Second Quarter 2020 Results

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- The spoken word shall prevail –

Good afternoon ladies and gentlemen and welcome to our second quarter 2020 financial results presentation.

Today's conference call will be hosted by Yves Müller, CFO of HUGO BOSS and Spokesperson of the Managing Board. As always, during the Q&A session, I kindly ask you to limit your questions to a maximum of two, to allow everybody to ask his or her questions.

There's a lot to cover today. So, without any further ado, let's get started and over to you, Yves.

Thank you Christian, and good afternoon ladies and gentlemen. Also from my side, a very warm welcome to all of you. I hope you and your families are all safe and sound during these difficult times.

In the next twenty-five minutes, I will guide you through our second quarter operational and financial performance. I will also elaborate in detail on the progress we have made when it comes to executing our measures aimed at protecting the financial stability of our company during this extraordinary situation.
But first, allow me to take a step back and reflect on some fundamental First and foremost, a global and severe crisis like the COVID-19 pandemic calls for companies to take a clear stance! As a global corporation, HUGO BOSS is aware of its responsibility to people, society, and the environment. The relevance of corporate responsibility has never become more evident as in fiscal year 2020. In this context, prioritizing the safety and well-being of employees, customers, and partners forms an essential part of our company's responsibility.

Therefore, our decision to temporarily close a large part of our global store network at an early stage of the pandemic was without a doubt the right thing to do. And while this decision weighed heavily on our financial performance, in particular in the second quarter, it was simply the only alternative.

Secondly, digitization has proven to be more important than ever before, as COVID-19 has further accelerated the ongoing consumer shift from offline to online. As you are all aware, the digital transformation of our business model together with the strong push of our own online business, has been an integral part of our strategy for several years. As the industry continues to face an unprecedented situation, and consumer behavior changes towards online, we will further accelerate our digital push in the years to come, to ultimately tap the full potential of digitization.

In this context, during the second quarter, we strongly accelerated the international rollout of our online store hugoboss.com by tapping into 22 additional markets. And with Canada and Mexico, the next two markets are just about to be onboarded tomorrow, on August 5, 2020.

Last but not least, the COVID-19 crisis has shown that it is crucial not to overlook other challenges. While coping with the economic consequences of the pandemic requires our full attention, it is equally important to push ahead with important social topics such as diversity and sustainability. Two subjects that are absolutely essential for HUGO BOSS.

While diversity forms an integral part of our corporate culture, recent events have shown that we can and must do even more! Therefore, we are establishing the position of Global Head of Diversity & Inclusion, who will address the topics of equality and diversity across our company, as well as a Global Diversity Task Force to implement initiatives and measures that encourage an open dialogue worldwide.

At the same time, we are making further progress across our many sustainability initiatives. Most notably, we are continuing to increase the share of sustainable materials and products in our collections. Our successful Vegan Suit and our Traceable Wool Collection, both being very well received globally, are just two examples in this regard.

As a company, we assume full responsibility for the economic, ecological, and social impacts of our business activities – before, during, and after COVID-19. And while "putting people first" will remain our guiding principle, we will continue to focus strongly on the operational recovery of our business. Therefore, let's now take a closer look at our second quarter performance.

As outlined to you back in May, we implemented comprehensive measures in the magnitude of around 600 million euros aimed at protecting cash flow in fiscal year 2020. Executing these measures was THE top priority in Q2 and I am pleased to report that we have made substantial progress within all areas.

- Starting with operating expenses, where we realized additional savings of around 100 million euros in Q2, primarily reflecting significant personnel expense as well as rental savings. I will elaborate on these savings in more detail later on when discussing the quarterly profit and loss. Further cost savings of around 50 million euros have meanwhile been implemented, which will ensure incremental opex savings of at least 150 million euros for the full year.

- Secondly, we adjusted our capital expenditure by postponing all non-essential retail and IT investments. Regarding our target to cut our capex budget for the current year by around 50 million euros, we have already freed-up additional cash flow of at least 40 million euros by the end of June, reflecting our strict approach during the second quarter. At least 10 million euros will be generated over the next months.

