H U G O B O S S

HUGO BOSS FY 2018 Analyst Conference Call

Transcript – Q&A Session

March 7, 2019

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, at the Capital Market Day in November, you had introduced a mid-term target of growing sales between 5% and 7% annually until 2022. So your 2019 target of growing sales mid-single-digit, I think means between 4% and 6%. Is there any reason why the average growth will be a bit more back-end loaded? Or is there any reason to be a bit cautious this year for some macro reason?

My second question relates to the OpEx development. I understand that most of the operating margin gains in 2019 should come from the gross margin. So implicitly, there will not be any OpEx leverage. Could you please elaborate on the different buckets - as there is a cost efficiency program in place, and some digital investments? What will be the impact from the cost savings and from each of the investments that you're targeting?

Mark Langer (CEO): Let me give you some color on the top line guidance. For us, the 5% to 7% that we forecast as average growth rate in our business plan 2022, is also covered in our mid-single-digit perspective for this year. You are right that there are elements from a macro perspective that let us take a cautious view and necessary preparation step in 2019 – which is just in the beginning. But we would see our top line guidance for the full year 2019 as being overall in line with our mid-term guidance.

In particular, for Q1 2019, we face a tough comparison base with a strong like-for-like that we recorded in Q1 2018. In addition, the delivery shifts that we have seen in wholesale will burden at least the first half year of 2019. Therefore, I think we are well advised with a mid-single-digit top line guidance for 2019.

Yves Müller (CFO): Regarding the question on OpEx: First, I want to highlight that in 2018 we achieved our bottom-line target by operating leverage. The gross margin decreased by 90 basis points, and we still achieved our bottom-line guidance. For 2019, we will further pursue our efficiency program. On the other hand, we are committed to invest into the digitization of our business model. With our 2019 guidance of a top-line improvement in the mid-single-digit range and an EBIT improvement in the high single-digits, we are clearly delivering on what we have promised at our Capital Market Day, i.e. to deliver an increase in EBIT margin in 2019.

With the focus on our strategic priorities, we have the right recipe to move on. We as the Managing Board also have to balance between future sustainable growth and delivering short-term profit. Just to give you the right perspective on the investments that we are doing: Today, we record around EUR 130 million of online sales within our wholesale business. We will continue to convert wholesale partners into a concession model, because we are convinced that this is tactically right. Secondly, as of today, we are present in only 12 countries with our own online store hugoboss.com. Therefore, there are many white spots remaining for our hugoboss.com business. In addition, the store renovations will have a big impact on sales and sales productivity. Whenever a rental contract will be renewed, we will start our remodelling, because it pays off. By the way, we are indeed saying that gross margin will be improved by up to 50 basis points; but this does not exclude the possibility that we still might show operating leverage in 2019.

Antoine Belge (HSBC): Just one follow-up on Q1. Do you expect retail like-for-like in Q1 to be a bit below your mid-single digit target for 2019? What has been the running rate in the first two months?

Mark Langer (CEO): We can't comment any further on Q1 trading. However, we are all aware that we experienced a strong double-digit like-for-like growth in our U.S. retail business in Q1 2018. This, as we know, will not reoccur due to the one-time effect of the tax reform having driven short-term customer demand in Q1 2018.

Q1 will be the toughest quarter to beat from a like-for-like perspective. Q1 2018 retail comp store sales were up 7%, i.e. the strongest quarter in 2018. In addition, we quantified the wholesale shift effect from Q1 2019 into Q4 2018 at around EUR 10 million. Both effects are burdening the momentum. However, we are strongly convinced of our full year guidance for 2019 and this is what we want to re-confirm also today.

Andreas Inderst (Macquarie): First, as you guide on reported EBIT for 2019, what kind of one-offs can we plug in for 2019? Would it be best guess to plug in a similar EUR 13 million negative impact, given all the measures you have assumed?

