HUGO BOSS First Quarter Results 2017

Metzingen, May 3, 2017
Mark Langer (CEO)

- The spoken word shall prevail –

Good afternoon, Ladies and Gentlemen, and welcome to the presentation of our First Quarter Results 2017.

HUGO BOSS had a solid start to 2017. In a volatile and in many parts of the world still declining market environment in premium and luxury apparel, we held up well. I'm particularly pleased with our performance in core markets such as the UK and China. Our growth in Germany demonstrates the strength of the brand on its home turf despite the price increase implemented last year. And while we continue to have work to do, we also made good progress in restructuring our US business.

Overall, Group sales increased by 1% in currency adjusted and in euro terms, reaching EUR 651 million in the first quarter of 2017.

By region, sales in Europe increased 3%. Supported by a slightly different timing of deliveries compared to the prior year, the wholesale business contributed high-single digit growth, while own retail sales in the region remained stable.

The UK continued to outperform and grew by 7% in currency-adjusted terms. Sales in Germany were up slightly, reflecting positive momentum in wholesale in particular. In own retail, a weaker performance in the outlet channel more than offset good performance in our full price stores, where conversion rate improvements and an increase of average transaction sizes contributed to growth. In the other larger markets, France and the Benelux, sales were down as a result of a weak start into the year which was not fully offset by an improvement thereafter.

Robust demand from tourists, in particular from Chinese and Russian nationals, contributed to growth in the region. Nonetheless, our European business continues to be driven by domestic customers first and foremost. This group accounts for more than 80% of own retail sales in the region.

Sales in the Americas were depressed by ongoing declines in the US. In the overall region as well as in the single market, revenues declined 7% in currency-adjusted terms. Nonetheless, performance in the US improved sequentially versus 2016 levels as we limited the declines in both wholesale and own retail.

Sales in the wholesale channel were down in line with our full year guidance of a low-teens decrease, still affected by the discontinuation of off price business we initiated in mid-2016. Retail sales were down mid-single-digit. While our mainline stores continued to suffer from significant declines in customer traffic, performance has stabilized in the outlet channel. This reflects better execution as well as the limitation of off-price business in the wholesale channel. The latter has clearly started benefitting customer footfall in our own outlets.

In Asia, overall sales were up 1% in currency-adjusted terms. Disproportionate growth in Mainland China was partly diluted by declines in Japan, Australia and some of the region's smaller markets.

Comp store sales in Mainland China were up at a double-digit rate also in the first quarter of 2017, although we have now started lapping the significant price reduction introduced with the launch of the Spring 2016 collection early last year. A better conversion rate and strong unit growth drove the increase. This reflects the brand's improved value proposition, effective marketing and better consumer confidence following at least two years of significant declines in the local premium and luxury apparel market. However, China's overall sales growth of 3% fell short of this comp store performance because of ongoing weakness in Hong Kong and Macau and store closures in the prior year.

By distribution channel, own retail sales remained stable in local currency terms. On a comparable store basis, business was down 3%. After a slow start to the year, performance improved noticeably towards the end of the period, particularly in Europe. However, customer traffic declines dragged down performance over the entire period. All other metrics improved. By region, comp store sales in Europe declined in line with the overall Group. The Americas recorded a mid-single-digit decline, the Asian business was flat from this perspective.

Despite the moderation of store expansion, around a fourth of the Group's own retail sales are not like-for-like yet. This has to do with openings and takeovers in 2016 and the first three months of 2017, but also with larger renovations during which stores are taken out of the comp store base. In sum, the non-like-for-like component of retail sales made a low-single-digit contribution to retail sales in the first quarter, completely offsetting the comp store sales decline. We do expect a similarly positive contribution also in the full year, although the size of our retail network will remain largely unchanged.

In the first quarter, we opened five new stores, three of them in the Korean market. In Europe, our new store in the GUM shopping gallery in Moscow was the highlight opening of the quarter. Following the takeover of our franchise store in 2016, we now moved to a new 400 square meter location. Net of closures, however, the number of freestanding stores declined by six locations. This means that we have now closed five of the around twenty loss-making stores we intend to shut down by the end of 2017. An increase in the number of shop-in-shops, predominantly related to a takeover in Canada, more than offset the decline of freestanding stores, so that the Group's overall store count remained virtually unchanged.

By retail channel, the outlet business delivered the best performance. As mentioned earlier, this was largely due to the Americas, where channel sales benefitted from high price sensitivity among consumers market-wide as well as the restructuring of our wholesale distribution. In the two other regions, retail performance was very consistent across the different formats with just one exception - online.

