HUGO BOSS

Transcript – Q&A Session
March 11, 2021

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.

Edouard Aubin (Morgan Stanley): My first question is on Asia ex-China, which was down double-digit. You mentioned earlier that there was some impact in Hong Kong and Macau from tourism. But could you please provide a bit more color on what happened there by geography?

On your guidance for 2021, you talked about sales well above 2020 and an improvement in EBIT. The consensus is currently looking for around 18% growth in 2021. Does this qualify as "well above"? And regarding EBIT margin for 2021, consensus is expecting that it's going to be around half of what it was in 2019 pre-COVID.

Yves Müller (CFO and Spokesperson of the Managing Board): In mainland China, we have seen double-digit growth in Q3 and Q4, which was also supported by an increase in local demand as the Chinese did not travel as much as in prior years. This strong momentum has prevailed also in the first quarter. So mainland China remains very strong. In other relevant markets, such as Japan and Australia, we saw gradual improvements over the quarters and also over the weeks, especially in Australia, which is very restrictive in terms of going into a lockdown in case of increasing infection rates. Also in Japan, infection rates are still high. The majority of stores were open, but they were operating on reduced opening hours. Hong Kong and Macau is a different thing, with missing Chinese tourism still weighing heavily on both markets.

On 2021: with a global store closure rate of 30% in January and February, Q1 will be a difficult quarter. We expect sales to decline by up to 20% in Q1 and that gross margin will continue to be affected by elevated markdown activity. On the other hand, we have every confidence that, starting with Q2, our performance will gradually improve. Once countries are back to normal – like Mainland China, where infection rates are under control – you see a significant pick-up of demand. Also in markets such as the Middle East, where vaccinations are already well advanced, our business is clearly picking up. This gives me confidence with regard to the expected recovery of our business. Over the last several weeks, for example, was saw that our markets in the Americas are clearly improving in this regard. Besides this, our pipeline of product and marketing initiatives is really filled up. We will also continue to push the casualization of our business model. When it comes to casualwear, we had a very strong order intake for our Fall/Winter 2021 collection, clearly exceeding our own expectations. All this is fueling our confidence that sales will strongly improve in 2021.

Jürgen Kolb (Kepler Cheuvreux): You mentioned that you're seeing an uptick in those markets that have been opening up and where vaccinations are progressing. Are you seeing a specific shift in fashion demand? Are consumers trending towards event dressings again? Do you see a special pattern of consumer demand?

Secondly, regarding your ambitions on leveraging your omnichannel capabilities. Where do you have to add additional functions in order to provide your customers with a fully meshed omnichannel experience?

Yves Müller (CFO and Spokesperson of the Managing Board): In markets such as China and the Middle East, we are experiencing some kind of pent-up demand reflecting that during the lockdown periods, weddings and similar events have been postponed. On the other hand, we are experiencing that after lockdowns, customers really want to go out and shop.

On our omnichannel approach: already today, our hugoboss.com website is connected to our brick-and-mortar business in key markets. We now have to ensure to also connect all other relevant markets to ensure that functionalities like "order from store" and "click and collect" are available for all our customers. On top of this, we are working on projects to introduce these kind of services also in our online concession business, together with the respective marketplaces. The third initiative is linked to "shipping from store". There are multibrand platforms like Farfetch where you can ship from store in order to leverage your own brick-and-mortar retail business. So these are the main projects ongoing to ensure a seamless customer experience across all touchpoints.

Jürgen Kolb (Kepler Cheuvreux): Have you noticed any kind of products that are selling particularly well?

Yves Müller (CFO and Spokesperson of the Managing Board): It's really broad based: categories like for example jersey, denim, and sneakers are performing well. On top of this, there is pent-up demand for special occasions, with customers looking for smart casual items for example.

Chiara Battistini (JPMorgan): Looking beyond 2021, which should still be negatively impacted by the lockdowns, what is your assessment on the recovery and the return to 2019-levels going forward? Do you think that the pre-crisis level can be achieved in 2022, or is it a longer-term story?

Secondly, how do you see the broader formalwear market evolving as we come out of the pandemic? Are you factoring in a meaningful pent-up demand for formalwear or rather ongoing declines versus 2019 levels, given the ongoing casualization trend?

Finally, are you comfortable with current consensus for 2021? Any comment on that?

Yves Müller (CFO and Spokesperson of the Managing Board): Starting with your third question. We have the policy that we don't comment on consensus, also because there are different consensus out in the market. Therefore I provided some qualitative statements on this topic earlier.

