HUGO BOSS

HUGO BOSS Conference Call Q2 2017

Transcript – Q&A Session
August 2, 2017

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

Antoine Belge (HSBC): First of all, on the gross margin, you only had a very limited increase, even though there was a big differential between retail up 6%, and wholesale down 6%. The gross margin increase has been 10 basis points. So I'm a bit surprised that you didn't get more gross margin improvement or does it mean that the FX impact was really huge?

Second question, regarding the marketing spend. There has been volatility in between the two quarters. Can you guide us about the overall evolution for the full year or in terms of year-on-year growth as a percentage of sales? And if so, qualitatively, is there a shift towards more digital versus traditional media?

And finally with regards to CapEx, there is a set of EUR 20 million postponement. I know it's a bit early to talk about 2018, but does it mean that the CapEx for next year could be closer to EUR 180 million to EUR 200 million?

Dennis Weber (Head of Investor Relations): Starting with your first question on gross margin, you are right that there was a significant negative effect and that was currency, especially related to the devaluation of the British pound. Our U.K. business had a very strong performance in the second quarter: it was up at a low double-digit rate. That means that the effect on gross margin was also relatively large.
Other than that, you're right, one would have expected a better gross margin performance, just due to the channel mix effect i.e., a better sales performance in own retail over the wholesale. All other factors which had also impacted gross margin performance positively or negatively over the last few quarters, had a neutral impact in the second quarter, rebate management in particular. We held the overall rebate level stable, with some differences in between the regions, and also inventory valuation was a nonevent in the second quarter.

In terms of the marketing spend, yes, there is a different phasing of marketing expenditures this year compared to last year, as we want to support the repositioning of our two brands.
Later on, you will see a list of events that we have ahead of us for both brands and events that will fall into the second half of the year. That includes fashion shows. We had one in June for HUGO and one for the BOSS Menswear in July, another one for the BOSS Womenswear, although that was a smaller event that we held in Berlin, also in July. All these events come with more extensive campaigns, in digital channels in particular. That is reflected then also in the marketing spend.
Overall, we expect marketing expenditures to rise at least slightly relative to sales in the full year.
In terms of digital, we commented in the past that by now, we spend around 70% of our media spend in digital channels. That is also what you should expect in 2017.

In terms of CapEx, also here, I agree with your general observations of the fact that there will be a shift of renovation projects into the next year. One should expect higher investments in 2018 compared to 2017. Although, we will still fall short of the peak levels in terms of investment activity that we had seen in 2015. Remember, that we had an investment spend of EUR 220 million in 2015.

Zuzanna Pusz (Berenberg): First of all on the like-for-like performance: has there been any noticeable trends throughout the quarter? Has there been an acceleration towards the end of it? Can you give us an idea of that negative price mix effect: was it low single-digit?

Secondly, on the U.S. performance in a bit more detail. Your comments about the improving performance are a little bit different to what we see from other players. So do you see this as sustainable? Is it purely brand specific given the improved assortment or could it be that there is simply some stabilization in the market?

Finally, on the online business, you see a nice improvement this quarter. Could you give us a bit more color on that please? Have you made any improvements to the website functionality? Or is it due to different merchandising assortment?

Dennis Weber (Head of Investor Relations): Starting with like-for-like trends over the course of the quarter, there was no significant pattern that we would call out.
At the time of the Q1 earnings publication, the trends towards the end of Q1 had been better already compared to the beginning of the first quarter, and this trend basically sustained also into the second quarter.
The price mix effect was negative indeed, in line with what we had also outlined at our last Investor Day in 2016 in London. Indeed, this was a low single-digit negative for like-for-like sales. Therefore, the negative impact from a decline of average selling prices was more than offset by a better traffic, although we continued to be challenged on that metric, and most noticeably, far better conversion rate.

