HUGO BOSS

FIRST QUARTER 2020
CONFERENCE CALL

MAY 5, 2020

Transcript – Q&A Session
May 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.

HUGO BOSS AG Dieselstrasse 12 D-72555 Metzingen Phone +49 7123 94-83377 Fax +49 7123 94-80237

Jaina Mistry (Deutsche Bank): Firstly, on inventories, based on your commentary, by when do you think the inventory position will be clean? And what proportion of your inventories today are evergreen versus seasonal? My second question is on cost savings. What magnitude of cost savings did you realize in Q1? And of the EUR 150 million that you've guided to, what will be the phasing over the year?

Yves Müller (CFO): Like we said, we expect savings on the Opex side to be at least EUR 150 million. We only had some first savings in Q1 because the lockdown only started to affect the majority of our business in mid-March. So, the EUR 150 million will be more or less spread over the next quarters, with a more pronounced effect in Q2 and Q3.

Mark Langer (CEO): On the inventory side, we do about 20% of our business with evergreen articles that have no specific connection to the spring/summer or fall/winter collection. As Yves already explained in detail, we have already shown our ability to slow down the inflow of fresh merchandise in the first quarter. So despite depressed sales levels in retail and wholesale due to the lockdown, we have seen a very modest increase in inventories versus the previous year. We have now clearly adjusted our production volumes both on the retail and wholesale side for fall/winter and beyond. Inventory that will not be sold at full price will be used as inventory for our factory outlet business for the first half year of 2021. So we have adjusted both, our production volumes for full-price business as well as off-price business. And we have already identified and implemented measures to improve our inventory situation by around more than EUR 200 million until the end of 2020, which would give us a relative size of the inventory to the business size comparable to previous year. So at this point in time, we expect a normalization of the inventory in terms of its structure as we go into 2021, but we expect a healthy relationship between inventory and business size already in the second half of 2020.

Jürgen Kolb (Kepler Cheuvreux): Also on the inventory side, maybe one quick one. What exactly are you writing off in Q2? You mentioned Spring/Summer, but is that also the case for Fall/Winter and the upcoming Fall/Winter collections? And maybe some more indications on how much you think you have to reduce the price of the merchandise when you ship it to the factory outlets? And secondly, I noticed HUGO had a very strong casualwear business in Q1, which was up double-digit again. And I was wondering if you could maybe give us some indication what kind of products sold well and what the the casualwear share in your product mix is right now at HUGO.

Mark Langer (CEO): So to be very clear, we have taken already quite significant adjustment measures on the Fall/Winter merchandise. So there's no write-downs on Fall/Winter expected for now. However, what we flagged is that we do expect, due to the low volumes caused by the lockdown, some movements on the Spring/Summer merchandise. Our system will indicate write-downs both on Spring/Summer 2019 merchandise which we were not able to sell at an expected speed in our off-price business and on the Spring/Summer 2020 of our full-price business. Because on the Spring/Summer merchandise, as you probably know, we had no chance to react because we were hit by the full magnitude of the slowdown at the end of March. So the inventory write-downs that we are indicating to relate to the Spring/Summer 2019 and 2020 collections. An encouraging trend that we continue to see is on HUGO, which maintains its momentum especially on the casual side of the business. You remember that's one of the elements of our mid-term growth plan, that clearly delivered. And we have seen also in this overall depressed first quarter a double-digit growth in casualwear, which has brought the casualwear business at HUGO now almost on pari with the formal business. Due to the category remigration, the business part is overly affected by HUGO, but we have seen a 12% growth in HUGO casualwear in Q1. So, despite the circumstances of the corona pandemic, we have still seen a strong underlying demand for the HUGO contemporary segment.

Thomas Chauvet (Citigroup): Two questions, please. The first one on your online business. Are you capable of coping with the triple-digit growth in April for another couple of quarters from a logistics standpoint? How do you ensure you won't miss revenue opportunities as well as maintain a high level of customer service? And secondly, can you give us a kind of a demand-recovery scenario update in Q3 and Q4? It seems you want to be quite positive on Q3 and maybe the beginning of Fall/Winter. If H2 was worse than expected, what level of incremental cost savings could you implement? I think you mentioned in an interview this morning a potential headcount reduction. And just a follow-up on Jürgen's question earlier, and the casualwear of HUGO, when do you think you could translate that very brand-specific momentum into BOSS? We're still seeing boss casualwear not performing as perhaps it should be even in this environment.

