise model we had worked with before. While the cooperation with Rainbow has facilitated forging close ties with the real estate community and building deep local market insights, we have witnessed a widening performance gap between the 55 stores operated by the JV and the remaining almost 60 stores on the Chinese Mainland fully controlled by us. This is a clear indication of the success we have had in building retail sophistication and a strong operational platform, now allowing us to take over the business much earlier than we had originally expected.

We are confident that the consolidation of our distribution activities will further elevate the quality of brand presentation and increase productivity in a market offering tremendous opportunities for HUGO BOSS going forward.

Given that the joint venture entities had been fully included in the consolidated financial statements since 2010, the immediate impact on Group results will be limited to the cash outflow reflecting the purchase price payment and the profit line, where net income attributable to minority shareholders will decline to virtually zero from the third quarter onwards.

By distribution channel, we are pleased with our performance in the channel that we have made core to our current and future strategy – own retail. First half year own retail revenues were up 18% on a currency-adjusted basis. This was due to healthy comp store sales growth as well as space expansion.

On a comparable store basis, revenues grew 5% in the first half year and 4% in the second quarter. Europe continued to be the best performing region, recording increases above the Group average. While the Americas returned to growth after a weaker start to the year, Asia suffered from a more difficult trading in China and a moderation of growth in Japan in the second quarter.

In many markets, traffic continued to be a drag on performance. However, better conversion rates, an increase of units per transaction as well as a more premium price mix more than compensated for this.

Wholesale sales decreased by 6% excluding currency effects in the first half year as well as the second quarter. Several factors impacted this development:

- Firstly, the pre-order business was down, reflecting cautious ordering by customers in the second half of 2013.
- Secondly, the short-term replenishment business, which represents around 20% of overall wholesale sales, developed below expectations, in particular in the second quarter.
- Thirdly, the revenue shift from shop-in-shop and franchise store takeovers accounted for around two percentage points of the overall decline.
- And finally, effects from a different timing of deliveries compared to the prior year hurt second quarter performance but will benefit Q3.

Last but not least, the licensed business declined marginally in the first six months as double-digit growth in female fragrances and the smaller watch category were not enough to fully offset declines in the men's fragrance business.

Moving below the top line, gross margin strength continues to be the main driver of earnings improvements, reflecting the ongoing transition of the Group's business model towards own retail.

Year-to-date, the Group's gross margin advanced by 260 basis points to 66.0%. A positive distribution channel mix owing to the above average growth of own retail as well as a further reduction of markdowns compared to the prior year mainly contributed to this development. Both factors were approximately equally sized.

In the second quarter, the pace of margin improvement moderated as expected. Nonetheless, in addition to channel mix effects, we benefitted from lower markdowns again, although the comparison base had become significantly more difficult in this respect from Q1 to Q2.

Selling and distribution expenses increased 13%, primarily driven by higher own retail expenditures as a result of expansion and takeovers. In addition, marketing expenditures were up at a double-digit rate. Relative to these two effects, additional costs from the migration of the flat-packed goods distribution activities to the new center in Filderstadt only had a minor effect.

Administrative expenses were up 5%, reflecting good discipline in overhead cost management.

As higher costs offset the gross margin improvement, first half year operating margin declined by 20 basis points to 20.6%. In absolute terms, EBITDA before special items grew 3% to 242 million euro. Group EBIT increased 3% as well, even though depreciation charges were 13% above the prior year level.

Profit growth benefitted from a better financial result compared to 2013. Net financial expenditures more than halved as we utilized a smaller portion of available credit facilities and minimized the effect from exchange rate movements.

The Group's tax rate remained stable at 23%, so that net income attributable to shareholders improved 7% to 143 million euro, translating into earnings per share of 2.07 euro.

In the first half year, operating profit development differed meaningfully by region.

In our largest region, Europe, margin expanded slightly as gross margin improvements offset retail expansion-related cost increases. In the Americas, profitability benefitted from strict pricing discipline. As a result, operating margin was up 220 basis points. In Asia, however, margin contracted by 600 basis points. While gross margin was up also in this region, the negative sales development as well as marketing- and retail-related cost increases drove an operating deleverage.

Let's turn to the balance sheet.

At the end of June, trade net working capital was up 10%. Inventories increased 12%. In addition to the effects from retail expansion and takeovers, the delivery shift in wholesale, where a larger portion of the Fall collection will be shipped only in the third quarter, impacted inventory growth. In light of the healthy ageing structure and declining write down quotas as well, we hence remain comfortable with overall stock levels.

Receivables were down 8%, primarily due to the declines in our wholesale business. Finally, trade payables decreased 3%.

Investments amounted to 52 million euro in the period. At 40 million euro, own retail expansion and renovation accounted for the lion's share of capex. Compared to 2013, investments declined by 37% or 30 million euro, primarily reflecting the non-recurrence of expenditures related to the construction of the flat-packed goods distribution center.

