Full Year Results 2018 Presentation

Metzingen, March 7, 2019

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- The spoken word shall prevail –

Good afternoon ladies and gentlemen.

My name is Christian Stöhr, I am heading up the Investor Relations activities here at HUGO BOSS and I would like to welcome you to our full year 2018 financial results presentation.

Today's conference call will be hosted by Mark Langer, CEO of HUGO BOSS, and Yves Müller, CFO. We have a lot of topics to cover today, so let's get started and over to you, Mark.

Thanks Christian and good afternoon ladies and gentlemen. Also from my side, I would like to welcome all of you - following our meeting today either via the web or over the phone - to the presentation of our 2018 financial results.

In the next thirty minutes, Yves and I will discuss our 2018 fiscal year operational and financial performance before taking a closer look at our expectations for 2019, the first full year of our mid-term strategic business plan.

But let me start with a quick review of the 2018 fiscal year.

I am pleased to report that we achieved our targets for 2018, thus delivering on what we had promised almost exactly one year ago. Back then, in March 2018, we highlighted the importance of successfully implementing our strategic priorities, as they will be the key enabler to accelerate brand momentum and deliver sustainable profitable growth.

With currency-adjusted sales growth of 4% to 2.8 billion euro, we have increased our pace of growth as planned. Even more encouraging is that this growth was broad-based, no matter whether we look at the performance by region or by channel.

Above all, our own retail business, and here in particular our online business, enjoyed dynamic growth in 2018. While sales growth accelerated in all regions, it was in particular the important Asia/Pacific region where the positive trend from previous years continued. Despite some uncertainties with regards to the strength of the underlying Chinese economy, our Chinese business continued to record overproportionate growth in 2018.

This positive sales development does not only show that both BOSS and HUGO resonate well with our customers, it also means that the consistent execution of our strategic priorities has started to pay off.

Besides sales, operating income also turned out as forecasted at the beginning of 2018. At 489 million euro, EBITDA before special items remained on the prior year's level. A series of investments to ensure sustainable, profitable growth was the reason why we have not yet converted sales growth into higher profits. These included especially investments in the quality of our products and in the digital transformation of our business model.

I am particularly pleased that we also made significant progress in implementing our strategic priorities in 2018. In this context, we are very proud of the successful realignment of our BOSS and HUGO brands, aimed at addressing our customers clearly and more consistently through our Two-Brand-Strategy in the future.

With the launch of the Spring/Summer 2018 collections, our customers were able to experience the new brand positioning for the first time last year. And although the two brands are clearly distinguishable from each other in terms of their individual attributes, targeting different customers, they embody the same high values such as quality and fit, innovation and sustainability. It is these attributes, making both BOSS and HUGO the preferred brand of choice for our customers.

While the feedback we get from our customers following the brand realignment is encouraging to all of us, it is important that we continue to listen carefully to what our customers have to say - be it through our physical stores, our own website, or the various digital channels. In doing so, we will create the best products in our industry, maximize customer satisfaction, and drive brand desirability!

From a brand perspective, clearly the BOSS and HUGO fashion shows were particular highlights in 2018.

In September, we presented BOSS Menswear and BOSS Womenswear together again for the first time as part of New York Fashion Week. With the theme “California Breeze”, the new Spring/Summer 2019 collections created excitement – and received very positive feedback. The event also left a strong mark in the digital world, where we reached more than 50 million fans and followers throughout our various social media and brand channels.

HUGO had already presented its Spring/Summer 2019 collections in July as part of the Berlin Fashion Week. Inspired by those who mix and match styles of different decades to create their own aesthetic and with striking neon colors, light fabrics, and contrast details, HUGO reflects the modern street style of Berlin's “mix masters” and club scene.

We also made significant progress in further developing our distribution strategy. That was true especially for our online business, which, as you know, is of strategic importance for us. In 2018, we recorded strong double-digit growth in our own online business and, for the first time, achieved sales of more than 100 million euro. This is proof positive that we successfully implemented improvements to the hugoboss.com website and that customers are responding very well to our online presence with its consistent alignment toward BOSS and HUGO.