Mark Langer (CEO): The nature of one-offs is that even for the smartest management team they are hard to predict. Especially, as we would discuss this item at such an early stage now. That is why you will get no further quantification on implicit one-offs in our 2019 forecast. However, given the global structure of our business and the complexity of our supply chain, there will most likely be one-time expenses also in 2019. We think it is the right thing to do – also with the IFRS 16 changes that Yves has explained to you – to guide on EBIT from 2019 onwards, which includes also these one-time effects. We just follow best practice in our industry in this regard. You can be sure it is a management obligation to manage the business to ensure we deliver on our results, which will probably include some less predictable items such as one-off items.

Andreas Inderst (Macquarie): My second question is on your 2019 market expectations for the U.S., China and Europe. Can you please outline your growth prospects beyond your general comment, for China in particular?

Mark Langer (CEO): First, something that we already highlighted at the beginning of the year with our preliminary results is that – while industry voices speculated on a slowdown of Greater China – this was not the case for us in Q4 2018.

We have seen a very robust above Group average performance in this part of the world. By the way, also some smaller Asian markets, for example Japan, also showed very strong results. We are happy, without going into much further detail, with the Chinese New Year development – a clear revenue driver in Q1 2019. This is embedded in that we expect an above Group average, i.e. high single-digit growth, for the Asia/Pacific region. This strong underlying market is clearly more favorable than what we are currently seeing in the European or North American markets. In addition, we expect the Asian/Pacific market to also benefit from our investments into

the digital distribution. The upgrading of our collaborations with important partners like Tmall will allow us to tap more aggressively into these growth opportunities.

Our outlook on Europe and North America is a bit more muted. For the full year, these markets will clearly contribute to growth, but with growth rates that will rather be in the low to mid-single-digit range. As I mentioned earlier, especially the U.S. market is burdened by a very strong like-for-like comparison base from Q1 2018. However, this will be a single quarter effect. Nevertheless, we do see that the underlying market is clearly more muted compared to the Asia-Pacific region for all of our industry. And this is reflected in our forecast.

John Guy (MainFirst): Just one clarification on retail sales densities. I noticed that there was a restatement on your reported sales densities within your retail business. They seem to have moved up by only EUR 100 to EUR 10,700. This is still EUR 800 below where you were back in 2015. Is this correct? What improvement in productivity do you expect for 2019?

Secondly, your gross margin to increase by up to 50 basis points in 2019. Moreover, you commented on progressively reducing your stock levels over the course of the year. I appreciate that the bulk of what you have in stock is effectively never-out-of-stock inventory. Could you please comment on how you see the moving parts within gross margin, because you said that markdowns would be better managed going forward? The effects should be slightly positive. You also talked about a positive channel mix for 2019. There has not been a positive channel mix in 2018. I also guess that there will probably be some implied markdown, maybe not that much, given where you are going to sell your stocks.

Finally, on the costs: the selling expenses were obviously very well managed in 2018 –down to just under 200 basis points. Marketing was also down by 6% or 60 basis points. Clearly, you will be looking into investing in both of these areas, with the new store concept and with pushing your two-brand strategy going forward. Therefore, when you say that there might be some operating leverage coming from the expense line, where is that going to come from?

Yves Müller (CFO): Regarding sales productivity, as we said at the Capital Markets Day, we will be clearly focusing on achieving a 4% CAGR in sales productivity for our brick-and-mortar business. What we did is – and this is what we said back at our Capital Markets Day – that we have now excluded our own online business in this calculation, and this is what we will also do going forward. Regarding the sales density improvement of EUR 100: be aware, that this is true on a euro basis. However, if you take adjust this figure for currency-effects, it was up between 3% and 4%. Therefore, currency-adjusted sales density growth has actually been quite close to what we are expecting on average until 2022.

