HUGO BOSS Second Quarter Results 2017

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Dennis Weber (Head of Investor Relations)

- The spoken word shall prevail –

Good morning and a warm welcome to our Investor Day 2017.

In the last three months, we not only reached important milestones in the repositioning of our brands but also returned to positive comp store sales growth in own retail, ending a series of six quarters of declines. Robust growth in our key markets UK and China drove the improvement.

As a result, second quarter Group sales increased by 3% excluding currency effects. In euro terms, revenues were up 2%.

By region, Europe held up well in the period. Second quarter sales remained stable on a currency-adjusted basis despite a high-single-digit decline in the region's wholesale business. This was due to a shift in the timing of customer orders. Compared to the previous year, a larger share of Spring/Summer collection deliveries in Europe fell into the first three months of the year, supporting first quarter results at the expense of the second. In own retail, however, performance improved sequentially.

This was particularly true for the UK, where overall sales increased at a low double-digit rate in the second quarter. Growth was attributable to good local demand as well as robust increases in our business with tourists. Backed by current trading also after the anniversary of the Brexit decision last year, we continue to be confident that our UK business will grow solidly in the second half of the year as well.

In Germany, trends in own retail remained unchanged compared to the beginning of the year, while the wholesale business suffered somewhat from the delivery shifts. The business in France was down at a low double-digit rate as a consequence of timing effects in wholesale, a later start of the season-end sale period as well as a difficult market environment. In the Benelux, however, trading improved.

Our American business returned to growth for the first time since mid-2015. In the second quarter, regional sales were up 5% in euro terms and 3% excluding currency effects.

Sales in the US increased 2% as a result of improvements in own retail and wholesale alike. The former benefitted from a stabilization of customer traffic trends and an uptick of conversion rates in directly operated stores. Online sales rose at a double-digit rate. As a result, the full price retail business performed almost in line with the outlet channel, which had started recovering already towards the end of last year. Overall own retail like-for-like sales in the U.S. were hence stable. .

The US wholesale business returned to slight growth in the second quarter as we are now largely behind the clean-up of distribution initiated in Spring 2016 during which we discontinued all business with pure off price retailers. However, keep in mind that this performance comes on the back of a particularly weak comparative in the second quarter last year. That is why we still expect sales in our US wholesale business to decline at a high-single-digit rate in 2017, impacted by weakness in our formalwear business in particular. Nonetheless, this represents a slightly more positive outlook compared to our original expectation of a low-double-digit decline.
Finally, sales in Asia Pacific recorded a 10% increase in currency-adjusted terms in the second quarter. This represents a sequential improvement compared to the beginning of the year, driven by better trends in South-East Asia and the Pacifics.

Performance in Greater China remained strong. Sales in the market were up 14% in local currencies. Keep in mind that the price adjustments we implemented at the beginning of 2016 had virtually no impact on our performance anymore. The improvement was rather driven by good brand momentum and better retail execution supporting conversion rates in particular. As a result, like-for-like sales in Mainland China continued to grow at double-digit rates. In addition, a stabilization of trends in Hong Kong and Macau contributed to performance.

In Japan and Australia, the next largest markets in the region, trends picked up compared to earlier in the year, driven by improved retail execution and better tourist demand.

By distribution channel, own retail sales increased 5% in euro terms and 6% in local currencies in the second quarter. On a comp store basis, the business was up 3%. In the first quarter, it had still been down 3%. This reflects sequential improvements in all three regions. Like-for-like sales in Asia were up at a mid-single-digit rate. In Europe and the Americas, the increase amounted to a low-single-digit rate.

In all three regions, better conversion rates and higher volumes drove growth. Average selling prices declined slightly as a consequence of the outperformance of casualwear over formalwear and gradual changes in the merchandising mix, where we are strengthening our offer at commercially important entry price points.