To further strengthen our digital footprint, in fall 2018, we intensified our partnership with the online retailer Zalando. While, for the first time, we added BOSS businesswear to the product range available through Zalando, importantly, from now on we will be offering this collection via the partner program platform by ourselves – from product presentation to pricing to fulfillment.

I am convinced that we will be able to serve the needs of our customers even better in the future with this sort of cooperation. Consequently, we have set ourselves the goal of entering into further cooperations in the online segment in the coming years, starting in 2019, with a strong focus on Asia/Pacific and Europe.
In 2018, we also successfully advanced our most important distribution channel, brick-and-mortar retail. By rolling out our new BOSS store concept, we further optimized and modernized our store portfolio. Already today, our customers can experience our

menswear and womenswear collections in a new, exciting environment in 26 BOSS stores worldwide.

With modern architectural features and a large number of digital services, this store concept guarantees customers a unique shopping experience. Importantly, the new store concept has also started to yield financial benefits, as reflected by improvements in sales, units per transaction, and store productivity, which we were able to witness for a number of renovated stores.

HUGO has also been presenting itself with an innovative new look in many major cities since 2018. The first HUGO stores with their unique store concept opened last year in London, Paris, and Dubai, among other key metropolitan areas. In total, we have opened twelve HUGO freestanding stores in 2018 and see the potential for additional openings in 2019 and beyond. Our fashion-conscious, progressive HUGO customers from all over the world are impressed by our unconventional store designs and the tight integration of social media features.

While we truly believe in HUGO's ability to excite our customers in a mono-branded environment, we will carefully assess future store openings by their potential to drive profitable growth for our company.

To conclude on our strategic initiatives, we have also made very good progress in driving the digitization of our business model. We increasingly develop and distribute our collections using digital tools. This enables us to respond faster to changing market trends. This is particularly true for HUGO – our digital speedboat – where product development for certain parts of the collection is fully digitized already today.

For distribution to wholesalers, we rely more and more on the use of digital showrooms, which have been in operation for the HUGO brand since the end of 2017. Digital showrooms allow our wholesale customers to browse the entire HUGO collection and enable orders to be placed directly. And in our physical stores, we provide customers with a high-quality and seamless shopping experience thanks to a large number of digital services across all our distribution channels.

There is no doubt, the digitization of our business model – from beginning to end – is in full swing and we are excited about the many opportunities that will come with it in the future.

Ladies and gentlemen, this concludes my review of the operational highlights of 2018. Before I talk you through our operational expectations for the 2019 fiscal year, let me hand you over to Yves, who will give you some more details on the financials for 2018 and the financial outlook for 2019.

Yves, over to you!

Thanks very much, Mark, and good afternoon, ladies and gentlemen. As Mark already mentioned, in my comments today, I will focus on the financial highlights for 2018 and 2019.

As you know, this was the first full year for me as the CFO of HUGO BOSS. I am encouraged that we delivered on our top- and bottom-line targets for 2018, despite some external headwinds that the industry had faced during the course of the year.

As promised, and as Mark already alluded to, our strategic initiatives have yielded an acceleration in sales growth in 2018. Group sales increased by 4% on a currency-adjusted basis. In euro terms, sales were up 2% to 2.8 billion euros, reflecting the ongoing appreciation of the euro against most other currencies in 2018.

All three regions recorded currency-adjusted sales increases in 2018:

- Europe was up 4% in currency-adjusted terms, benefitting in particular from double-digit growth in Great Britain and solid growth in most of the region's other markets, including France and BeNeLux.
- The Americas were also up 4% on a currency-adjusted basis, thus exceeding our initial expectations of a low-single-digit increase for the full year. The important US market returned to growth in 2018, up mid-single-digits.
- Lastly, looking at Asia/Pacific, the region recorded a strong 7% increase on a currency-adjusted basis. Momentum in China remained strong throughout 2018, resulting in high-single-digit sales growth. Japan was an especially bright spot in the region, recording low-double-digit growth in 2018.

