HUGO BOSS Investor Day 2017

Transcript – Q&A Session with Mark Langer (Chief Executive Officer), Bernd Hake (Chief Sales Officer) and Ingo Wilts (Chief Brand Officer)

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

Antoine Belge (HSBC): I have three questions. First of all, regarding the Spring/Summer 2018 orders. You said that orders are broadly flat year-on-year. Are you just including external buyers or also internal orders for your own retail business? The press release mentioned a more difficult trend in the brand's businesswear. When you say more difficult, do you mean more difficult as compared to athleisure wear or has it been more difficult compared to the previous businesswear collections? Please also explain if those were only initial orders and how much they are accounting for when comparing the total season versus replenishment?

My second question is on the senior management changes you have mentioned. When will these people arrive?

And finally, on the HUGO brand. Is it fair to say that compared to November, the brand is still in some sort of testing phase. So you haven't taken any new decision in terms of rolling out more stores, or allocating more spend behind the brand? Or has there been any change since then?

Mark Langer (CEO): We only refer to third-party pre-orders when we talk about pre-order development. We are talking of a wholesale business of roughly a billion euros, with the Fall/Winter collection having a greater weight. So it is not 50/50. We do have data now for the Spring/Summer 2018 collection, which probably accounts for a bit more than 30% of our annual wholesale revenues. And with all these changes that Bernd highlighted and also some nervousness or initial resistance, I think it was quite an accomplishment to achieve pre-order figures on a similar level as compared to last year. Please keep in mind that we are talking value, not volume. With the Spring/Summer 2018 collection, we also have decreased selling prices in European markets outside Germany, including a reduction at the HUGO brand. So in this aspect, I am very happy, especially with HUGO and the performance in casualwear.

You saw the performance of formalwear versus casualwear over the last seven years in my presentation. There is a trend to wear sneakers, like Ingo is doing today, at the expense of more expensive Budapesters like I'm wearing. This trend is here to stay. I'm very pleased with the reaction from Nordstrom. We need to rebuild this relationship. We have to be better than our competition and we are very confident that our collection will deliver.

On the senior management changes, I presented six people. All of them are with us already. Some of them joined the Group already a bit more than a year ago. The only gentleman who is missing is our CFO, Yves Müller. He will join us at the end of this year, beginning of 2018 at the latest.

Let me come to HUGO. At the time of our last Investor Day in London in November 2016, we had the idea and the market research indicating that there is a sizeable and distinct market segment which we cannot serve with BOSS. Today, we outlined why there is an enormous business opportunity for HUGO. We have ticked all boxes in terms of collection, in terms of pricing, in terms of marketing, in terms of store concept. All of this will bring the HUGO brand to life. We had a good initial reaction from our wholesale partners. We are closely analyzing the distribution of HUGO, so we are in discussions with wholesale partners with regard to the relocation of some of our existing HUGO shop-in-shops to make sure the brand environment is right. We will have a lot to tell you in twelve months from now.

Luca Solca (Exane BNP Paribas): Could you please bring some depth of context to the vision that you presented this morning when it comes to bringing HUGO and BOSS in the broader market context? You were talking about a relatively flat or slightly growing market. When I look at the market, I actually see that there is a lot of turmoil, with former business models like the ones from the designer brands Ralph Lauren and Armani suffering a lot and falling off a cliff. Premium denim is also falling off a cliff, while streetwear is booming. Mid-price, retail-integrated brands like Sandro and Maje are booming. So how do you fit in those changes? And why do you qualify to be among the successful players?

And you were talking about distribution and the distribution strategy. As there are even doubts that wholesale customers could be there in the future, how do you see the evolution of your distribution in that context?

Mark Langer (CEO): You have touched on many topics.

So of course, we are looking at current market trends in terms of technology and fashion. As Ingo explained, we see the casualwear trend as an enormous opportunity for us, because we have the design, sourcing, production and distribution capabilities to take full advantage of it.

