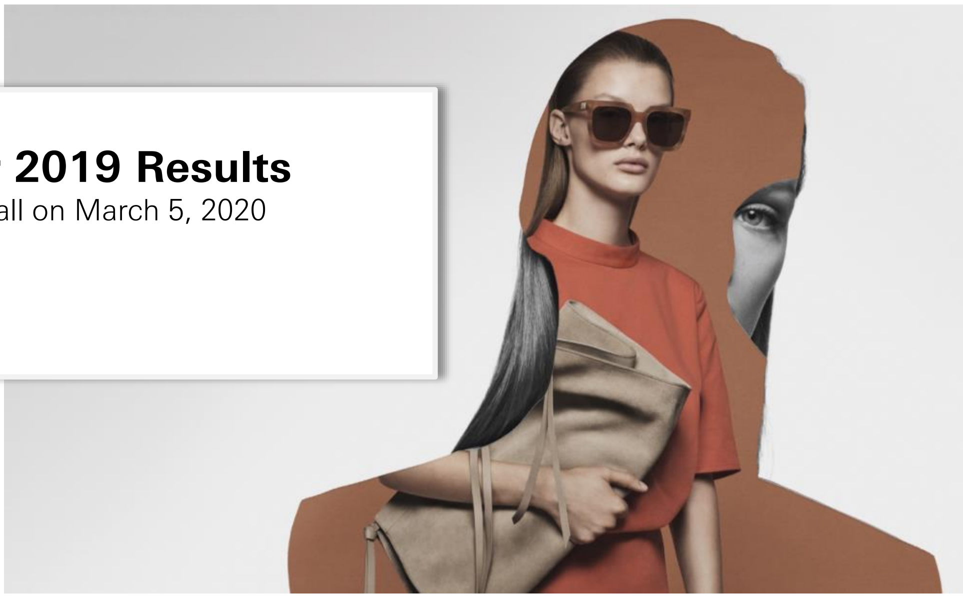
HUGO BOSS FY 2019 Analyst Conference Call

Full Year 2019 Results
Conference Call on March 5, 2020



Transcript – Q&A Session
March 5, 2020

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.

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Antoine Belge (HSBC): First of all, I'd like to have a clarification about the impact of the coronavirus on your EBIT in Q1. You said there will be a "low double-digit million euro" impact; because you were quoted this morning on Reuters with a "low single-digit million euro" amount. So, "low double-digit", meaning, let's say, if it's around EUR 12 million, would that be comparable to the EBIT of EUR 55 million you recorded in Q1 last year, so something around a 25% impact?

My second question relates to your guidance for 2020. You guided for overall retail growth, but without quantifying a guidance for retail like-for-like. I assume that most of the retail growth will come from online conversions like Zalando, and the completed store renovations, rather than from like-for-like. Therefore, I assume like-for-like will develop flat in 2020. Is that calculation broadly right?

Thirdly, regarding the U.S. Whilst I understand fully your guidance for Asia, I was a bit surprised to see only a flat sales guidance for the Americas. Is there any impact included from the coronavirus there? Or is it just that you need to do more cleaning in U.S. department stores, outlet stores, et cetera?

Mark Langer (CEO): Let me just clarify the first point. It probably was just a transfer mistake, but we were consistently guiding the market to expect a low double-digit million euro impact on EBIT in the first quarter. However, we ask for your understanding that we cannot make it even more concrete. It's already quite a precise quantification of the impact on Q1 at this point in time. So, it should have been also in the Reuters quote, a low double-digit million euro impact on Q1 EBIT from the coronavirus.

We haven't guided for like-for-like at this point in time. Clearly, we're driving retail sales productivity. That will remain one of the core elements of our strategy. We made good progress, and even saw an acceleration in the course of 2019. Under normal circumstances, the fourth quarter can be seen as a very good proxy for that we're making very good progress in this regard. Clearly, like-for-like, in particular with regard to the temporary closures in Asia, has been severely affected most recently. Hence we are not in the position to give you a like-for-like guidance at this point in time. Hopefully, we'll have more clarity to that when we speak again later this year.