On your first question: It comes without sayint that we are working on the fastest recovery possible! Daniel Grieder will join on June 1st and we are preparing a strategic agenda for the years to come, kind of a five years' plan that we will present in the second half of this year.

Regarding your question on formalwear: with the pandemic, the casualization trend has seen another strong boost. In 2020, around 25% of our business was linked to formalwear, 50% to casualwear and 25% to shoes, accessories, bodywear and hosiery. This means that in 2020, the share of formalwear has decreased by around 10 percentage points. While we expect the casualization trend to continue, we see kind of pent-up demand also for formalwear in those markets that are recovering from the lockdowns.

Chiara Battistini (JPMorgan): One follow-up on the latter: I was pleasingly surprised by your comment on HUGO Casualwear having returned to growth in Q4. Could you please share more color on this, especially on a regional basis?

Yves Müller (CFO and Spokesperson of the Managing Board): In Q4, HUGO Casualwear has been very successful in particular in the European market when it comes to logo-inspired casualwear styles and jersey products, plus sneakers, track-suits and these kind of products.

Thomas Chauvet (Citigroup): Coming back to the outlook for 2021, specifically cost inflation. If we adjust the 2020 cost base for the EUR 110 million store impairment charges and a few other one-offs, you had an underlying total cost base of around EUR 1.3 billion. EBIT consensus for the year 2021 stands at EUR 145 million. So that seems to imply OpEx up only 1% to 2% given the gross margin assumptions. I know that there are a lot of moving parts to your ongoing cost efficiency program. But as you guide for strong revenue growth, does that kind of cost inflation makes sense to you? Could you provide more details on which cost lines might grow much stronger than low single-digit, maybe A&P?

Secondly, on your shareholding structure. There is the Marzotto family at 15%. And Mike Ashley's Frasers Group raised its stake to 15% earlier this year, so that's 30% combined. If we focus just on Frasers, they referred to the stake as a strategic position. They are also among your top 10 wholesale accounts globally. What type of dialogue do you have with Frasers? Do you see potential for reinforced distribution agreements online and offline, or specific product lines for House of Fraser or Sports Direct? Would it even make sense for them to seek a seat in the Supervisory Board?

Yves Müller (CFO and Spokesperson of the Managing Board): On the second one regarding the shareholder structure. We are talking to the Frasers Group on a quarterly basis, just like to every other institutional investor. You're right, they're among our top 10 wholesale partners and we are growing our business with the Frasers Group, reflecting our very good operational relationship. Regarding their shareholding, there are no interferences so far with respect to the commercial relationship. On the contrary: the relationship with Frasers Group is very constructive also on the commercial side. Furthermore, so far, we have not seen any interest of the Frasers Group to get a Supervisory Board seat.

Regarding your first question: overall, your estimations are not wrong. We clearly want to continue our tight approach on cost control, especially when it comes to Q1. On the other hand, we have to observe how our business will recover over the quarters to come. This means that, alongside the recovery of our business, we will also have to invest into our brands and marketing in order to support growth.

Jörg Philipp Frey (Warburg Research): Regarding the cost line, can you provide us with the amount of non-recurring cost savings in 2020, like the impact from short-term work or rent forgiveness during the temporary store closures? And, kind of offsetting these effects, the impairment charges in 2020 also lowered the regular depreciation base. Can you provide a number on the sustainable reduction of D&A due to the impairments?

Secondly, on your cooperation with Russell Athletic. What is the sales potential for this collection? What price points are we talking? Is this a premium pricing relative to your existing athleisure offering?

Yves Müller (CFO and Spokesperson of the Managing Board): The majority of our cost savings generated in 2020 is not sustainable, but rather non-recurring in nature, in particular with regard to short-time work and rent reliefs. On the other hand, there were also some initiatives aimed at sustainably lowering the cost base. On top of this, yes, we expect D&A to be lower as a result of the impairment charges of EUR 110 million that we recorded in 2020.

On your second question regarding our cooperation with Russell Athletic, which is a big thing for us! We're going to launch the first collection on March 24th. The sales potential is expected to be around two to three times that of the collections we launched together with, for example, Porsche or Anthony Joshua. So the sales potential is clearly within the double-digit million euro range, with price points comparable to that of our regular casualwear collection, focusing on younger customers. But it's not only the products that we are selling. We will also launch a big marketing campaign including a digital live event. On social media, the launch will be accompanied by high-profile brand ambassadors as well as micro-influencers, to ensure this collaboration will go viral.

Thierry Cota (Société Générale): First, on gross margin. You mentioned the impact from elevated markdown activity in Q4 and in Q1. Can you provide us a magnitude of that impact? Is it fair to assume that the impact was around three percentage points in Q4? And do you expect something similar in Q1? Going forward, do you expect the impact to vanish gradually or to remain visible for some time?