Mark Langer (CEO): We highlighted above 100%-growth for the online business for the month of April, but this is not a full year indication. But your question was not whether we forecast doubling online sales for the remainder of the year, but whether we are capable to deal with that. Our ability to serve customers with our multichannel warehouse set-up has clearly proven to be beneficial and a strategic asset for the group in the current times of lockdown. We are not dependent on any third-party providers in fulfilling these online orders. We don't have to fight for getting our right place in a queuing systems. It's all run by HUGO BOSS's own inventory pool. So we have been very swiftly able to shift inventory that we initially bought and allocated to brick and mortar to the online side of our business. So, under the assumption we would see a high double-digit growth or even triple-digit growth in e-com, our logistical capabilities will be no limiting factor to fill these demands. We also monitor very carefully our service levels in terms of fulfillment. As you know, a lot of our business also comes via concession third-party platforms now. Zalando is working very closely with us to ensure and monitoring our service levels in comparison to the industry. And I can assure you that HUGO BOSS stands out in terms of service quality relative also on these multi-brand platforms, which is also proof on the sophistication and capabilities of our e-com platforms. As we indicated in our outlook for the second quarter, we do expect a continuous release of the lockdown in core markets. We have already seen first indications in Europe. I think you're well aware of some of the trends we also see on the other side of the Atlantic happening in the U.S. And I think Yves also gave some details with regards to the encouraging trends we have seen in China. The latest trading days in April were even better than what we have seen at the beginning of the quarter.

So I think there's a clear sign that we are on a recovery path as stores begin to reopen. Yet, there's also a wide range of potential outcomes for the upcoming quarters, which makes it difficult for us to already give you a full year guidance. So at this point in time, we do expect an improvement in the second half of the year, as we expect the second quarter to be the low point on the performance. However we can't provide more color on the second half of the year and the full year development at this point in time.

We do see over-proportionate growth also for the BOSS Sportswear business. The implementation of the two brand strategy has clearly shown that the consolidation of at least our casualwear and smart casual offering is a key element for driving better sales density in our stores. Also, the feedback that was provided to us indicates that BOSS has started to gain traction on the wholesale side. We already mentioned the development in the U.S., that has started to stabilize. Here, we have seen good momentum in the first two months of 2020 under the new leadership of Stephan Born. I am absolutely confident that once we have this crisis behind us, BOSS Sportswear will be an important growth driver for us in core markets, whether it´s in Europe or in our two non-European markets, the Americas Asia.

Antoine Belge (HSBC): My first question for Mark is - were there any difference in views in terms of the strategy at HUGO BOSS for you to leave the company? Can you provide an update about the search for a new CEO? What type of profile and what could be the time frame?

My second question is back to this guidance for Q2 of an EBIT loss of at least EUR 100 million. What would be the gross margin evolution on that assumption? In this context, how meaningful will the inventory valuation effect be? By the way, I mean it seems that other companies have taken measures on their inventory already in Q1. So what's the reason for delaying that to Q2?

Mark Langer (CEO): I ask for your understanding that any details or reasons for my departure end of September is something that we will not discuss in public. But it's important to say, I'm very aligned with the Supervisory Board and also as the Chairman. The decision was not based on any disagreement on the strategy of the Group, which we as Managing Board and also Supervisory Board fully endorse. I'm also unfortunately not the right person to ask on the profile of the new CEO. That's the full obligation of the Supervisory Board. So this is something that neither Yves or I can give you any further color on. Of course, I will be in my current role until the end of September. I agreed to serve in an advisory role until the end of 2020. But I'm also absolutely confident that with the current Managing Board, the company is in very good hands in these clearly difficult times.

Yves Müller (CFO): Regarding the guidance for Q2, we expect an EBIT loss of at least EUR 100 million. But for the time being – because of the high level of uncertainty – we are really not able to provide you with any guidance regarding the gross margin outlook. With regards to inventory valuation: Be aware that the majority of the lockdown, especially for 85% of our business in Europe and in the United States just started in the middle of March. So the two main determining factors of the inventory valuations, the aging structure and the coverages were actually in a fairly good position at the end of Q1. But what we expect is that due to the closures we have experienced in April and our expectation for the remaining Q2, we expect that the inventory valuation will hurt the gross margin in the second quarter of the year.

Thierry Cota (Societe Generale): First, coming back to the 50% minimum sales drop you expect in Q2, can you give us some granularity on your thinking, whether there should be a difference in trends between wholesale and retail and whether you think Europe and the U.S. should be, as in Q1, pretty much in line or not?

And secondly, on online, if I'm not wrong, the growth was a little slower in Q1 and in Q4. I was wondering if there was any less visible space impact last quarter versus the previous quarter.