Together with the profit increase, this drove higher free cash flows translating into a further reduction of net debt.

Ladies and Gentlemen, in light of first half year financial results development and the visibility we have on the rest of the year, we reconfirm our full year guidance.

We are confident Group sales will increase at a high single-digit rate on a currency-adjusted basis. Own retail will continue to generate double-digit growth driven by healthy like-for-like increases and the contribution from new space. Going forward, we expect the latter effect to moderate compared to first half year levels as a result of the anniversary of several bigger takeovers and store openings in the second half of 2013. However, this effect will be partly compensated by new store openings, which we now forecast to amount to around 50 even on a net basis.

Wholesale sales will be stimulated by the positive reception of the Fall collection. Based on the good visibility the order book provides, we are confident we will compensate first half year declines in this channel for an approximately stable development in the full year.

The expected wholesale sales pickup will also be supportive to the Group's operating profit growth which we forecast to amount to a high single-digit rate. Gross profit margin will continue to drive this development, primarily due to the positive channel mix effect. With gross margin improvements offset by rising own retail and marketing expenditures, we continue to expect an approximately stable operating margin in the full year.

Finally, we remain confident in the achievement of a positive net cash position at the end of the year, even though the cash outflow related to the JV takeover has rendered this target more ambitious compared to original expectations. Good profit growth, disciplined working capital management and value-enhancing investments amounting to between 110 and 130 million euro will remain the foundation of strong free cash flow generation.

Let me now hand over to Claus-Dietrich Lahrs. Claus…

Thank you, Mark, and good afternoon, Ladies and Gentlemen.

At our analyst conference in March, we introduced several new initiatives in the different elements of our growth strategy. Now that we are half way through the year, I would like to update you on our progress in implementing them.

One of the key initiatives on the "brand" side of our business is our sharpened focus on womenswear.

Here, we are very satisfied with the momentum that has built around the arrival of Jason Wu as Artistic Director for BOSS Woman and his first collection presentations. As a result, womenswear sales are up 15% year-to-date even though the BOSS Woman Fall collection, the first collection designed by Jason, hit the stores only just before the end of the quarter. Many of the customers we have seen in the first half year have made contact with the BOSS brand for the first time, underlining the awareness and curiosity we have created.

Momentum is clearly building further as global PR coverage continues to increase. To just mention one of the most prominent examples, Diane Kruger dressed in a BOSS outfit made the cover story of the July Vogue in Germany as a true eye-catcher. Other titles where we took the cover page and featured prominently also in the editorial part included Harper's Bazaar, British ELLE and W in the US.

Needless to say, we remain very confident in our expectation of double-digit growth in womenswear this year and its positive contribution to store productivity and profitability. However, it would be short-sighted to look at this business from just a quarterly perspective. We are committed to building womenswear into a sustainable competitive strength, ensuring its health and profitability in the long term. In this respect, the womenswear build will stretch far beyond the current year.

Our next appearance at the New York Fashion Week will shift focus to 2015 already. On September 10, we will present the BOSS Woman Spring collection.

After our successful and much regarded debut in February, our ambitions are equally high this time. Again, we will execute a comprehensive social media-driven campaign to activate friends, followers and consumers around the world and emotionalise them for our product. While we won't give away any details beforehand, the collection will revolve around Jason Wu's key theme – the feminine interpretation of modern business.

In line with this proposition, we have just launched the BOSS Ma Vie fragrance. Building on our success with the other launches over the past two years, US-actress Gwyneth Paltrow is the face of the campaign again. Initial sell-in results are very promising, so that we expect the scent to develop into a major driver of our female fragrance business. Supported by the buzz around our core apparel offering, this business is up at a strong double-digit rate year-to-date.

The essence of BOSS Woman is captured more closely than ever before in the current Fall/Winter campaign, shot by famous artists Inez & Vinoodh in New York.

The fusion of sophistication and femininity with the clarity and precision grounded in our menswear heritage is not only visible in the collection. It is also reflected in the artistic appeal of the campaign, portraying top model Edi Campbell as a confident, yet very feminine and sensual woman, perfectly showcasing the DNA of BOSS Woman.

We have also made sure to emphasize the link between menswear and womenswear in the look-and-feel of the campaigns. Scott Eastwood, youngest son of American actor Clint Eastwood, is the new face of the BOSS Fall/Winter campaign. The black and white aesthetics capture his natural and engaging charisma as well as the sophisticated simplicity of BOSS Menswear.

While we invest more in advertising in 2014, sport sponsoring continues to play an important role in our marketing tool box as well.