Better performance in online also had a positive impact on like-for-like sales. In the second quarter, the own e-Commerce business returned to growth after a disappointing start to the year. Sales were up 9%. You may remember that we flagged a number of drivers for this improvement already in our last earnings call: at the end of the first quarter, we had reduced page loading times significantly, for example. We also started to make better use of CRM opportunities. A stronger focus on performance marketing as well as progress in search engine optimization also contributed to growth. Nonetheless, there continues to be further work to do to achieve our target of growing online sales also in the full year. Above all, we are adapting our product offer more closely to the specific needs of the online customer with the launch of the Fall/Winter 2017 collection.

New space made a low-single-digit contribution to retail sales growth in the second quarter. The number of freestanding stores declined compared to the end of last year as we closed 14 locations in various markets and opened 10. However, the shop-in-shop network grew due to a takeover in the Canadian market, so that overall retail space expanded slightly in the first six months.

Turning to the wholesale channel, second quarter sales were down 6%, largely due to the aforementioned delivery shifts in our European business that we had flagged in May already. Based on the order book for Fall/Winter 2017, we expect trends in Europe to be better again in the second half of the year. In the Americas, however, weak demand in particular in our US formalwear business will continue to pressure sales. We will also remain very disciplined when it comes to selling into the US department store channel in order to avoid excessive inventories and clearance sales, so US wholesale sales will decline year-over-year also in the second half of the year.

Last but not least, the license business had a stellar performance again in the second quarter. Sales were up 27% due to strong double-digit growth in the fragrance business in particular. Strength was broad based across the product portfolio, including BOSS and HUGO as well as our Men's and Women's fragrances.

Looking ahead to the remainder of the year, we expect growth rates to normalize as we will start to lapse the strong increases seen since the takeover of the fragrance business by Coty in autumn last year. However, a full innovation pipeline should ensure good momentum. For example, we will launch BOSS THE SCENT INTENSE in August, accompanied by a comprehensive cross-media campaign featuring British Actor Theo James and German model Anna Ewers.

Sales in the total BOSS business increased 2% in the second quarter. This includes the BOSS Green and BOSS Orange lines which will be integrated into the BOSS brand going forward. Performance was particularly strong in BOSS Green, which grew at strong double-digit rates.

HUGO sales were up 6%. This represents lower growth compared to the beginning of the year, primarily due to the timing effects in our European wholesale business to which HUGO has a relatively larger exposure than BOSS.

Please be reminded that the upcoming changes in the positioning of both brands had no effect yet on performance in the quarter as the new collections will hit the stores only towards the very end of this year.

By gender, the overall menswear business was up 3%, outperforming the womenswear business where sales declined 4%. While we remain committed to also growing the latter, this reflects the attention and resources dedicated to menswear so that the core of our business returns to growth as quickly as possible.

Turning below the top line, gross margin was up slightly in the second quarter, even on the back of a strong increase last year. This was largely due to channel mix, that means the outperformance of the own retail business over wholesale. However, the positive effect was partially offset by currency effects, predominantly in relation to the British Pound. All other factors had a neutral impact. This includes rebate management, where gains in Asia were balanced by slightly higher markdowns in Europe and the Americas.

Operating expenses remained tightly controlled, although the effects of some cost saving initiatives implemented last year are now tapering off. Nonetheless, the far more moderate pace of retail expansion as well as the renegotiation of rental contracts limited the increase of selling and distribution expenses, which was largely due to higher marketing investments in the context of the brand repositioning. G&A expenses increased as we expanded our digital teams and systems infrastructure.
As a result, second quarter EBITDA before special items remained unchanged compared to the prior year quarter at EUR 108 million. In contrast, we recorded a significant swing in special items. Last year, we booked more than EUR 50 million of provisions and impairments related to planned store closures. Including some additional charges in connection with management changes, special items amounted to EUR 57 million back then. This year, we recorded income of EUR 6 million as we negotiated better than forecasted exit terms with landlords. As a consequence, we were able to release some of the provisions booked last year. The prime example in this respect is our Kerry Centre store in Shanghai, where we exited just one selling floor while maintaining the rest. As a result, the store has turned profitable while the exiting costs for just one floor were markedly below plan.

Taking these effects into consideration, net profit was significantly above prior year levels, amounting to EUR 58 million in the second quarter.