Mark Langer (CEO): Let me start with the online question. Online was also not completely immune to the, I would even call it shocks, as the coronavirus became a global pandemic. There was a period starting mid/end of February, where on the top of consumers' minds, was the search for sanitizers and toilet papers, but not necessarily apparel - at least in some markets. This has meanwhile clearly changed, in particular during the second half of March. And as I said, we are very pleased with the momentum we have seen in April. So we do believe that customers have adopted to that. There continues to be very high interest in our brands. So our CRM activation continues to work, maybe not to the full level as it is not able to drive people to our stores, but we are happy with the traffic it generates at our site, and as I already said, also at our concession partners. Clearly, at the biggest one, Zalando, where we have taken our control for the BOSS side of our business, I'm extremely happy with the underlying demand for our collections. So the 39% online growth in the first quarter was not an even number. We had a very strong start before the online business slowed down significantly in the context of the virus. This momentum has seen a come back.

Yves Müller (CFO): Europe and the Americas form a good 85% of our business. We now expect that the lockdown will be gradually relieved in some countries within these regions. Nevertheless, this will take a while. From a channel perspective, it will be somewhat evenly divided between retail and wholesale as both channels are now starting to trade in these respective countries. Speaking about wholesale, as you know, the wholesale business in APAC is almost negligible. But still keep in mind that even in the Asian region, there are some countries like Japan and Singapore, where it's more likely that there will be no trading in May because of governmental regulations. So we will probably see a gradual pickup there not before June.

Kathryn Parker (Jefferies): My first question is on the store performance in China. You've given the April figure, but I wondered if you could tell us what the exit rate for the month was and whether you expect to turn positive in May or June?

And then my second question is on wholesale, whether you would consider buying back any unsold stock from your wholesale partners to prevent them from discounting it? And how much control you actually have on the timing and depth of discounting in your wholesale business?

Mark Langer (CEO): Thank you very much, Kathryn. As we said, we have seen a steady improvement in China. If you look at the full month, we have seen our business recover 80% to 85% or even to the pre-corona level in the recent weeks. But it's too early to tell whether this is prediction for the full second quarter, where we have seen further encouraging signs. We will not give you a full quarter guidance for the Chinese market because the data set is still too uneven and does not give us a full trend. Please also keep in mind, that two important sub-segments of the Chinese market, Hong Kong and Macau, continue to be severely affected. So if you just take a certain regional part of China, you're right to assume that we might already see a flat or even positive development for the full quarter. But we are still cautious on the outlook of total China for the second quarter. So we would ask for your patience. We will give more color on it as soon as we have the complete second quarter results. But it's absolutely clear that we expect China as a region and the markets within it to firstly return to growth at HUGO BOSS.

As you can imagine, for most of our wholesale partners, we are the number one menswear apparel partner. So we have spent a lot of time with them to weather the crisis. The part that we have adjusted first was their buying budget for Fall/Winter as we were able to postpone or cancel some of the production orders which were not fully placed at our production site, both in-house or third party. That reduces inventory pressure both in our balance sheet but also for our wholesale partners, which placed a mandatory pre-order in January and February. We are also evaluating very carefully and then decide on a case-by-case base how we deal with trade receivables. Then we try to spread the challenges that we all face in an even way. Some of these wholesale partners are even our landlords because we're sometimes working with them on a hybrid deal with parts of our business being wholesale for them. So we try to find mutual acceptable ways to weather this difficult situation with us. But there's one thing that we are not going to be offering, and that's a return of inventory. It was a decision from our partners to buy inventories at the current levels. We clearly have to deal with an excessive Spring/Summer inventory situation ourselves. So we do not expect to have any inventory returns from our wholesale partners.

Elena Mariani (Morgan Stanley): Going back to China, I could imagine that you are not benefiting massively from a repatriation of purchases, but still to a certain extent, you are. So maybe can you remind us what's historically been the percentage of sales to the Chinese cluster that was happening outside of China. And maybe if you have any view on how the cluster has been developing recently as opposed to the specific sales within Mainland China. And then you were kind enough to talk about very recent trends. Have you seen anything interesting in Germany in the very recent weeks? I'm asking because there was another brand today that indicated very encouraging trends, even better trends than in China. So maybe if you have some observations, it would be nice to know.

And then, my final question is about all the measures that you have put in place to protect your free cash flow. I was wondering whether you think this would be enough to protect your liquidity situation in case of a worst-case scenario. So in other words, if the situation does not improve in the second half of the year as quickly as you expect, do you think that what you've done is enough? Or would you need to do and put together incremental measures to protect your liquidity and balance sheet?

Mark Langer (CEO): We do about 10% to 15% of our revenues with the Chinese cluster overall, including domestic consumers but also Chinese tourists shopping in our stores in Paris, London or in the Americas. As they are now restricted to travel, we expect that they are also part of our recovering volume or momentum that we currently see in China. As you can imagine, it's hard to predict whether the transaction we are processing with these customers is something that in normal circumstances might have happened in Korea, Japan or in Europe. But based on the feedback that we get from our Chinese colleagues, we do believe that a part of the recovery path in China is due to the fact that Chinese consumers are being forced to shop at home and it's very unlikely that this tourism will return to shopping habits outside of China in the foreseeable future, which might have other repercussion on our global business setup.