Regarding the gross margin guidance of growth of up to 50 basis points for 2019: clearly, we will see a positive channel mix effect, as we forecast retail to outgrow wholesale. Moreover, we expect to see a slight positive effect from markdown management. In Q4 2018, this is actually what we have achieved: we had a very good like-for-like performance of 4% and we even lowered our markdowns as

compared to the prior year. This will continue actually also in 2019. We expect to see an improvement in gross margin of up to 50 basis points. Markdown management, i.e. less rebates as compared to 2018, will contribute to this. In addition, we want to improve our free cash flow from EUR 170 million in 2018 to a range of between EUR 210 million and EUR 260 million in 2019, although we forecast CapEx to be higher in 2019 than in 2018. The dominant part of free cash flow growth will be coming from profit improvements and the normalization of inventory levels.

Regarding the marketing expenses: yes, they decreased in 2018 versus 2017. However, please keep in mind that with IFRS 15 there has been an accounting change: a mid-single-digit million euro amount, previously recorded as marketing expense, had to be reclassified and hence booked as sales deduction. This refers to shop fit contributions that we are granting to wholesale partners. This reclass predominantly led to the effect that marketing spendings went down in 2018.

John Guy (MainFirst): One additional question on your fast-track concept to bring products quicker to market and drive a higher full-price sell-through: What has been the percentage of fast-track in terms of sales for 2018, and where are you going to take that in 2019?

Mark Langer (CEO): With our fast-track concept, we re-produce bestseller items that we identified early in the season. It is something that we have been doing for many years already. Both our wholesale and our retail channel are benefiting from it. For certain product categories, be it Jersey or even Clothing, we are able to re-produce items for which we see a stronger than anticipated sell-through. That surely is not something completely new.

The far more exciting part is that we are now able to have a digital developed collection – by the way, something that we can also use from a marketing perspective. Within this digitally developed collection, items such as sneakers, trousers, jersey or outerwear are developed now with lead times of less than 7 to 8 months. This represents a reduction of more than 5 months versus previous practice, and allows us to be much closer to the latest fashion trends, especially in casualwear.

We are now within the fourth generation of our digitally developed HUGO collection. For the first time – and I think it's an important milestone – we have now seen a digitally developed collection to slightly outperform in productivity, sell-through rates, and lower markdowns, as compared to the traditional one. It is still early. As I indicated, we are just starting to grow the digitally developed part of our collection. However, as this proves to be a structural advantage, I think it is a very strong sign that this is not only a far more cost efficient, but also a superior way to operate in our industry. That is why we would like you to focus more on the overall reduction in lead times via the digital development process, than on the fast-track process, which is more or less already common practice within our industry.

Jürgen Kolb (Kepler Cheuvreux): First, Mark, you just talked about the digitization and your speedboat at HUGO. When do you think the digital advancements that you have developed at HUGO can be shifted over to BOSS?

Secondly, on marketing, your guidance was always a marketing level of 6% to 7% of sales. Is that still the run rate, given the IFRS 15 impact? Or shall we assume that going forward the marketing expense ratio will rather be at the low end of that corridor?

Mark Langer (CEO): You are right. With HUGO, we have developed digital capabilities – be it our digital showroom, be it a fully digital development process – and this is spreading quickly throughout our organization. Sometimes, designers or technical developers that are working with these tools for HUGO are also serving different brand lines, be it BOSS Menswear or Womenswear, for some product categories. So also for BOSS, we started to see already in 2018 that the number of physical prototypes is going down in some product categories, such as outerwear. Therefore, I am very confident that – even though we have not quantified it yet – we will quickly transfer the learnings from HUGO into the development process of BOSS. What we can already confirm today is that we have initiated to use the digital showroom also for BOSS, also triggering some investments in 2019. In doing so, we will start to reduce our samples also for BOSS in 2019. We got very positive feedback from wholesale buyers using the digital showroom, as they say it is a much better tool to curate your buy. Regarding the development side for BOSS, we will probably give you more details on our expansion plan in the later course of this year.