Our e-Commerce business was down 27% in the first quarter, suffering from a double-digit decline of site visitors as well as from a deterioration of conversion rates, in particular in the all-important season end sale period in January. This performance underlines very clearly that the focus we placed on insourcing key digital activities in 2016 has come at the expense of short-term operational performance. So while it was right and for the Group's long-term benefit to take full control of online fulfillment in Europe and to rebuild customer relationship management in-house, we are challenged to improve e-Commerce sales performance as quickly as possible.

For this purpose, we formed a cross-functional task force in January. Since then, we have made good progress in addressing some of the key issues across the sales funnel:

- First, we have started optimizing the hugoboss.com website to improve its ranking in relevant key word searches, reacting to some significant changes implemented last year in the way search engines determine the order of results.
- Second, given our progress in rebuilding customer relationship management in-house, we are increasingly better positioned to capture more customer data online as well as in our stores, so that we can reach out to consumers in a more personalized way. A campaign to re-activate existing customers in February and March yielded some very positive results already.
- Third, all development work now adheres to the principle of "mobile first", replacing our former focus on desktop and tablet whose share of traffic has declined.
- Fourth, we have significantly shortened load times, so that site performance is in line with peers again since the end of March.
- Fifth, we have started working on design, content and usability to improve user experience and the site's commercial performance, leading to a stabilization of conversion rates towards the end of the period.
- And finally, a clear focus on bestselling items will mean that the offering will lean much more towards commercially important entry and medium price points again, leading to a leaner but deeper assortment with the launch of the Fall '17 collection in August.

As a result of these measures, performance has started to improve towards the end of the first quarter. We are hence confident to return to growth in our online business in the remainder of the year. In the second quarter already, we expect performance to be visibly better compared to first quarter levels.

Returning to my analysis of first quarter sales performance, wholesale sales were up 2% in currency-adjusted terms. This performance was better than what we expect for the full year due to some delivery shifts in our European wholesale business. These shifts supported first quarter sales at the expense of the fourth quarter last year as well as the second quarter this year. However, also excluding this effect, the European business continues to trend clearly better than our wholesale operations in the US, where weak underlying demand is expected to weigh on sales throughout 2017, although the pressure from the restructuring of distribution in 2016 will fade gradually.

Finally, the license business was up solidly as a result of good growth in the fragrance business, which continues to benefit from the takeover by Coty in 2016. Performance was driven by "BOSS The Scent" and the successful launch of "BOSS Bottled Tonic" – another extension to the BOSS Bottled family of fragrances introduced in early 2017.

The total BOSS business, of which fragrances are obviously just a small part, declined 1%. This includes the BOSS Green and BOSS Orange lines which will be integrated into the BOSS brand going forward. The former recorded strong double-digit growth across all major product groups, reflecting healthy consumer demand in athleisure. Sales of the BOSS core brand, however, suffered from a more restrictive distribution in the wholesale channel.

Sales of the HUGO brand were up 16%. Driven by space gains in wholesale as well as increases in own retail, this performance is a further sign of the growth potential the brand has in the contemporary fashion segment.

And this is true for menswear and womenswear alike – in the first quarter, a double-digit increase of HUGO sales drove 2% growth in our overall womenswear business, which hence developed slightly better than menswear. The latter was up 1%.

Let me now go through our quarterly results in more detail.

Gross margin was up 30 basis points year-over-year and reached 64.4%. Margin benefitted from a significant decline of rebates in Asia, where the adjustment of selling prices last year led to a strong improvement of full price sell-through rates. In the other regions, rebate levels remained virtually unchanged. Currency effects in relation to the devaluation of the British Pound and, to a lesser extent, the negative channel mix effect in the quarter offset some of the gains. Pricing had a neutral impact on gross margin. Note that we did not implement any further price adjustments in the last three months and do not anticipate any major changes also in the remainder of 2017.

Operating expenses were almost stable. This still reflects the cost savings we generated in the later stages of 2016, in particular with regard to the renegotiation of store rental contracts. In addition, store closures had a first positive effect. As a result, we were able to at least limit the deleverage effect from the negative comp store sales performance in the period. In addition, this year's different phasing of marketing expenditures limited cost growth. While marketing expenses remained virtually unchanged in the first quarter, we will intensify brand communication around the launch of the new BOSS and HUGO collections later in the year.