In Germany, from an operational perspective, we are quite happy how the startup of operation has been. I think we are well prepared in terms of processes, new hygiene standards, staff training to serve our customers under these circumstances. However, please keep in mind, that it's just a handful of stores that we have started to operate. Our observation is that traffic in inner cities and shopping malls is very impacted with very reduced numbers of visitors coming to our stores. But we have seen a steady improvement. In Austria, even a bit more than we initially thought, but it's not a rapid return to more normalized levels like we have seen in China. Actually, from our perspective, the recovery in China is stronger, week on week, than the recovery we have seen so far in Central Europe.

Yves Müller (CFO): First of all, I think it's important to look at our last balance sheet of the annual financial statement, where we had net debt of EUR 83 million. We are starting with a very solid balance sheet. We as Managing Board, were very often criticized for such an unleveraged balance sheet. At least now we know what it is good for. I think it is very important, to always prepare for the uncertainties. We did all the cash measurements, like the EUR 600 million that I'm alluding to. We did a cash flow forecast. And clearly, we did this on a monthly basis. And still, if you draw this down on the monthly basis, even the worst case would be covered in terms of our liquidity position. So I'm very confident that we do everything to secure the liquidity. But I think it's always good to be prepared for more uncertainties. And of course, we are preparing this as well.

Melanie Flouquet (J.P. Morgan): I'm bouncing back on the comments you made about the Chinese spending more at home. Clearly, you had less exposure to travelers, so there is less repatriation impact. But also I suspect that this raises another question mark, which is whether you should accelerate your expansion because you are still relatively small with the Chinese consumer compared to other premium brands and other luxury brands. So could we see a reallocation of your store plans in the coming two years with more accentuation on China and less, for instance, in Europe or in other adjacent countries? Could that be a consequence of this crisis?

My number two question is on e-commerce. Would you be so kind to maybe share with us what your learnings on the e-commerce performance are? Are you seeing any big product doing particularly well? I imagine casual is doing well. What are you seeing by price point?

And my last question is on allowances for wholesale accounts that you referred to in Q1 of a high single-digit million euro amount. Is this a one off, a big impact that you took straightaway? Possibly, I was thinking is this linked to some U.S. department stores' difficulties? Or should we expect some of these charges to continue in the coming quarters?

Mark Langer (CEO): Thanks, Melanie. China has clearly been a key pillar of our growth strategy prior to corona, and it has proven itself to be the focal point of the very serious crisis. So in terms of CapEx adjustments, the country least affected – because least penetrated and offering the best financial terms – is China. And during our approval processes over the last couple of weeks, I can tell you the vast majority of projects, be it renovation, relocation or new stores, was in the Chinese market. So we will do and fund all business endeavors to enlarge or to grow also our physical retail network in China.

And I was just visiting China a couple of weeks prior to the shutdown, meeting also some landlords. And especially in the menswear apparel segment, the feedback I received relative to our peers was extremely strong, and we were able to secure bigger and better locations relative to other menswear players. So this is one element we pursue. What we are also seeing is that the Chinese market is also quite innovative when it comes to omni-channel services. During the period of the lockdown, we have worked with our Sales Associates to use WeChat to stay in contact with our customers and introduce them to a new offering. We have decided now with our Chinese management to scale this business to serve customers in these times where physical retailing is restricted even more. Just another anecdotal evidence is that both Tmall and JD were extremely happy with the growth that BOSS has demonstrated over the last couple of weeks. Both platforms also benefited in China from the development or the impact from the coronavirus. And the BOSS brand in particular moved up quite significantly in the relevance as a leading menswear brand.

On e-com we knew before that the baskets look differently on the e-com business relative to brick-and-mortar. The short answer is this has not changed fundamentally after the coronavirus. So there are certain product categories that are easier to purchase online than to buy in stores. The suit that you wear for the most important interview is probably something you buy in a store. The dress that you buy for the most important dates that you have when meeting your parents in law is probably the one you still would like to try on in one of our stores. So again, we have not seen a fundamental change in consumer demand during the crisis.

Yves Müller (CFO): Like we said, we had an impact in our P&L in a high single-digit million euro amount. And the question was whether there are some individual wholesale accounts. Overall, as you might know, there are in particular four of our customers that are struggling. All these have an exposure which is less than EUR 2 million, which we have some now booked in allowance. And the remaining part is a kind of reserve we especially have as a prudent business man that we booked because we are doing a lot of sizable business with international markets. So this is the kind of reserve that we book in the Q1 based on our own expectation estimates.

HUGO BOSS AG Dieselstrasse 12 D-72555 Metzingen Phone +49 7123 94-83377 Fax +49 7123 94-80237