On the Americas, a market that's still very much impacted by the wholesale business. We have seen a very disappointing wholesale development throughout 2019. We do expect some improvements. However, we expect the wholesale business still to weigh negatively on our business, to some extent, particularly in the first half of the year. In contrast, we have seen improvement on the retail side of our business. I flagged the flat like-for-like development in this region in the fourth quarter, which is a significant improvement towards the performance seen earlier in the year. We feel comfortable with guiding for an overall flat development for the Americas in 2020. It's, at least for us, less impacted by tourism inflow. But still, both in Europe and North America, we have seen a decrease in Chinese tourism in recent weeks as compared to the prior year.

Antoine Belge (HSBC): You expect a gradual improvement. What about the notion of pent-up demand? Will you be able to catch up a bit of what was lost? This has been discussed by your peers, for example, for handbags. However, for your type of products, do you think that what is lost is lost due to seasonality? Or do you expect some kind of compensating effects when demand will pick up again, especially in China?

Mark Langer (CEO): Well, a sharp BOSS suit is a lifetime investment, and there's always the right time to purchase that, but we recognize that it's not the same commitment as, for example, for an engagement ring. So, we have to assume that apparel is a bit more "buy now, wear now" than some luxury product categories. It's not part of our guidance that some of the demand will recoup in H2. We are expecting a normalization of demand towards the middle of this year.

Jürgen Kolb (Kepler Cheuvreux): First, on free cash flow generation. What will drive free cash flow this year? I understand you don't want to give a precise guidance. However, can you share some thoughts on the individual levers of free cash flow generation, especially regarding trade net working capital and the inventory situation, in particular?

Secondly, on your suit business. When it comes to BOSS, you mentioned that formalwear is doing well. How is your suit business evolving and how did it perform in 2019?

Yves Müller (CFO): Trade receivables and trade payables are more or less expected to remain on the same level. So the key question is around inventories. As already highlighted, we clearly improved our situation regarding inventories in 2019. Nevertheless, the spread of the coronavirus will have some kind of negative impact on our inventory situation. For the time being, we take all existing measures: first, we are reallocating existing merchandise from Asia to Europe and to the Americas. Secondly, we are reducing the retail buy for the second half of the year in order to mitigate the risk. However, the uncertainty is very high at the moment regarding inventories.

Mark Langer (CEO): On the question on our BOSS suits: as you know, we were in Milan with our fashion show for BOSS Womenswear and BOSS Menswear, and showcased a collection that expresses the clear trend towards sophisticated tailoring. A lot of voices in the industry are predicting a hype around merging luxury and sportswear. However, to some extent, it's getting back to normal. We are quite happy to see that because if any brand stands for tailoring competence, it's BOSS. We have seen a very solid demand for our suit business, and we are working very intensively with Ingo Wilts and his team on new initiatives. The Vegan Suit is just one. We were almost overwhelmed by the demand for our Traceable Wool Collection, so there's clearly a strong demand for newness and great stories to tell.

Also, in terms of price points, in particular in the very sizeable German market. We have taken first orders for fall/winter, and received very positive feedback from important German wholesale partners on the extension of our suit offering towards the important entry price points of EUR 399 and EUR 449 – price points that we didn't cover yet as part of our global pricing strategy. However, to be very clear, it's not a lowering of prices, it's an additional offer that we are introducing with BOSS only in the price sensitive German market. This shall already positively impact our wholesale revenues in the second half of 2020.

Elena Mariani (Morgan Stanley): First, on the trends you have observed at the beginning of the year. You mentioned that you've seen strong double-digit growth in Asia in the first three weeks. Did you also witness a sequential improvement in Europe and in the U.S. versus last year? This would help to understand how things were trending, excluding the impact of the coronavirus, and the overall brand momentum before the outbreak.

Secondly, on your guidance. Are you factoring in a potential meaningful slowdown in travel retail, and maybe a longer-than-expected travel ban across several geographies that might go well beyond the next couple of months? Or do you think that, right now, it's too early to tell? If the situation is going to be worse than expected in Europe then maybe your current guidance will need to be re-adjusted.