- Thirdly and equally as important, we have put a strong emphasis on protecting our inventory position during the second quarter. A generally more cautious approach with regard to our never-out-of-stock business, an immediate adjustment of our own production to the lower demand, as well as a timing shift in terms of the delivery of our Fall/Winter collection into July has enabled us to protect cash flow by around 100 million euros in Q2. As we have significantly cut back merchandise for the upcoming Fall/Winter season, we will realize another 100 million euros in cash flow protection in the second half of the year.

- Last but not least, and as you are all aware, we suspended the dividend payment for fiscal year 2019, except for the legal minimum dividend of 4 cents per share. The retention of net profit has strengthened our financial flexibility by almost 190 million euros during the second quarter of 2020.

Overall, our relentless focus on executing these four measures, together with a temporary reduction in income tax payments, has yielded strong cash flow generation in Q2, as reflected by a positive free cash flow of 39 million euros in the second quarter. Consequently, we were able to compensate for around half of the negative free cash flow development in Q1, leading to a total free cash flow for the first half of 2020 of minus 46 million euros.

Securing sufficient liquidity is, and will remain, one of our top priorities for the remainder of the year. In this context, I am pleased to confirm that we have successfully exercised the increase option of our existing revolving syndicated loan. The latter now totals 633 million euros, of which 212 million euros were utilized at the end of June. In addition, we have secured further credit commitments totaling 275 million euros with a maturity date of June 2022. At the end of the second quarter, however, there was <u>no</u> need for utilizing these additional credit facilities.

With this, let’s now take a closer look at how COVID-19 has impacted our sales and earnings development in Q2, starting with the top line.

With approximately 50% of our global store network closed on average during the course of Q2, our business was significantly impacted by the pandemic and the corresponding lockdowns. This was particularly evident in Europe and the Americas – by far our largest regions.

In Europe, an average of 60% of our stores and shop-in-shops remained closed in the second quarter. Some important markets, such as the Great Britain, even saw its doors closed for almost the entire three-month period. In the Americas, the average store closure rate in Q2 was even higher at 70%. This reflects long-lasting store closures as a result of the severe lockdown in both markets – the U.S. as well as Latin America.

The picture in Asia/Pacific varied by market. While our stores in mainland China were able to welcome customers throughout the whole quarter, other markets – including Southeast Asia, Australia, and Japan – also had to close their doors for a significant amount of time. Still, the overall store closure rate was well below the Group average in Q2.

Altogether, our global store closure rate was most pronounced in April and only started to recover gradually throughout the month of May, before returning to a rather normalized level at the end of June. We ended the second quarter with around 90% of our global store network back in business.

The temporary store closures inevitably weighed on our brick-and-mortar retail business in the second quarter. Consequently, currency-adjusted sales in own retail declined by 58%, with comp store sales down 59% as compared to the prior-year period.

Also our global wholesale business faced a challenging quarter. Large-scale temporary closures of wholesale points of sale resulted in significantly lower deliveries to partners in Europe and the Americas. As a result, sales in the wholesale business were down 64% in Q2.

As a consequence of the widespread temporary store closures, a sharp decline in consumer sentiment, as well as international travel restrictions, Group sales declined to 275 million euros in the second quarter. This corresponds to a decrease of 59% as compared to the prior year, both in the reporting currency as well as currency-adjusted.

This brings me to the regions, where currency-adjusted sales in Europe were down 59% on the prior-year level. Due to temporary closures of own retail as well as wholesale partners' points of sale, all key markets posted double-digit sales declines. In particular, more than 90% of our own stores and shop-in-shops remained closed for at least five weeks in the second quarter, severely weighing on our brick-and-mortar business.

In Germany, where the first stores reopened already at the beginning of May, revenue declines were less pronounced than in the region's other markets, including Spain, Italy, and France. On top of temporary store closures, business in those countries also suffered from significantly lower tourist flows. Also Great Britain lacked behind, as the first stores only reopened towards the end of the second quarter. Overall, the regional sales performance in own retail was quite comparable to that in the wholesale channel, with June having seen a clear recovery in both channels as compared to the months of April and May.

Let's now move over to the Americas, where currency-adjusted sales were down 82% in the second quarter. The extent of the revenue decline was quite similar across the region's key markets as the lockdown and the corresponding temporary store closures weighed strongly on the overall performance.