Yves Müller (CFO): Regarding marketing expenses, yes, we stick to our range between 6% and 7% of sales per annum. As we already told you back at our Capital Markets Day, we will actually grow marketing expenses in line with our sales development. In addition, we have an ongoing project regarding marketing effectiveness, as we see a more efficient marketing spending coming from the higher share of digital marketing.

Elena Mariani (Morgan Stanley): First, on your online concession business: Can you please quantify the contribution from the conversion of online platforms into concession businesses in your 2019 guidance, as part of the growth can be explained by the transformation of some revenues from wholesale to retail?

In this context – excluding these effects – what is the effective underlying growth that you are expecting both in wholesale and in retail? I was getting to something like flattish wholesale growth for the full year and a low single-digit growth in physical retail. Could you confirm if my calculation is correct?

Secondly, on wholesale: I have been a bit surprised by your guidance – excluding also the effects from the conversion of wholesale online sales into online concessions – wholesale guidance seems to be quite soft for full year 2019. Can you please share some feedback from the retailers on your product launches, on the excitement around HUGO and BOSS, and why there won't come stronger wholesale growth in 2019 from on an underlying basis?

Mark Langer (CEO): We do have some visibility into the wholesale order intake for 2019. We do see a continued strong demand – like we have seen in our own e-com business – be it from wholesalers with hybrid models or online pure players, which are still clearly outgrowing the overall market.

So pure players like ASOS or Zalando, but also other wholesale partners are clearly growing at a rate above the underlying market. And our traditional department store partners that are operating in both physical retail brick-and-mortar and online, say that their e-com part of business is growing significantly stronger than the brick-and-mortar business.

The vast majority of our around EUR 1 billion wholesale business is still driven by brick-and-mortar sales in Western Europe and North America. Two regions, which are not benefiting as much as Asia from underlying momentum. This, and the order intake that we have seen, gives us good reason to be rather cautious and has us forecast our 2019 wholesale business to be rather flattish. In addition, the delivery shift effect from Q1 2019 into Q4 2018 plays a role here.

The first part of your question related to the potential dampening effect of the conversion of wholesale online accounts into retail concessions on our wholesale development, and how it clearly helps to grow sales in our retail business. However, it is too early to quantify this effect now. Many of these negotiations are still ongoing, also regarding the “switch over date”, and we still need to see what will be the full impact. Let me highlight that we are making good progress to grow our e-com concession business already in 2019. As you know, it is a major element of our 2022 business plan to quadruple our own e-com sales to EUR 400 million, with the biggest part of that growth to come from digital concessions.

We are having good negotiations and make some good progress, but it is too early to quantify the impact of that. The implicit CAGR of 40% on our e-com business growing from EUR 110 million in 2018 to EUR 400 million by 2022 is especially driven by concessions, both in absolute as well as relative terms. I prefer to give you more details on successful completed conversions at our quarterly release dates, starting with our next session on the Q1 2019 results on May 2nd. By then we will have better insights on the positive effect on retail, and on the dampening effect on wholesale.

Elena Mariani (Morgan Stanley): Given your full year 2019 guidance, can you please share your underlying assumption?

Mark Langer (CEO): I ask for your understanding, but we only say that without these concessions takeovers, wholesale sales would be slightly higher, and we see the corresponding effect on retail. I ask for your understanding, because the moment I give you quantitative details, we lock ourselves in, in an unnecessary way, to complete these deals - maybe on unfavorable terms, because we are committed to achieve a certain sales impact.

Moreover, I am not interested in the strongest top-line effect of that, but I rather want the most attractive deal for HUGO BOSS. For us as a management team, this includes to have some flexibility to do the right deal – and not just one, which is implicitly guided in our top-line guidance. We run this business for profit, and not for a certain retail sales target. Therefore, we need the flexibility to take the right decision for the business.

Elena Mariani (Morgan Stanley): One follow-up on your 2019 guidance based on reported EBIT rather than adjusted EBIT. Regarding reported EBIT, you recorded EUR 13 million of negative extraordinary items in 2018. Are you expecting to have a similar amount of negative extraordinary items also in 2019? Because otherwise, it's quite difficult to understand your underlying guidance on EBIT margin growth?