By distribution channel, own retail sales grew 4% currency-adjusted, supported by an increase in all formats. On a comparable store basis, own retail sales were up a good 5%, on top of a 3%-increase in the prior year period. Main driver behind this performance was a strong improvement in conversion rates, partially offset by a slight decline in the average selling price reflecting the higher share of casualwear in our product mix.

From a regional perspective, Asia/Pacific recorded the strongest performance with a high-single-digit comp store sales increase. Comp store sales in the Americas and in Europe grew at a mid-single-digit rate, each. I am particularly encouraged by the strong performance of our online business, up 41% on a currency-adjusted basis in 2018 and with strong double-digit improvements across all three regions.

Sales in the wholesale channel recorded a robust 5%-increase on a currency-adjusted basis, supported by mid-single-digit improvements in both Europe and the Americas. There were, in particular, two effects that contributed to the sales development in 2018, which ultimately turned out somewhat higher than initially expected.

- Firstly, our replenishment business, which allows HUGO BOSS to respond to short-term demand from wholesale partners, developed particularly strongly, up high-single-digits on a currency-adjusted basis.
- And secondly, we also recorded a positive effect from delivery shifts, which led to sales increases in the fourth quarter of 2018.

To conclude on our distribution channels, the licensing business declined 4% on a currency-adjusted basis in 2018. Increases in the license income for watches and eyewear were more than offset by declining license income from fragrances. The latter mainly reflects the anniversary effect of the change in license partner towards the end of 2016, which yielded double-digit increases in 2017. This said, we are clearly not satisfied with the current performance of our fragrance business and have raised this topic vis-à-vis Coty, our licensing partner.

Completing my discussion around the top-line development, let’s have a look at our brands. In particular, I am pleased about the strong performance of our BOSS brand, where sales increased 6% currency-adjusted. This development was driven by high-single-digit growth in both businesswear and casualwear.

HUGO, in turn, was negatively impacted by strategic distribution changes, aimed at sharpening the brand's positioning. In this context, in 2018 we continued to transfer selling space from HUGO to BOSS at those wholesale accounts where the brand environment speaks more to the BOSS customer rather than the HUGO customer. At the same time, we made further progress in our approach to no longer distribute the brand in some of our BOSS stores and to reduce the presence of HUGO in the outlet channel. All measures combined resulted in an anticipated sales decline, down 4% currency-adjusted versus the prior year level. Strong double-digit growth in casualwear could only partially offset sales declines in businesswear.

By gender, our menswear business recorded 5% currency-adjusted sales growth, driven by double-digit increases in casualwear and mid-single-digit growth in businesswear. Sales for our womenswear business declined 3% currency-adjusted, reflecting the reduction of selling space within BOSS freestanding stores. This could not be offset by growth for the womenswear of the HUGO brand.

Moving below the top line, let's have a look at the development of major P&L items.

At 65.2%, the gross profit margin declined 90 basis points in 2018, in line with our adjusted outlook for the full year. This development was mainly due to the planned investments in product quality, in order to upgrade our BOSS casualwear offering. In addition, currency effects had a slightly negative impact on the gross margin development.

On the cost side, selling and distribution expenses declined 2%. A slowdown in retail expansion and positive effects from the ongoing renegotiation of rental contracts in the own retail business were the main drivers for this decline.

Administration expenses grew by 4%, reflecting investments in the digital transformation of our business model. There is no doubt that these investments will help us to fully exploit the tremendous opportunities we have identified in digital. The strong double-digit increase of our own online business in 2018 is clearly a reflection of our first successes in this regard.

At 489 million euro, EBITDA before special items remained on prior year level as guided. Positive impacts from the increase in sales and the tight operating cost management were offset by the aforementioned investments in product quality and in the digital transformation of the business model.

Depreciation and amortization amounted to 129 million euro, down 18% on the prior year. This development is mainly due to a slowdown in retail expansion as well as lower impairments for our own retail stores, reflecting the improvement in underlying performance. As a result, EBIT rose by 2% to 347 million euro.