And while more than half our regional store network remained closed for more than nine weeks in the second quarter, some important BOSS stores, such as those at World Trade Center or Columbus Circle in New York City, even remained closed throughout the entire second quarter. Our U.S. wholesale business was equally impacted by temporary closures of wholesale points of sale, as reflected by significantly lower deliveries to important partner accounts.

Besides this, our U.S. business was also burdened by the unrest and demonstrations in May and June, which have put an additional strain on consumer sentiment.

To conclude on the regions, currency-adjusted sales in Asia/Pacific were down 36%. With the exception of mainland China, all of the region's key markets were affected by broader temporary store closures as compared to the first quarter. This particularly impacted markets such as Southeast Asia, Australia, and Japan, where our stores were closed by more than six weeks on average during the second quarter. In addition, business in Hong Kong and Macau continued to severely suffer from missing tourist flows. Please bear in mind that in these two markets, we usually generate around 75% of sales from tourists.

Mainland China, a strategically important market for HUGO BOSS, was the clear bright spot in Q2, as it continued its strong recovery that had already started back in March. After returning to growth in May, currency-adjusted sales further accelerated to double-digit growth in the month of June, resulting in a currency-adjusted 4%-increase in mainland China during the second quarter. This was driven by a repatriation of Chinese spend, an overall improvement in consumer sentiment, a strong conversion in brick-and-mortar retail, as well as triple-digit growth in the market's own online business.

Another bright spot was the stellar performance of our own online business, which not only continued its double-digit growth trajectory in the second quarter, but even saw a further acceleration. At 74%, currency-adjusted sales growth on hugoboss.com and on multibrand platforms operated in the concession model picked up noticeably in Q2, with growth being broad based across all three regions, each of them recording strong double-digit growth. This resulted in the period from April to June marking the strongest quarterly performance out of eleven consecutive quarters with significant double-digit online sales growth for HUGO BOSS.

Remarkably, the strong online growth was not only driven by returning customers, but also by a strong increase in first-time customers as compared to the prior-year period. While this confirms the increasing shift in consumer behavior from offline to online, it is particularly encouraging that millennials meanwhile belong to the fastest-growing customer group, clearly indicating that our web offerings resonate particularly well with younger customers.

To conclude my comments on the top line, let’s take a closer look at the sales development by brand and wearing occasion. As you would expect, the economic consequences of COVID-19 weighed on both brands –BOSS and HUGO – with currency-adjusted revenues down 60% and 50%, respectively. During the second quarter, in particular, sales declines in casualwear and athleisure wear were less pronounced than in formalwear. This was especially true for our HUGO brand, where sales in casualwear only declined at a low-double-digit rate.

Speaking about the different wearing occasions, allow me to make a few general remarks on the topic of “formalwear versus casualwear” and the trends that we have been observing over recent months.

Fiscal year 2020 will most likely be a rather challenging year for the overall formalwear market. This also has to do with companies enabling their employees to work remotely from home. By far the bigger impact, however, is directly attributable to social distancing as well as a general lack of events and occasions – from weddings, prom nights, and summer parties to company events as well as business trips. While the absence of these types of events temporarily weighs on our formalwear business, we expect a clear and strong rebound once social life starts to normalize.

Our formalwear business continues to be of great importance for our company, as it is the DNA and heritage of HUGO BOSS. However, at around 40%, the share of sales being generated from formalwear has clearly come down in recent years. Within formalwear, heritage tailoring today accounts for less than half of sales; in contrast, modern concepts and offerings such as mix-and-match, stretch tailoring or the broken suit have consistently gained relevance and will probably continue to do so in the coming years. We are well prepared to capture and lead the trend towards casual tailoring, which will be a focal point of the upcoming Fall/Winter 2020 and Spring/Summer 2021 collections.

Casualwear, on the other hand, has successfully proven its ability to be more resilient in the current environment, as it directly captures the trend towards a more relaxed clothing style and many consumers' desire to dress in a sporty style without compromising on value or quality. Now, casualization is a phenomenon that has been around for almost a decade, and enjoyed strong momentum for many years. This propelled the share of our casualwear business to meanwhile over 50% of Group sales. As we expect COVID-19 to accelerate the trend towards a more casual lifestyle even further, we will continue to focus relentlessly on driving the further casualization of our business model, across all types of wearing occasions. Now, ladies and gentlemen, this closes my remarks on the top line. So let's now move on to the remaining P&L items.