As a result, EBITDA before special items increased 4% to reach 97 million euro in the quarter. In the absence of special items and supported by lower financial expenses, net income was up almost 25%.

By region, profitability in Europe improved due to the positive sales trend and tight cost management. However, the Americas suffered from a significant drop in margin, owing to operating deleverage from the negative sales trend as well as some negative inventory valuation effects. In contrast, the Asian margin recovered well from prior year declines, improving by almost 700 basis points in the quarter. This was due to sales growth, the aforementioned reduction of rebate levels as well as the non-recurrence of inventory impairment charges in the prior year.

Turning to the balance sheet, trade net working capital was down 1% in currency-adjusted terms. A 4% inventory decline was the main driver behind the improvement. Inventories decreased in all three regions, with the most pronounced reductions in the Americas and Asia. Relative to sales in the last twelve months, trade net working capital continues to be up slightly.

Investments were below prior year levels solely due to a different phasing of retail openings and renovations compared to the prior year. Coupled with higher profits and a lower working capital cash outflow, this helped free cash flow turn positive again in the first quarter. Nonetheless, net debt was up slightly at quarter end.

Ladies and Gentlemen, our results in the first quarter, our performance since the end of the period as well as the measures we will implement in the further course of the year make us confident that 2017 will indeed be a year of stabilization, in line with the plan to return to profitable growth we outlined at the end of last year.

We are reconfirming our financial outlook today. We expect Group sales to remain largely stable in 2017 with growth in own retail compensating for a low to mid-single-digit sales decline in the wholesale business. On a comparable store basis, we forecast retail sales will perform within a range of -3% to +3%.

By region, Asia should perform somewhat better, the Americas somewhat weaker than the overall Group. Overall sales in Europe are expected to remain more or less flat on the prior year.

The Group's gross margin should improve due to positive channel mix effects and the non-recurrence of prior year inventory write-downs. However, negative currency effects, mainly associated with the devaluation of the British Pound, will curb the margin's rise.

Largely depending on the sales performance in own retail, EBITDA before special items is also expected to perform within a range of -3% to +3%. As we highlighted in March already, this forecast factors in contingency plans for further cost savings should retail sales remain under pressure for longer than we are currently expecting. Excluded even from these contingency plans, however, is our commitment to drive the transformation to a strictly customer-centric business model and the repositioning of our brands which we will support with a slight increase in marketing expenses compared to sales. Net income is expected to increase at a double-digit percentage rate, supported by the non-recurrence of costs incurred in connection with the aforementioned store closures.

Finally, we forecast investments and free cash flow in line with the prior-year-level. With regard to the latter, the expected profit increase will be offset by cash outflows related to the remaining store closures, the costs of which were booked in 2016 already.

In the next few months, we will reach important milestones in the implementation of the strategic changes presented a few months ago.

In just a few weeks from now, we will present the new HUGO Spring/Summer 2018 collection at the Pitti Imagine Uomo. With a combined mens- and womenswear fashion show, we will showcase the future creative direction of HUGO to the global fashion community gathering in Florence.

A few weeks later, BOSS will be back to New York with a menswear fashion show introducing the new brand strategy to relevant buyers and the press. The Spring/Summer 2018 collection on stage will be the first reflecting the integration of BOSS Green and BOSS Orange in the BOSS core brand. We will present this collection to the trade over summer. Keep in mind though, that it will only hit the stores at the beginning of 2018.

The collection before, Fall/Winter 2017, will still be based on the old brand logic. Nonetheless, it already features some elements of the new strategy. In particular, we have strengthened the casualwear offering. In addition, we have aligned the different brand lines more closely, so that the overall collection statement is far more consistent across business, casual and athleisure than in previous seasons.

The launch of the Fall collection will also mark some changes in the merchandising of our stores. Specifically, we will be expanding the in-store offering at entry price points to stimulate traffic and conversion. This goes hand-in-hand with the reintroduction of BOSS Green in more stores, considering the brand’s strong performance as well as general trends in the market towards more relaxed casual and even athletic-inspired dress codes.

Ladies and Gentlemen, we have exciting months ahead of us. 2017 will be a “year of implementation” and we will lay the foundations for bringing HUGO BOSS back to profitable and sustainable growth. The feedback from retail partners and customers makes me confident that we are on the right track. I look forward to meeting you here in Metzingen at our Investor Day in August, so that you can touch and feel for yourself what may still be difficult to grasp today.

But in the meantime, let me answer your questions on today’s set of results.