Mark Langer (CEO): We had years, where we have seen significantly higher non-recurring expenses. You remember that 2016 was an outstanding year with major retail restructuring, and we are clearly not envisioning something like this to happen in 2019.

Not only due to the IFRS 16 changes, we think it is right to guide on EBIT as the best proxy for the year. We will not provide you with our assumption for non-recurring expenses in 2019. It could be in the magnitude of 2018, but this is not a "budgeted value". However, be clear that if any non-recurring expenses will be incurred in 2019 – such as the one in Q4 2018 relating to pension liabilities – we will be very explicit. We have a valid track record to be very open to explain any non-recurring expenses transparently to our investors – be it positive or negative. We will disclose these items, but we cannot give you a more explicit guidance on the EBIT margin 2019 in this regard.

Fred Speirs (UBS): First, on online. You mentioned hugoboss.com currently being available in 12 markets. Can you give us a sense of what proportion of your total group sales are coming from those 12 markets?

Secondly, how do you factor FX into your guidance in terms of top-line and EBIT?

Mark Langer (CEO): The EUR 110 million online sales of 2018 were coming from these 12 markets. In 2019 we expect to add Scandinavia and Ireland.

Fred Speirs (UBS): Sorry, just to be clear: can you tell us the proportion of total Group sales for the 12 markets that you currently serve online? Can you quantify the online sales share in those 12 markets?

Mark Langer (CEO): First, it is easy to calculate the share of the EUR 110 million of the EUR 2.8 billion Group sales. Or if you look from the retail perspective, it is rather EUR 110 million out of EUR 1.8 billion retail sales. If you look market by market, the share may of course vary. Certainly, markets where we have the highest online penetration are the U.K. and Germany, each with a double-digit share of online on our retail sales. Italy, for example, is still a market where online penetration is lower. Overall, in the markets where we operate both with our brick-and-mortar and e-com business, the online share of our retail business is roughly in the high single- to low double-digit range.

Yves Müller (CFO): Regarding FX in 2019, overall, we expect only a very small, neglectable impact. That is what we included in our guidance. We see a very low single-digit million euro amount from FX negatively impacting EBIT. However, we are at the beginning of the year, and it is difficult to predict.

Melanie Flouquet (JPMorgan): How will the tax rate will evolve in 2020? If I got your outlook correctly, the tax rate will still be around 30% in 2019. So, when will it start to normalize, in 2020?

Secondly, on D&A. You recorded lower than usual impairments in Q4. Will that be the new normal, ex-IFRS 16? Or has it been an exceptional year with regard to the lower impairments?

Yves Müller (CFO): We expect the tax rate to go down in 2020 again, to a rate within the range of between 26% and 28%.

Regarding D&A, which is heavily related to our impairments: we recorded lower impairments in 2018, because impairments are usually extraordinary depreciations on the assets of our stores. There are three good reasons why impairments were lower in 2018: First, we have experienced a very good like-for-like performance recently, accelerating from 3% in 2017 to 5% in 2018. And the better the store performs, the less impairments you will have. Secondly, the slowdown in our retail expansion and the stronger focus on remodelling or relocating stores comes with less risk and, as a consequence, impairments are usually lower. Thirdly, we are much more restrictive regarding store approvals than in previous years.

Melanie Flouquet (JPMorgan): Just a clarification: will the like-for-like growth rates that you will report from Q1 2019 onwards exclude e-commerce?

Yves Müller (CFO): No, our reported like-for-like growth rates will continue to include our like-for-like e-com business. No change to prior years. They have always been included in our like-for-like growth rate, and this will continue also going forward. Just to be clear: the metric "sales productivity" clearly relates to the brick-and-mortar business only. In contrast, like-for-like also includes online, because there are like-for-like countries where we are doing like-for-like online business.