Your second question was on the U.S. and whether the upswing we saw in the second quarter is sustainable.
In own retail, we have indeed seen a stabilization of trends and that not only started in the second quarter. Remember, that we had mentioned improving trends in our Outlet business already towards the end of 2016 and at the beginning of 2017. Now full price distribution has followed. Hence, the gap in terms of sales growth in between these two retail channels in the U.S. has narrowed quite significantly, so that overall like-for-like trends were positive.
It is always very difficult to give an outlook for like-for-like sales performance. Of course, we are working on turning this into a longer-term trend.
In the wholesale channel, unfortunately, it would not be realistic to expect the same kind of performance also for the third and fourth quarter. In the second quarter, we benefited from a far easier comparative compared to the rest of the year. In the second quarter of 2016, we took a lot of action to discontinue business relationships with off-price retailers. We also accepted some returns in this process, something which helped the year-over-year comparison.
We have started implementing changes to our distribution in the U.S. wholesale market maybe earlier than others. This has had hit us very hard in 2016, with sales declines in our U.S. wholesale business of almost 30%. So maybe we are now a longer way through this process than others in the industry.

In terms of the online business, also here we are seeing a stabilization of visitor trends as well as an improvement in conversion rate, very similar to what we saw also in our physical stores.
This had to do with some technical improvements. I mentioned page-loading times, but also with an improved ability to reach out to consumers in a personalized way. This means we are in the process of insourcing our customer relationship management that helps our online business as well.
In terms of merchandising, we have improved but we would expect another benefit from that in the second half of 2017, as we have adjusted our internal buying. So the merchandising for the online store for the Fall/Winter 2017 collection will fit more specifically to the needs of the online customer than this had been the case in the first quarter.

John Guy (MainFirst): Starting with Europe, you mentioned in your expectations some resilient growth in some key markets including the U.K. for the second half of the year. If I remember correctly, in the European region, tourists account for about 15% of your own retail sales. Has there been any discernible change to that number? Do you think that you can continue to grow with a healthy pace in the U.K., especially given the tougher comp base as we move forward into the second half?

Second question, sticking with the U.S., you have now reduced off-price as a percentage of wholesale sales from 20% towards 5%. So you have done a lot of the heavy lifting already in the U.S. market. Easier comps aside, how do you think about the U.S. market over the long term i.e., in the course of the next two to three years? I expect you to be a little bit more cautious on the U.S. market as a whole.

And then on 2018, when we think about CapEx loading and about investments related to the new brand rollout into 2018: what can we expect for CapEx but also marketing costs and other related costs in 2018? You mentioned that you are looking for sales and earnings growths for 2018.

Dennis Weber (Head of Investor Relations): Probably I will have to refer a few of the questions to the later Q&A session with our Managing Board.

Let us start with Europe and the importance of tourists. You are right that we have always commented that tourist demand accounts for roughly 15% of our own retail sales in the region. That broadly still holds true today. Actually, this share is now slightly higher. So definitely, the business with tourists is doing better currently than the business with local clients. But when it comes to the U.K., the growth that we have seen in the second quarter, and also in the first half year, was half driven by locals and half driven by tourists. So also in terms of local demand, we saw growth in the U.K.

When it comes to the U.S. off-price business, you are right that we have guided for it to account for just a single-digit percentage of wholesale sales in that market. We are exactly on track to achieve this guidance.
When it comes to the overall market outlook, we would not say that this has improved over the course of the second quarter. We are not benefiting from any tailwind now from the overall market in the U.S.

When it comes to the longer-term outlook for the U.S., I would like to refer you to our Chief Sales Officer, Bernd Hake, later this morning.

Actually very much the same is true for CapEx. So as we discussed earlier, we do expect higher investment spend in 2018 compared to 2017. Beyond that, at this point in time, there are no large-scale investment projects which we believe could change the overall investment intensity of the Group to any significant degree.
We do not expect retail space expansion to reach the levels that we were seeing between 2010 and 2013. Retail expansion had always been our most important area of investment spend, but this is not going to come back. Therefore, there will be rather a shift from retail expansion into retail renovation.

Stacey Widlitz (SW Retail Advisors): Some of the brands have commented that in Europe they feel that the promotional environment i.e., what the department stores are doing, is kind of a reflection of the U.S. Are you seeing any of that? That is, is the European wholesale market going down the same promotional road as the U.S. market? What do you do in response to that?