The Group tax rate came in at 30% in 2018, as income taxes were higher than initially anticipated. Expenses related to the recognition of a provision for risks arising from an external tax audit were the main contributor. On the other hand, the 2017 non-cash tax expense in connection with the revaluation of deferred tax assets in the US did not recur. In line with EBIT, net income rose 2% to 236 million euro.

If we look at the earnings development by region, Asia/Pacific once again stood out, generating a significant margin improvement for the second year in a row. The region's segment profit rose 9% in 2018. In addition to the increase in sales, a decline in operating expenses contributed to this development. At 24.2%, the adjusted EBITDA margin was up 120 basis points on the prior year.

In Europe, segment profit was up 4%, as the increase in sales more than offset slightly higher operating expenses. As a result, the adjusted EBITDA margin increased slightly, by 10 basis points to a level of 31.1%.

In the Americas, operating profit was down 17% due to negative currency effects, following the appreciation of the euro versus the US dollar . These negative currency effects more than offset the positive effect from lower operating expenses. Accordingly, the adjusted EBITDA margin for the Americas was down 340 basis points to 17.2%.

Now, let's move over to the key balance sheet and cash flow items.

Starting with inventories, which were 14% currency-adjusted above the prior year level. Let me be very clear that one of our key priorities for 2019 is to bring inventories down to a normalized level. Compared to the first nine months of 2018, the inventory increase has already started to decline – a trend we expect to continue over the course of 2019!

Speaking about inventories, let me also reiterate what I had already explained back in November 2018: The vast majority of the inventory position is related to never-out-of-stock products, in other words product groups that are not related to a specific season. This in turn means that we should be able to normalize inventories sequentially during the course of 2019, without a need to sacrifice gross margin development – just the way we achieved this during the fourth quarter of 2018!

As a result of the inventory increase, trade net working capital grew by 16% on a currency-adjusted basis. At 19.7%, the moving average of trade net working capital as a percentage of sales based on the last four quarters was 110 basis points above the prior year level.

Investments in our business were once again a key priority in the last year, as Mark explained before. At 155 million euro, capital expenditure rose by 27 million euro compared to the prior year. The anticipated step up in store renovations as well as continued investments in the IT infrastructure were the main drivers for the increase.

With investments of 89 million euro, the Group's own retail business was once again the focus of investment activity. Of this, 45 million euro were spent on store renovations, an increase of 36% compared to last year and reflecting the almost 30 BOSS store renovations in 2018. Investments in store openings remained on the prior year level at 44 million euro, partly due to the planned opening of our new outlet in Metzingen.

IT investments rose to 36 million euro, an increase of 5 million euro versus the prior year. These investments mainly focused on the further digitization of the own retail business and the development of the ERP system.

The increase in working capital and the step-up in capital expenditure resulted in the anticipated decline in cash flow. While free cash flow, at 170 million euro, was noticeably below the level of 2017, this development was in line with our initial guidance. Finally, net debt only increased marginally to 22 million euro at the end of 2018.

Let me conclude my review of the 2018 financial year by reconfirming our commitment to our dividend policy, aimed towards continuity, which we had talked about in detail during our Investor Day back in November.

Accordingly, we will propose a dividend per share of 2 euro 70 cents for the 2018 financial year. This represents a 2% increase compared to the prior year, in line with the increase in net income. At 79%, the payout ratio will remain on the prior year level and thus at the very upper end of our dividend payout corridor of between 60% and 80% of consolidated net income.

Now, let’s change perspectives and look ahead into 2019, the first full year within our strategic business plan until 2022. The year 2019 will therefore be all about the execution of our strategic priorities and mark the first major milestone towards achieving our mid-term financial ambition.

We expect Group sales to grow at a mid-single digit percentage rate on a currency-adjusted basis, thus outgrowing the global economy as well as the relevant market segment in 2019. All regions are forecasted to contribute towards sales growth with the strongest increase expected to come from Asia/Pacific. The region is projected to grow at a mid- to high-single-digit percentage rate on a currency-adjusted basis, led by significant growth in the Chinese market. Europe and the Americas are both forecasted to grow at a low- to mid-single-digit percentage rate.