Mark Langer (CEO): Yes, it was truly a very encouraging start to the year, and I'm happy that we didn't give our full year guidance on the second week of January, as it would have been a bit “caught on the wrong foot” in this regard. Now, the world has clearly changed, and we have to deal with the consequences of the coronavirus. But you're right, the first three weeks gave us confidence as to that we have seen a continuation of the positive momentum also in the U.S., and in Europe. I'm absolutely convinced that the trend that we have seen in the fourth quarter reflects the underlying trend of our business. Once we get coronavirus behind us, this will help us to drive our business. Again, it confirms that our focus on the four strategic growth drivers – Asia, online, HUGO and retail productivity – is paying off, as reflected in the fourth quarter, and at the beginning of 2020.

You're right, we don’t have a crystal ball to predict to what duration and to what extent important markets will be affected by the coronavirus. We have to deal with the fact that our business has been already significantly affected in China, and, to a lesser extent, in other Asian markets. Our guidance does not factor in a short-term recovery, but we expect a return to normalized trading over the course of this summer. This means that the total duration of the impact on our business will probably be between 4 and 6 months. As the number of new infections in China seems to stabilize, we expect that the impact on our business in China will be smaller in the second quarter than in the first quarter. That's already reflected by the fact that the majority of our stores in China reopened in the meantime.

For the other markets in Asia/Pacific – in particular Japan, Korea and Singapore – we expect an impact beyond just the decline in Chinese tourism. Also domestic consumption is affected. Besides this, we also witness an impact from lower demand of Chinese tourists in Europe and in the Americas. However, in sum, we currently witness that business in Europe and the Americas seems to be less affected as compared to Asia/Pacific.

A flat sales development, from today's perspective, will make the lower end of our earnings guidance more likely. In contrast, if we would see a less intense impact from coronavirus, we expect to deliver 2% top-line growth, currency adjusted, and hence to deliver against the upper end of our EBIT guidance range of EUR 320 million to EUR 350 million. At our Capital Markets Day in June at latest, we expect to give you an update on our assessment for 2020, and also on the timeframe when to achieve the 15% EBIT margin target that we continue to see as a mid-term objective.

Elena Mariani (Morgan Stanley): Two small follow-ups: did you see an improved performance in Europe and in the U.S. at the beginning of January? Secondly, what you have seen in Europe across your retail store network over the past couple of weeks?

Mark Langer (CEO): I know there are lots of questions about current trading, but we will not comment any further on current trading on the first quarter. However, we have seen a continuation of the positive trends from the fourth quarter, also going into the first couple of weeks of trading in Europe. Still, also here, we now have a new situation as, to a lesser extent, Europe and the Americas are now also affected by the spread of the virus.

Jaina Mistry (Deutsche Bank): First, how do you expect gross margin to evolve in 2020, and what will be the key moving parts?

Secondly, how many stores will be included in your like-for-like calculation in 2020, and how many have been included in 2019?

Mark Langer (CEO): Let me start with the second one: our like-for-like universe is redefined at the beginning of each year, based on all stores that are open and operating for at least one entire fiscal year. So there's a continuous change due to new openings and renovations. In terms of percentage, however, there's not much change: in 2020, about 2/3 of our retail network is included in like-for-like.

Yves Müller (CFO): On gross margin: we don’t provide a concrete guidance for gross margin because of the high uncertainty we are currently facing. Plus, we want to simplify our set of KPIs that we guide on. Regarding the moving parts for our gross margin: we continue to expect a positive channel mix effect. Negative effects could include higher rebates due to the coronavirus situation.

Jaina Mistry (Deutsche Bank): Do you expect currencies to have a positive effect on your gross margin this year?

Yves Müller (CFO): For the time being, we expect that currencies will not have a significant effect on gross margin in FY 2020.

Kathryn Parker (Jefferies): First, on the new COO role. Do you plan to make any changes to your sourcing strategy? What changes are you hoping to achieve with regard to your sourcing and production?

Secondly, on store refurbishments and the new store concept: how many stores do you plan to refurbish or relocate in 2020?

Mark Langer (CEO): On your second question: I'm extremely happy with the performance of our refurbished stores. You have probably been able to visit them, either in London, Paris, or, in a few weeks from now, also in SoHo, New York. We have rolled out the new store concept to more than 100 stores already, and we are planning to add about 50 POS in 2020, either with new openings, renovations, or relocations. We're absolutely convinced that the new store format does not only provide a far better customer experience, but it's also an important element to drive higher sales density. As I said, in Asia, we will have some delays due to technical constraints, as some malls currently remain closed. But we are sticking to our game plan to renovate and upgrade about 50 POS to the new concept.