My second question is on your focus on younger customers. Do you have any data on demographics that you can share, e.g. by region, in terms of where you stand today versus one, two or three years ago?

Yves Müller (CFO and Spokesperson of the Managing Board): Gross margin declined by 530 basis points in Q4, with around 80% of the decline resulting from markdowns and inventory valuation – so 40% is coming from markdowns and the other 40% is coming from inventory valuation. We didn't expect the impact from inventory valuation during the course of the year, and we wanted to keep our inventories on the same level as end of 2019. We broadly achieved this. But, due to the lockdowns in Europe, we had to post some inventory valuation in Q4. Finally, the remaining 20% in terms of gross margin decline was mainly related to higher freight cost in the wake of the pandemic. While the inventory valuation effects are expected to fade away, we should expect some impact from elevated markdowns also in Q1 particularly reflecting the lockdown situations in Europe.

On the second question regarding younger customers. We have the youngest customers in China, followed by Europe and the Americas. As part of our Investor Day that we are planning to host in the second half of this year we will share some more insights around this topic and how we are addressing younger customers in particular. However, our brand initiatives – be it our cooperations with the NBA, Chris Hemsworth, or Russell Athletic – are clearly all aimed at younger generations in particular. With the recent launch of our NBA collection we saw a lot of new customers coming in, aged 15 to 30/35.

Volker Bosse (Baader Bank): On gross margin: is it fair to assume that gross margin will be back to its 2019 level by the end of 2022?

My second question is on your wholesale pre-order. It's good to hear that numbers for the Fall/Winter 2021 collection are positive. Can you confirm that this is true for both formalwear as well as casualwear?

Finally, what is your CapEx guidance for 2021?

Yves Müller (CFO and Spokesperson of the Managing Board): Starting with your question on CapEx. Our investments totaled EUR 80 million in 2020, while we initially guided for around EUR 150 million. For 2021, we expect CapEx to increase moderately, which means that investments should come in somewhere between EUR 80 million and EUR 150 million.

Regarding the Fall/Winter 2021, I can confirm that my comments on the strong order intake refer to all wearing occasions. The new collection particularly reflects our evolved approach when it comes to formalwear, using innovative products and materials such as reflected in our stretch tailoring offering.

Regarding gross margin, we won't comment on our expectations for 2022. Let's do 2021 first, where we obviously want to improve also our gross margin as compared to 2020. This means that we currently expect gross margin in 2021 to come in somewhere between the levels of 2019 and 2020.

Rogerio Fujimori (Stifel): What should we expect in the first half of 2021 based on your wholesale order intake?

With regard to your brand and product initiatives, how do you assess the level of brand heat today relative to your main premium apparel competitors, also with regard to your positioning on social media?

Yves Müller (CFO and Spokesperson of the Managing Board): We won't quantify our expectations on wholesale for the first half of the year. So let's focus on your question regarding brand heat. As I laid out during my speech, our follower base on social media has increased at a low double-digit rate in 2020, which is good. What's even better is that our engagement rates are also increasing as reflected by an increase in the average number of likes per post, for example, particularly on Instagram, where we made big progress. And by the way, we were among the first brands within our industry to get engaged on TikTok last year. Also over there, we are seeing a strong increase in fans and engagement.

Kathryn Parker (Jefferies): First, on your online business and the relative sizing of hugoboss.com versus your e-concession business, and whether you plan to convert more of your online wholesale accounts to your e-concession business also this year?

Secondly, on your retail store network. The number of shop-in-shops in the Americas has gone up by approximately 20 since Q3 2020. Is this reflecting positive developments with your partners, or is it normal course of business in terms of opening additional stores?

Yves Müller (CFO and Spokesperson of the Managing Board): Starting with your second question on shop-in-shops in the U.S. The increase is first and foremost reflecting a further strengthening of our relationship with Macy's where we extended our shop base also for HUGO to address younger U.S. customers. On the other hand, we also converted our business at Hudson's Bay from wholesale to retail.

On your first question regarding online: while hugoboss.com accounts for around 60% of our own online sales, the e-concessions make up around 40%. In total, we grew our own online business by 49% in 2020. And while growth in Q4 kind of decelerated a bit, mainly reflecting a high comparison base, I'm very confident with regard to the development that we've seen in Q1 so far. We have seen a reacceleration in sales growth both at hugoboss.com and at our e-concessions. Regarding further possible conversions from wholesale to retail in 2021, there are some accounts to be converted soon, for example in Germany and in Russia.