HUGO BOSS has been the official outfitter of the German National Football Team since June last year, supplementing our key sport sponsoring activities in golfing, sailing and Formula One. Germany's World Cup win means we have chosen the best partner at the right time. Top to toe in HUGO BOSS, the team looked like champions both on and off the pitch. And Jogi Löw and his coaching team not only won the title dressed in Made-to-Measure suits but also topped all fashion rankings – true style and success beyond the game.

With a comprehensive social media campaign, we exploited the sponsorship very effectively, achieving unprecedented reach and consumer awareness far beyond Germany. While the immediate value of this is difficult to measure by definition, we made clear once again that HUGO BOSS is all about success – the attribute consumers associate most with the brand.

Speaking of success, we also celebrated the spectacular Players Championship and US Open wins with Martin Kaymer, one of our key testimonials in golf. In the US, Martin dominated the competition from start to finish, dressed in four different BOSS Green outfits that allowed him to keep cool even in blazing heat.

You might have realized that the German National Football Team as well as Martin Kaymer are both sponsored by carmaker Mercedes-Benz as well. And there are more touch points: while we are championing motor sports, for example, Mercedes-Benz supports fashion platforms in 26 countries.

Given the similarities in our brands' positioning and values, it has been a logical decision to further deepen our relationship. As a result, we have entered into an international cooperation in the area of marketing and communication, enabling both brands to tap synergies when addressing shared target groups in the premium and luxury segments. The arrangement entails the exclusive leveraging of the partners' products in selected marketing and communication initiatives. These include for example productions for print and TV campaigns and the various social media channels. The two partners will also continue to join forces for events and sponsorship activities- expect to hear more on concrete projects shortly.

Switching to the second pillar of our growth strategy, retail, let's take a look at our most recent expansion activities.

Openings in the quarter reflect the growing importance of travel retail for HUGO BOSS. In light of our global brand appeal as well as the strong overall expansion of this distribution channel, we are increasingly managing airport locations ourselves rather than through franchise. In doing so, we benefit from our dedicated expertise in fashion retailing giving us a competitive edge over many more broadly diversified players in this market.

During the second quarter, we established own stores at Hong Kong Airport, where we secured a prime location in Terminal 1 in a highly competitive tender process, London Heathrow Terminal 2, Madrid and Milan Linate. At Copenhagen Airport, we took over an existing location from a franchise partner.

In total, we opened 37 stores and shop-in-shops in the first half year. Region Europe accounted for roughly two thirds of this, including several shop-in-shops opened with department store partners such as Printemps and Galeries Lafayette in France and House of Fraser in the UK. An additional 14 takeovers related primarily to the introduction of the concession business at David Jones in Australia.

Net of 33 closures across various different markets, the number of own retail stores operated by HUGO BOSS increased to 1,028 at the end of June.

Beyond our physical retail activities, we put high emphasis on driving our digital strategy.

Our current focus is on integrating commerce and content on hugoboss.com more closely than this has been the case in the past, offering an engaging, entertaining and intuitive gateway to HUGO BOSS in all its facets.

The first step we have now made by launching our own online store frontend. Previously, the technical lead for the store's platform infrastructure had been with our fulfilment partner. In addition to much faster loading times, the insourcing has given us increased control over product merchandising and editorial content, supporting an immediate uplift in the quality of presentation through a cleaner, puristic, slightly re-arranged design – have a look at our eCom store at hugoboss.com yourself.

As a second and next step, we will relaunch the hugoboss.com starting page and overall architecture to eliminate the artificial differentiation between product content on the one hand and brand content on the other. In doing so, we adapt to the diverse and ever changing needs of our consumers spanning information, entertainment, inspiration and the ability to find just one specific product. Expect this step to be completed by the end of the year.

In sum, our physical retailing as well as our digital strategy will drive the quality and consistency of our global brand presentation - something that is at the heart of our global growth ambitions forming the third pillar of our growth strategy.

As Mark Langer has already gone through our regions in much detail, let me jump directly to operations, the final pillar of our growth strategy.

At the beginning of July, we formally opened our new flat-packed goods distribution center in Filderstadt, close to company headquarters in Germany. The high rack warehouse in particular, offering more than 400,000 storage places served by a fully automated shuttle system, makes the facility the most modern of its kind in the European apparel industry. After a period of intensive testing and the subsequent ramp-up, the new center is fully operational now. As a result, we discontinued operations in the two old facilities – one we exited completely, for the other we are considering alternative forms of usage at the moment.

The advantages of the new setup in terms of speed-to-market and lower handling costs will start to come through in the second half of 2014. However, at the same time, we will also incur the first operating lease payments, so that the net financial effect on Group results will be limited in the current year. As a key enabler of our retail-driven strategy, the full benefits of the new set up will then unfold in 2015 and beyond, both strategically as well as from a pure financial point of view.

Thank you for having joined our call today. We look forward to speaking with you again on November 4, when we will publish Nine Months Results. Please also save the date for this year's Investor Day in Paris which will take place on November 19. Have a good afternoon!