We will have to deliver on two fronts – sales productivity and HUGO:

In the second quarter, we have seen a return to positive retail like-for-like growth in all three regions. Everything that we do has to bring this company back to sustainable like-for-like growth. We have more than 1,100 points-of-sale. And as Bernd said, we will have many of them also in five years from now, even though we will consolidate our presence in the outlet channel. So we will have to assess all our actions, not only from a collection but also from an operational perspective, on their potential to drive sales densities in our stores, particularly on the BOSS side of our business.

On HUGO, we take a more mid-term perspective. We mentioned that HUGO has outperformed in terms of order intake. But we will not corner ourselves by saying "HUGO will be x percent of our revenue" or by giving an absolute revenue target for HUGO. We know the business models in the contemporary segment and you can be sure that we studied them very carefully with regard to what we can learn from them and what we should incorporate in our blueprint for HUGO. The size of the opportunity for HUGO is very relevant. HUGO has a high probability to become a success. We are off to a good start, but it is too early to give you a more detailed outlook.

The wholesale performance of HUGO in the second half of 2017 will play an important role when it comes to determining the order intake for the second half of 2018. In addition, we are introducing the HUGO store concept to a number of wholesale partners at the moment. The outcome of these discussions will determine which momentum we are able to build in the second half of 2018.

Volker Bosse (Baader Bank): Starting with your outlook on 2018, is it fair to assume a sales growth of about 3% to 4% with stable margins and from 2019 onwards margin improvements?

And the second question is regarding your online strategy: how do you see your need to team up with marketplaces or with players that have decent frequencies. As I understand, it is a monobrand online store that you operate. So how do you see that developing going forward?

And the third question is regarding your mobile strategy. How is your mobile share of website traffic and how is your overall strategy going forward? Can you also give us an update on which apps are available, in which region and where do you stand here?

Mark Langer (CEO): On the outlook, there will be growth in sales and profits in the coming year. I also shared with you that, based on our research, we expect market growth of 3% to 4%. However, this is not an indication that we will see the same numbers for us. We will update you on our quantitative forecast for the fiscal year 2018 when we present full year results for 2017 in March 2018.

Bernd Hake (CSO): On mobile, for approximately nine months now the share of visitors coming via mobile devices has been larger than the share of customers coming via iPads or desktop devices. Today, it is probably a 65/35 split and it is increasing further.

Our website has two reasons to exist. One is clearly the commercial reason. We want to further penetrate the market and drive our omnichannel services. On the other hand, it is also a tool which helps us to further grow brand desirability and to showcase what the brand stands for. And here, I see huge opportunities with regards to sponsorships to create more content. Many of our customers do not even know what we are doing in sports. This is an opportunity. On the other hand, we are also very good in dressing the international businessmen and women. However, our online competitors build better content than we do. One of our next steps will be to provide more fashion advice – how to dress when you go to business or how to dress when you go to a party – so we will infuse more content into the selling process.

Jürgen Kolb (Kepler Cheuvreux): Mark, you mentioned Izmir as a relevant factory. Shall we expect additional Izmirs? Do you think you need more owned factories in order to fulfill all your targets when you talk about becoming more speedy, more focused, more personalized? Or is that factory now at a full capacity swing that you would like to even increase?

Secondly, also related to that. Would that be a kind of a think tank for you to develop more IT services to be, again, more digital also on the production side? Something that we have seen at the sporting goods guys?

Lastly, on the personalization. What level of business could that really develop? I mean, I understand that with sneakers, you change your colors, fair enough, but how can you really personalize and can that be an impactful business overall?

Mark Langer (CEO): Let me start with Izmir. To put everybody on the same page, this is one of the biggest production facilities when it comes to suits and formalwear in the industry. It allows us to have a R&D department there led by a gentleman who was working in product development for many years in Metzingen. He transferred to Izmir two or three years ago. He has done a very good job in building R&D capabilities which he can employ in two areas. One is productivity, because that is what we ask him to deliver quarter-after-quarter. To ensure that we deliver higher productivities in all categories, but also to be leading in our portfolio. Of course, this is also relevant for the suit and shirt partners that we work with to see how this technology can help us to have a closer collaboration when it comes to the product development, but also on time productivity. We are making good progress there. We have been approached by a third party. We do not disclose names but we have started to offer our spare capacity to others, not necessarily because we need them to drive full utilization, but it is also a good yard stick to see if we are really world-class in terms of productivity that we can also offer to a selected number of non-competing brands.