From a channel perspective, growth will once again be driven by our own retail business, where sales are expected to increase at a mid- to high-single-digit percentage rate on a currency-adjusted basis. This forecast is based on the assumption that comp store sales will grow at a mid-single-digit percentage rate on a currency-adjusted basis. In addition, our online business will continue to contribute overproportionally to retail growth.

Turning below the top line, the gross margin is expected to increase up to 50 basis points in 2019. This development will be supported by a positive channel mix as the retail business is expected to grow stronger than wholesale. In addition, improvements in markdown management should contribute to the gross margin development.

Operating expenses are forecasted to increase moderately. First positive effects from the efficiency program will be largely offset by further digital investments including the expansion of the concession model, as well as the rollout of the hugoboss.com website to additional geographies. These investments are not only important to drive the further digitization of the business model, but also to further stipulate the positive sales momentum in our online business.

EBIT, our new key performance indicator to judge our bottom-line performance, is forecasted to increase at a high-single-digit percentage rate and thus stronger than the top line. This development will be driven by the anticipated sales increase, the improvement in gross profit, as well as tight operating cost management. In line with EBIT, net income should also increase at a high-single-digit percentage rate.

Moving over to the balance sheet, we expect capital expenditure to increase to a level between 170 million euro and 190 million euro. Our clear priority for investment activity will continue to be our own retail business and IT-infrastructure. Alongside the accelerated upgrade of existing BOSS stores to the new store concept, we are also investing in our new state-of-the-art outlet in Metzingen, which is expected to open in September 2019. Investments in IT-infrastructure will mainly focus on further strengthening the online business, and expanding our digital brand communication and CRM capabilities.

As promised back in November, we will continue to put particular emphasis on inventory management, as we are committed to bringing down inventories. In this context, 2019 should see a gradual improvement quarter after quarter, as we forecast inventories to be stable towards year-end. This will result in a decline of average trade net working capital by 50 to 100 basis points compared to year-end 2018. Consequently, free cash flow is expected to improve significantly to a range of between 210 million euro and 260 million euro.

Now, before handing back to Mark to look at our operational topics for 2019, let me spend a minute on IFRS 16. From our press release earlier this morning, I am sure you have noticed, that our outlook for 2019 does not include any implications that are expected to occur following the first-time adoption of IFRS 16.

To make it very clear, the implementation of IFRS 16 will not have an economic impact on HUGO BOSS. It has no effect on the way our business is run, nor on total cash flows. It does, however, have a significant impact on our balance sheet. There is also an impact on the P&L, as lease expenses are no longer booked as operating expenses, but split into two components: firstly, depreciation of right-of-use asset and secondly interest from discounting future lease obligations. IFRS 16 also has an impact on free cash flow as operating lease expenses are no longer treated as operating expenses and this will, as a result, boost operating cash flow.

To be more precise, we expect the following implications to occur during the course of 2019:

- The increase in total assets on the balance sheet will be between 1 billion euro and 1.2 billion euro.
- EBIT is expected to increase by a low-double-digit million euro amount as the depreciation of the right-of-use asset will be lower than the previous operating lease expenses.
- Net income instead is forecast to decline by a single-digit million euro amount as the sum of depreciation and interest charges is expected to be slightly higher than the previous operating lease expenses.
- And, last but not least, free cash flow is expected to increase by a low-triple-digit million euro amount.

To ensure comparability between our 2018 actuals and our 2019 outlook, we will report 2019 actuals both including and excluding the effects from IFRS 16, starting with our reporting for Q1 2019 in May.

With this ladies and gentlemen, let me hand you over to Mark to share with you our initiatives for 2019.

Thank you, Yves. There is no doubt, ladies and gentlemen, that with the financial outlook presented today, we will achieve a major milestone towards our mid-term financial ambition of growing the business with a 5-7% top-line CAGR and towards achieving a 15% EBIT margin by 2022.