Dennis Weber (Head of Investor Relations): I will give you the short-term answer and then again, our Chief Sales Officer Bernd Hake is going to give you the longer-term answer.
In terms of trading in the second quarter, indeed, we have seen an earlier start of promotions market-wide. We have followed that in our European own retail operations to some degree. This is simply a consequence of the fact that the European apparel market, especially in the wholesale channel, has been depressed for quite some time now.
Following the market data in Germany, the German market has seen declines in four out of the last five years now, at least when it comes to physical retailing.
Whether the market entrance of some off-price concepts from the U.S. into Germany will change the overall structure of that market, this is something that we may discuss later on.

We also have received some questions that came in over the webcast.

Frank Böhme (Investor Relations Manager, HUGO BOSS): Via webcast, we have received a question on our outlet channel: "what was the impact from the outperformance of outlets over full price stores on your gross margin in Q2 or in H1?"

And as a follow-up on that: "how does the EBIT margin of your outlet channel compare with that of the full price stores?"

Dennis Weber (Head of Investor Relations): It is true that overall the outlet channel still grew at a stronger pace when compared to the rest of our own retail operations. However, the outperformance was smaller in the second quarter as this was still the case at the beginning of the year. This is largely due to the U.S. market, where the trends converged to a stronger degree.
So overall, as outlets obviously do have a lower gross margin compared to full price retailing, there is a negative margin effect, but we would count that into channel mix.

So, coming back to the discussion with Antoine earlier, the overall positive channel mix effect was diminished to some degree by an adverse channel mix within own retail operations, as outlets had a better performance compared to full price retailing.

However, on the EBITDA level, there is no significant difference. The overall economics of an outlet are totally different compared to a full price store, but net-net, there is not a large difference on the EBITDA level.

Frank Böhme (Investor Relations Manager, HUGO BOSS): Via webcast, we also received a question on provisions: "do you expect further releases of provisions related to store closures similar to what we have seen in Q2?"

Dennis Weber (Head of Investor Relations): The short answer is: no, we don't. That should have been rather an exception. Of course, we negotiate as good as we can when it comes to exiting the remaining 15 locations that we have flagged will be closed until the end of 2017. But at this stage, we do not expect any other positive effect, i.e. release of provision, in the remaining two quarters of the year.

Charmaine Yap (Redburn): My question is on Womenswear sales. The decline in the second quarter, is it a reflection of space or is it a reflection of other cost like marketing and personnel?

Dennis Weber (Head of Investor Relations): It is actually both. First, we shifted our marketing activities to Menswear to quite a significant degree. I commented on that earlier by saying that around 70% of our media spend in 2017 will be dedicated to Menswear. That was the other way around only two years ago. While it is difficult to quantify the exact correlation between marketing spend and sales performance, we are pleased that this had a positive impact.
In terms of the retail space allocation, we have rather implemented gradual changes. Therefore, please do not walk away with the impression that Womenswear was underperforming Menswear throughout our retail network. This is simply not the case.
For example in London, there are some stores like Sloane Square, or also, Regent Street, where Womenswear is doing very well and in some cases even better than Menswear in terms of sales productivity levels. So it's always a case-by-case decision how we allocate retail floor space in the different locations. But overall, yes, Womenswear has lost a bit of space, especially when it comes to shoes and accessories, which we had push quite hard in 2015 and 2016, and where retail performance had been disappointing in the past.

Mark Josefson (Equinet Bank AG): I have one follow-up question with respect to the own retail performance in Q2. Obviously, nice recovery there. If we look back to last year, it was a very depressed base across all the regions, with e-commerce as well was low last year. The latter particularly depressed also in Q1 of this year.
How much of an influence was e-commerce on your like-for-like performance in the second quarter?

Dennis Weber (Head of Investor Relations): Our online business was dilutive to like-for-like sales performance in the first quarter, almost by around one percentage point.
Now given that online at least slightly outperformed the overall retail business in the second quarter, that was a very small positive, but it did not move the needle.
In other words, the majority of the improvement between the first and the second quarter rather was coming from the physical comp stores, while online of course contributed to that improvement.