You mentioned speed and agility. We see in our industry a trend to more nearside production to shorten lead times. The success factors for HUGO are not just quality, design and value for money. It is also our ability to react quicker than our competition to new fashion trends. Here we will see two trends, even though we are happy with our current share of in-house production: There will be definitely be a closer collaboration with suppliers. And there will be a wider role to play for our own factories – keep in mind that we have a quite sizable shoe factory in Italy as well – with the ultimate aim to beat the competition also in terms of speed on the more fashion part of our collection.

Ingo Wilts (CBO): Personalization is very important but we have to see this from two different angles. One is what Bernd explained, the personalization of services. The other one is personalization of the product. We do this already. In our Made-to-Measure line everything is personalized. You can even have your name stitched in the product. We also personalize scarfs. The challenge is agility and speed. We need to be faster with this because you do not want to wait three months for your scarf, because by then winter is over. So what we discussed last week is how to take this out of our regular sourcing process to become faster. We see this as a key factor for the future.

Bernd Hake (CBO): There is nothing more exciting than to receive content which relates to you, which is personalized. So when you are a business customer, you will not be attracted by sportswear mailings. The more we know you, the better we will understand your needs and what inspires you.

Zuzanna Pusz (Berenberg): You have mentioned your new retail concepts for shop-in-shops and also the fact that some of your partners have previously invested in the concepts you had for the Orange and Green brand lines. I was wondering, how did that go? I mean, have all of them actually agreed to invest in the new shop-in-shop concept? Did you have to take some share of that investment?

On the new products, I mean for a while, I think one of the concerns has been that your core customer could be aging. I was wondering with the stronger focus on casualwear – I appreciate that the new collection will come later in the year but you already made some changes – have you noticed any changes in the type of consumer you are attracting? Have you seen a bigger share of younger customers coming to the stores?

Bernd Hake (CBO): We are in discussions with every wholesale partner right now with regard to the future positioning of our brands. We usually have shop-in-shop contracts over three to five years. Many stores reflect our new strategy very well. However, there are also cases where a repositioning would make sense with a view to traffic or customer demographics. In these cases, we discuss with the department store partner where to relocate and how to share the investment between the two of us.

Mark Langer (CEO): On your second question, we have to look at two different time periods. As of now, we still have a BOSS Menswear Collection with three color codes. The current HUGO collection does not reflect the full extent of changes we discussed this morning either. It is not that we did not offer casualwear in the past, but we need to excite people now. You have seen the enormous reach of our fashion shows. It is a first step in the marketing funnel and it all starts with awareness.

You asked about the average age of our customers and by how many weeks or months we have improved. We have stabilized, maybe we have improved. The age of our target customer is 39 for BOSS and slightly younger for HUGO. There still is a way to go for us. We did not hide from the fact that the average age of our customers has increased more than we liked. We see encouraging signs but we are not seeing dramatic changes yet, because the new collections are not yet in the stores.

Dennis Weber (Head of IR): We have one question coming in over the webcast. It is on management compensation with regard to the new senior management members. The question is, what are the major targets and KPIs, both quantitatively and qualitatively, that will determine their compensation and various share incentives over next 3 years or so?

Mark Langer (CEO): We do have a short term and a long term incentive scheme. I will focus on the long-term incentive scheme.

So there are two quantitative targets. One is aligning our interest with our investors, so the actual performance of the HUGO BOSS share price relative to the MSCI World Textile Industry Index. And the outperformance is a major part of our compensation over a three year performance period and a one year vesting period. And of course, it is our financial performance in terms of capital returns over a midterm base.

In addition, there are two more qualitative factors. One is how good are we in inspiring our employees, not only when it comes to attracting but also retaining talent in terms of being an employer of choice. We work with the “Great Place to Work” initiative to do a global assessment on the progress that we make here, to be seen by all employees as an attractive place to work. And last but not least, sustainability is an important factor for many stakeholders, in particular for our employees. It is important that we make progress in improving our strongly recognized efforts to become more sustainable in all aspects of operations. This is measured in the Dow Jones Sustainability Index assessment where we are not a member yet, although we have improved a lot. The exact score is not disclosed but we are close. We are not yet on the level of adidas and Kering which are clearly the two companies we take as a reference. These two quantitative and two qualitative factors determine our long term incentives payout.