The appointment of Heiko Schäfer as Chief Operating Officer is something that I'm very happy and excited about. First, it's his experience. He has a long track record working at adidas and in a fast-moving environment. He brings additional perspective in speeding-up production and sourcing processes. He has demonstrated a very keen focus developing and sourcing products at superior quality and at very competitive prices. Our cost of sales are a major element where we continue to see significant opportunities to drive profitability going forward. Also, Heike Schäfer is one of the leading industry experts when it comes to further digitizing development and production processes. So taking something that's already in good shape, and bringing it from good to great, is clearly something we expect Heiko to deliver at HUGO BOSS.

Thomas Chauvet (Citi): First, on cost inflation. If I take the midpoint of your sales guidance, which would be a +1% sales increase, and the midpoint of your EBIT guidance of EUR 335 million, that implies a low single-digit cost inflation this year, assuming obviously some gross margin pressure. Is that a fair assumption for cost growth this year? And if the sales guidance would need to be revised down due to further disruption from coronavirus in H2, have you already identified additional cost savings that you could achieve in the second half of the year?

Secondly, can you share some of the topics of discussions you had with the Supervisory Board over the past year, particularly with the Marzotto family, given they've recently raised their stake to 15%? They've been a long standing partner and believer in HUGO BOSS, so is there anything you can share for now, or is that something for discussion later at the Capital Markets Day in June?

Yves Müller (CFO): Regarding cost inflation: Overall, your hypothesis is right. We will continue to execute our efficiency program in order to limit cost inflation as much as possible. In the current situation of high uncertainty, we are even more focused on this.

We expect CapEx to be lower in 2020 than in 2019. Last year there has been a big impact from our investments in the new opening of our outlet in Metzingen. Besides the non-recurrence of these investments in 2020, we will also continue aiming at increasing CapEx efficiency by around 20% to 25%, in particular when it comes to the remodeling of our BOSS store network.

Besides this, we remain very active in covering also all other costs, especially in China. Renegotiating rental expenses with the landlords in order to get some short-term relief is just one example. So we try to mitigate the negative effects coming from lower top-line growth at least to some extent via compensations on the cost side.

Mark Langer (CEO): Regarding the second question: obviously, any discussion between the Managing Board and the Supervisory Board will remain confidential. However, you were referring to the increase in the shareholding of the Marzotto family, which was sizable. It was almost a 50% increase in their shareholding, as they are now above the threshold of 15%. We are very happy with the support, the investment and the commitment from the Marzotto family, as demonstrated by this increase in investment. It's a dual role that Luca and Gaetano Marzotto represent as members of the Supervisory Board, but also as our single largest shareholder. This should be seen as an endorsement that our company has a potential that's not fully reflected yet. And there is a strong belief in the potential of our strategic initiatives that we continue to work on also in 2020.

Regarding the extension of the Managing Board, and as I said earlier, I'm very happy that we have a broad consensus that the COO role is an important one. It has the full endorsement from the existing Managing Board members, and we are truly looking forward to Heiko joining us in just a few days.

At our Capital Markets Day in June, we will share our financial ambition for the years to come, and reflect on where we stand in executing in 2020 against the backdrop of the impact from coronavirus. All this, of course, will be aligned with the Supervisory Board.

Thomas Chauvet (Citi): One follow-up on the COO appointment. In what way will your CEO role evolve in terms of your main focus and projects?

Mark Langer (CEO): To be clear, first, I will ensure that we have a smooth transition in responsibilities on the operations side. I'm absolutely confident that this will happen in a very smooth and effective way. But it's clearly also the intention that I will have more time available to put an even stronger focus on the retail and wholesale side of our business, as this is decisive for our success going forward. I will have more flexibility and time available to deal with our markets and distribution channels as well as our business partners.

Philipp Frey (M.M. Warburg): First of all, you alluded already on your happiness regarding the refurbished BOSS stores. In the past, you provided us some numbers on the productivity uplift. Therefore, could you be a bit more precise and compare the performance of the newly renovated stores with the older ones?