From a regional perspective, profitability in Europe suffered from the sales shortfall in wholesale. Operating expenses remained stable. In the Americas, the sales improvement in the second quarter went hand in hand with a slight margin expansion. And in Asia, segment profitability benefitted from the combination of robust sales growth and good cost control in own retail operations in particular.

Ladies and Gentlemen, I focused my comments on the second quarter in order to give you a good understanding of most recent trends. Let me also summarize where we stand after the first six months of the year.

Group sales were up 2% on a currency-adjusted basis. Europe performed in line. Sales in the Americas declined 2%, sales in Asia/Pacific were 5% ahead of the prior year, both in currency-adjusted terms.

In line with sales, EBITDA before special items was up 2%, too. A better gross margin was offset by slightly higher operating expenses in relation to sales. Net profit more than doubled following the non-recurrence of prior year one-time expenses.

Before outlining our expectations for the rest of the year, let me give you some more color on key balance sheet items and cash flow performance.

At the end of the first half year, inventories continued to be well controlled. Group inventories were down 4% in euro terms and 3% in local currencies, driven by double-digit declines in the Americas and Asia/Pacific. Additionally supported by a decline of receivables and an increase of payables, traded net working capital was down 8% in currency-adjusted terms. The rolling average of trade net working capital over sales declined to 19.2% - the lowest level since the end of 2014.

Investments were down significantly compared to the prior year period. The decrease was almost entirely due to own retail. Year-to-date, we spent 30% less in this area, reflecting fewer new store openings but also phasing effects related to the renovation of existing stores. This year, renovation projects will focus on the second half of the year, in time with the implementation of the new BOSS store concept. As a result, overall investment spend will be weighted towards the second half of the year. In addition, we shifted a number of renovation projects to 2018 in order to best incorporate the learnings from the first rollouts.

IT was the second most important area of investments. In the first half year, we spent around EUR 10 million in this area, in particular in relation to the rollout of omnichannel services, e-Commerce and customer relationship management. Expenditures in this area were in line with the prior year.

As a consequence of better earnings, lower capex and the reduction of trade net working capital, free cash flow more than doubled and also net debt declined significantly compared to the prior year period.

Ladies and Gentlemen, we have guided for 2017 to become a “year of stabilization” for HUGO BOSS. Our results in the second quarter and the first half year period demonstrate that we are on track to deliver on this promise.

That is why we are confirming 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 continue to forecast retail sales will perform within a range of -3% to +3%. Obviously though, the lower end of this forecast has become a less likely outcome now compared to three months ago.

By region, overall sales in Europe are expected to remain more or less flat on the prior year. The Americas should perform somewhat weaker than the overall Group, Asia/Pacific somewhat better.
Besides our sales outlook, our profit forecasts remain unchanged, too.

The Group’s gross margin should increase slightly year-over-year. A positive channel mix effect and the non-recurrence of prior year inventory write-downs will compensate for negative currency effects, mainly associated with the devaluation of the British Pound.

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%. Net income is projected to increase at a double-digit percentage rate, supported by the non-recurrence of costs related to the aforementioned store closures.

Finally, we are adjusting our forecasts for investments and free cash flow. As we are shifting a double-digit number of renovation projects to the coming year, investments will be around EUR 20 million lower than originally planned. We now project them to be in a range between EUR 130 million and EUR 150 million in the full year. Consequently, we raise the free cash flow outlook to around EUR 250 million.

To summarize my comments today, the results of the second quarter make us even more confident in the achievement of full year targets. We are encouraged by the improvement of retail sales trends in all three regions. And while we invest in building brand momentum, we maintain strict control of costs to keep margins stable.

A continuously difficult market environment means that we are not immune to setbacks, of course. Nonetheless, we look ahead to the rest of the year and beyond with the confidence that we are heading in the right direction.

Before discussing the progress in strategy implementation in more detail, I'll be pleased to answer your questions. Keep in mind that there will be a second Q&A session with the entire Managing Board later on, so please limit your questions in this session on today's set of results and our outlook for the remainder of 2017.