John Guy (Main First): Ingo, you talked about the differentiation between HUGO and BOSS core, but at the moment from a pricing perspective, both HUGO and BOSS core pricing is relatively similar. And there is going to be up to a 30% difference in pricing going forward. When you talk about that different consumer, are you not worried that there is going to be cannibalization or cost-saver effects, given the fact that you are going to have to make quite a significant change in price from one brand to the other?

Mark, just around 2018 and talking about targets and talking about sales growth and profit growth. Margins relatively flat. Within that in terms of cost phasing and thinking about selling and distribution, you are not really planting so many flags anymore in terms of stores. And so what sort of increase could we see on the marketing side or any other sort of cost relative in order to effectively neutralize out that margin?

Bernd, around your online concessions that you talked about. Can you give us an indication as to what the size of that business could be in the U.S., opportunities to grow that? And I guess, the opportunities to protect the margin because clearly, taking an online concession model should give you a little bit more firepower when it comes to limiting the markdown volatility that you may see in the U.S.

Ingo Wilts (CBO): First of all, we do not think that there is any cannibalization in terms of product, even if we talk about suits. It is a price difference, HUGO is more based in the premium and BOSS in the upper premium segment. Even if we offer suits at different price points, the HUGO suit is already a very, very good product and we make sure that in terms of quality and fit it is up to the HUGO BOSS standards. But in BOSS, we have an even higher quality and it is also a different design. We offer our customers a wide range of products and across both brands we make sure that there is no cannibalization in terms of the product.

Bernd Hake (CBO): Talking about online concessions. We will not move to the U.S. before we have started in Europe. So the first point is that we are sitting together with the core online players in Europe at the moment. And we are discussing alternatives on how we can take over their wholesale business and run it as a concession. With this in mind, we definitely play the two brand strategy. And in many of our online stores and at online wholesale partners we see that the brand environment is a better fit with the HUGO customer today. At the moment, most of our online partners have the competitive set for HUGO. They are performing quite well in the sportswear business.

However, the end game of big online players is to become also popular in premium and luxury. And here, we can definitely support them and get better terms. We will only go into an online concession, and this is why it sometimes takes time to decide, when the financial terms are right. We are not trading profitability for growth. We have a profitability target in mind that determines the concession fee we are willing to pay.

Mark Langer (CEO): Let me try again to give you as much detail as possible on 2018.

We told you in London already that we do not expect significant changes in our gross margin in 2018. Today, we gave you some reasons why we came to this conclusion. Channel mix – keeping all others things equal - still has a slightly positive impact, but it is much smaller than what we had in the past when we benefited from disproportionate growth in own retail. And there are a lot of things happening in our collection, changes in retail prices but also a smart investment into product quality. If an investment into product is required to beat competition, we are willing to make it. We had already flagged this eight months ago. We will not stop until we are sure that we have a superior product at BOSS and HUGO for all wearing occasions, even if this puts pressure on our gross margin.

We continue to run a tight ship when it comes to fixed costs as we have demonstrated also over the last quarter. However, some of these fruits you can only squeeze once. We cannot repeat the optimization we did last year to the same extent this year. To give you a very tangible example, we had just one womenswear fashion show last fall, but we did three fashion events this fall: HUGO, BOSS Menswear and BOSS Womenswear. It was the right decision and we have had tremendous results, so I am very happy and we will do it again. And we know that we have to fund some of these investments internally. But there is no low hanging fruit, so we cannot just carve out another 10 million or so in other parts of our business to fund these investments. In the second quarter, we ramped up marketing expenditures. This will be an important factor also in 2018. We continue to invest in the digital enhancement of our business model, be it through an investment in people or systems. We will grow profitability when we grow sales and we do expect the market environment to be more supportive going forward. But it is too early for a guidance, so we will not commit to margin improvement in 2018 today.