Secondly, regarding your online concessions. Can you comment on the volume uplift you are seeing from converting online partners to the concession model? Is it fair to assume that not only your sales but also your volumes have increased since?

Lastly, on the like-for-like cost of your retail network. Is it fair to say that these are likely to stay below inflation this year?

Mark Langer (CEO): Regarding our refurbished BOSS stores, of which the vast majority is still in the non like-for-like part of our business as they have been renovated over the last 1 or 2 years, we are very happy that we have seen an encouraging uplift. In general, we continue to see the trend of higher sales and sales densities at the refurbished stores. Driving sales density is of key importance and one of our strategic initiatives. We will focus on that one also at our Capital Markets Day in June as we will provide you with more facts and figures on the progress made.

On online concessions: a reason why we also see volume uplifts after the conversions from wholesale to retail is the inventory pooling effect. After the conversion, the inventory is managed by HUGO BOSS. Given the size of our own online business at hugoboss.com, this makes conversion attractive both for HUGO BOSS and also our partners. So not only Zalando, where we converted our BOSS casualwear business last summer, but any new partner, be it in Europe or in the Americas, will benefit, as their gross merchandise value should increase with the access to the full inventory depth of HUGO BOSS. However, the conversion effect on volumes is difficult to quantify. But in general, we do not only record the retail conversion effect on our top-line, but also witness higher volumes.

Lastly, on your question regarding retail cost. For the short term, we now have to manage staffing. With regard to our pay-to-sales ratio, we need to ensure that we have the right staffing levels, which is difficult in some cases, as we don't want to lose talents during times of depressed sales. On the other hand, we see a high willingness, especially from Asian landlords, to work together on getting at least a temporary cut on rental payments. So this will help us to mitigate the impact on the inflationary aspects in the short term.

Thierry Cota (Société Générale): First, on outlet sales, as they grew as a percentage of sales last year. Was this due to a switch of the markdown business from stores to outlets. Or is it reflecting a rise of markdown revenues in general? Can you provide the amount of the overall markdown revenues?

Secondly, on your retail online business. Can you provide a breakdown of the EUR 151 million of online sales reported for full year 2019? I'm sensing that sales from hugoboss.com grew at around mid-single-digit pace last year. Is this correct, and have you envisioned a slowdown for that part of your online business?

Mark Langer (CEO): Our online concessions give us more control regarding pricing and the circumstances merchandise are sold. Like we have done in physical retail, we prefer to rotate fresh merchandise at full price in our online business instead of using online for secondary distribution. That's one element which led to a shift of sales from previous wholesale online business to own controlled outlet distribution.

But it’s also clear that, looking at Woodbury Common Outlets in New York or Bicester in the U.K., outlet remains a winning sales format. I was in the Valley just before Christmas, and I saw the long lines. So there is clearly a preference for many consumers to take advantage of the price discounts offered by brands in the factory outlet environment. And our objective is to be best-in-class when it comes to menswear apparel in the outlet channel. Besides aiming at productivity improvements, the upgrades of our outlets in Bicester, Woodbury, and also in Metzingen are clearly intended to ensure a world-class shopping experience for our outlet customers. Overall, we expect our outlet share to be around 25% of retail sales, as this is what we consider as a healthy balance for our business. In 2019, you are right, our outlet business outperformed our full-price business in terms of sales growth.

Thierry Cota (Société Générale): Can you give us a sense of the scale of the markdown revenues as a whole? Is it fair to assume that about half of the Group sales are not sold at full price?

Mark Langer (CEO): Well, it’s a normal and valid part of the business to offer customers an end-of-season sale in stores. However, we will not separate these sales as outlet sales.

Finally, to clarify on your question regarding sales growth of our hugoboss.com business versus that of our online concessions in 2019: the development of our dot-com business in 2019 was better than what you estimated, although we won’t provide a concrete breakdown. The concession business was obviously driven by its expansion. But clearly also growth of sales generated via hugoboss.com was above the mid-single-digit range that you suggested.