But 2019 will be much more than that. Most importantly, 2019 will be a year, where we will make further progress towards our vision of “being the most desirable premium fashion and lifestyle brand globally”. This is what ultimately drives us, and this is what our strategic initiatives in 2019 will be centered on.

In 2019, our initiatives will once again focus on driving personalization and speed to ultimately enhance the desirability of both BOSS and HUGO. This will be our guiding principle, no matter whether we define our action plan from a brand, distribution, or operations perspective. Let me therefore show you some of our operational initiatives for 2019 to further drive brand momentum and excite our customers.

Starting with the BOSS fashion show that took place in New York City three weeks ago, where both our menswear and womenswear collections for Fall/Winter 2019 were presented. This time, the gallery district in Chelsea has inspired the design and creation of the new men’s and women’s looks in the collection. Highlighting the event as “BOSS Curated”, the art of sophisticated style was celebrated with fine attention to detail, modern silhouettes, and unique materials with artistic highlights.

To leverage the content from the fashion show, we put a particular focus on social media, using the most relevant social media channels. On Instagram, for example, followers had the opportunity to look behind the scenes and to see the runway presentation from multiple perspectives.

To drive excitement with our customers, we will put an even stronger focus on collaborations in the years to come. Here, I am particularly proud that we were able to enter into a close collaboration with Porsche in the innovative Formula E.

As part of this collaboration, we will be launching a joined collection, incorporating design elements of the first fully electronically powered Porsche Taycan. The high-quality collection consists mainly of sporty casualwear styles and modern tailoring. The collection will be available in selected stores and online later this month.

Moving over to HUGO. The brand will continue to play a key role in driving the digital transformation of HUGO BOSS. After successfully introducing the digital collection in 2018, this year will see a further extension of the digitally developed assortment. By year-end, we are targeting up to 10% of HUGO’s total collection to be developed digitally. This compares to 1% in 2018 and is consequently a major milestone towards commercial reality!

To drive engagement with the HUGO customer and to create more buzz around the brand, HUGO will return to Berlin this summer to celebrate the brand and the city in a new, innovative way. There is more big news around HUGO to come, in particular on the marketing side of things and we will talk about it over the course of 2019. So, stay tuned for some exciting announcements later this year.

2019 will of course also be a year where we will make further progress in exploiting online opportunities. Starting with our digital flagship hugoboss.com, which will be rolled out to additional geographies as already mentioned during the Investor Day. In the second half of 2019, Scandinavia and Ireland - markets with a strong digitally minded customer base – will be onboarded to our digital flagship.

In addition to our own website, in 2019 we will continue to expand the online concession business by adding new, leading online platforms to it. Some of them will be conversions from former wholesale models – some of them will be new partnerships we are about to enter into. And, of course, not to forget our partnership with Zalando, where we will be intensifying our collaboration by adding further countries to our Partner Program.

On the brick-and-mortar side, we will continue to optimize our BOSS store network. We have seen great improvements in retail KPIs for many stores that were either renovated, right-sized, or in some cases even relocated. Unsurprisingly, the further optimization of our store network, aimed at driving retail productivity, will become one of our key priorities for 2019. This will include some of our large flagship stores such as on the Champs Élysées to give you just one prominent example.

As you know, we are also committed to growing our physical footprint for the HUGO brand. In this context, 2019 will see further store openings across a number of metropolitan centers, among others Moscow, Hong Kong, Singapore, and Los Angeles. The expansion in 2019 and beyond will clearly be of a gradual nature and not be anything close to an aggressive push to ensure we run the right number of stores in the right areas. We are looking forward to introducing HUGO's mono-branded appeal to a larger customer base all over the world.
Now, ladies and gentlemen, this concludes my operational outlook for 2019. Yves and I are now happy to take your questions. Just like in previous quarters, we kindly ask you to limit the number of questions to two, so that all of the participants will hopefully have a chance to ask their questions.

OK, ladies and gentlemen, that completes our conference call for today. Our next reporting date will be May 2nd. If you have any questions, please feel free to contact any member of the Investor Relations team. And with that, I would like to thank you for your participation and wish you a very good day. Talk to you soon. Bye-bye.