Piral Dadhania (RBC): My first question is on the product range and your product offer in general. What improvements did you implement in terms of the overall range architecture, both in terms of the breadth and depth of SKUs across key categories? Can you also provide some more color on the rationale around expanding the entry price suit offering in Europe?

Secondly, again on online growth for 2019: what would be the underlying like-for-like growth for online, excluding the impact from online conversions? This would help to get a feel for the underlying trend, before adding on the impact of conversions.

Mark Langer (CEO): Let's start with the second question. Clearly, you have seen the 35% full-year growth in our e-com business with an acceleration in the fourth quarter. The like-for-like part of this mainly reflects our own dot-com business, because our like-for-like base in the online concession business is still small. However, to give you an indication, on a like-for-like basis, we achieved low double-digit growth in our online business that's either controlled via concessions or via dot-com.

Regarding your question on collection complexity: yes, the expansion of our suit offering towards these new price points in Germany adds some complexity. However, overall, I'm very happy with the streamlining of complexity that we have achieved in the course of our two-brand strategy. Particularly for BOSS, where we have integrated the previous BOSS Green and Boss Orange offer into the overall BOSS offer. In doing so, over the last years, we significantly optimized the casualwear part of our business, and eliminated overlaps. Therefore, the rationalization on complexity is more or less done. But complexity will still remain something we have to review season by season. Also for Heike in his new role as COO, it might be a topic to further optimize and streamline our offering. Please keep in mind that particularly, we are our own biggest customer in the way we can bundle volumes for our own retail business. This will allow us not only to manage complexity in the development, but also to have higher sourcing volumes when it comes to buying and producing collections.

Piral Dadhania (RBC): Since you've integrated BOSS Orange and BOSS Green into the BOSS core brand, how much did you rationalize the overall SKU count? How many duplicate products have you since taken out to reduce complexity?

Mark Langer (CEO): It was particularly important for the casualwear part of our collections. For casualwear, which includes jeans, t-shirts, outerwear, jersey products, and key knitwear styles, among others, we've reduced roughly 30% of the complexity between 2018 and 2020.

Volker Bosse (Baader Bank): First, on coronavirus, do you expect any disruptions in your supply chain in Asia, which could become visible in the second half of 2020 with the delivery of the fall/winter collection?

Secondly, on the new COO, what are the key projects on Heiko Schäfer's agenda?

Finally, on womenswear, which was down 2% in 2019, currency-adjusted. What is the strategic outlook for your womenswear going forward?

Mark Langer (CEO): Also for womenswear, we have seen a very solid finish to the year – a return to growth, even if it was a bit more muted. I'm overall happy with the development we have seen. Also, the feedback for our upcoming collection is very positive, supported by our most recent fashion show in Milan. Besides that, as we speak, we have a blockbuster fragrance launch together with our partner Coty. "BOSS Alive" is not an unisex fragrance like, for example, "BOSS The Scent", but a fragrance for the BOSS woman only, supported also by strong testimonials like Emma Roberts and Chloe Bennet. So I'm very happy to see good momentum on the womenswear side of our business.

On the impact of the coronavirus on the sourcing side, we currently see all our Asian suppliers being back in operations. There was kind of a temporary slowdown due to the fact that travel within China was restricted. But at the moment we don't see any significant disruption in our supply chain that could have an impact on product availability for our fall/winter merchandise. We are taking a cautious view on some of the buying decisions for our retail stores in Asia/Pacific, as I said earlier, but we currently do not expect a disruption from the sourcing side.

Regarding the priorities of Heiko Schäfer, and I already touched on that earlier today, it's about further enhancing capabilities on our operations, sourcing and production side. There's clearly an enormous opportunity to become even more efficient in terms of product costing and product engineering. This is an area where he brings strong expertise from his former roles. But it's not only about the cost value ratio for our products, it's also about the development process as such. He has demonstrated in previous roles that he is capable to install very fast and reactive development processes. That will allow our creative teams to take later design decisions on colors and on certain fabrics, using digital development platforms that we have already started to introduce. I believe with his experience and his knowledge, Heiko will take it to the next level. As we said, he will be starting a few days from now. Clearly, Heiko will bring a fresh view to the operations part of HUGO BOSS, and he will be available to answer your questions when you will meet us at our Capital Markets Day in Metzingen in June.