Starting with the gross margin, which decreased to 54.6% in the second quarter. Around 90% of the gross margin decline is a direct consequence of an inventory write-down of 25 million euros predominately relating to the Spring/Summer 2020 collection. The sale of this collection was significantly affected by temporary store closures in the wake of the pandemic. In addition to this, slightly higher markdowns also contributed to the gross margin decline. Other factors, such as channel mix or currency effects, had only negligible effects on the gross margin development in Q2 and largely compensated for each other.

Moving over to our operating result in the second quarter, where the sales decline together with the lower gross profit inevitably weighed on our EBIT development. At the same time, we were able to considerably cut our underlying operating expenses, therefore cushioning the economic consequences of COVID-19 to some extent.

Overall, our underlying operating expenses decreased a strong 25% to 274 million euros in Q2. This development was largely driven by underlying selling and distribution expenses, which saw a 31%-decline, reflecting the cost-saving measures that we had implemented in the wake of the pandemic.

In addition to lower variable rents, reflecting the temporary store closures, we successfully renegotiated rental contracts in key markets, resulting in rent reliefs as well as rent deferrals. We also generated significant payroll savings, as we reduced working hours and personnel costs for the Group's national and international subsidiaries. This also included the implementation of short-time work as well as putting a global hiring freeze into effect.

While the magnitude of the rental and payroll savings were quite comparable – together they contributed more than 80% to the opex savings achieved in Q2 – we also spent considerably less on print media advertising and physical marketing events. Finally, we also cut back on all non-business-critical expenses.

We now move on to administration expenses, which declined 2% versus the prior-year level, despite one-off expenses in the mid-single-digit million euro range which primarily related to Managing Board changes. This development was largely due to a reduction in payroll costs as well as a general halt on non-business-critical corporate expenses, including significantly lower travel expenses.

As a result, underlying EBIT in the second quarter totaled minus 124 million euros compared to 80 million euros in the same period last year, in line with our projection from early May.

As you have seen from our announcement earlier this morning, during the second quarter we have recorded non-cash impairment charges in the amount of 125 million euros. These impairment charges were entirely attributable to the pandemic's negative impact on our retail business, as they primarily relate to impairments for right-of-use assets in the amount of 88 million euros as well as fixed store assets totaling 33 million euros. In addition, we recorded a small goodwill impairment of 4 million euros related to our sales unit in Australia. Considering these non-cash impairment charges, reported EBIT amounted to minus 250 million euros in Q2.

To conclude on quarterly profit and loss, net income excluding the aforementioned impairment charges amounted to minus 96 million euros. The decline of net income was less pronounced than that of EBIT, reflecting a tax credit as a result of the pretax loss incurred in the second quarter.

With this, let's now take a quick look at the balance sheet.
Currency-adjusted inventories increased 2% in the second quarter. The muted inventory growth was supported by the successful execution of our initiatives to significantly reduce inventory inflow. Besides this, the write-down of inventories for the Spring/Summer 2020 season also curbed inventory growth. When excluding the impact of the change in the basis of consolidation of our entity in the Middle East, inventories would have developed even broadly stable year-on-year.

At the end of Q2, trade net working capital was 7% above the prior-year level, currency-adjusted, reflecting the slight increase in inventories as well as lower trade payables. This was partly offset by lower trade receivables as a result of lower wholesale sales.

Capital expenditure declined by 66% in the second quarter as most retail and IT investments were postponed to protect cash flow during the pandemic. However, business-critical investments still took place, including the relocation of our important

BOSS store in New York's SoHo district, which reopened its doors to customers just a few days ago.

Now, before I come to an end, ladies and gentlemen, allow me to say a few words on our expectations for the full year and the second half year in particular.

While the further development of the pandemic in many key markets remains uncertain – something that makes it impossible for us to provide you with a reliable sales and earnings forecast for the full year 2020 today – we remain optimistic that the global retail environment will continue to gradually improve. This, in turn, should also positively impact our sales and earnings development in the second half of the year and allow us to make further progress along our overall recovery, which started at the beginning of May.

Retail sales trends during the second quarter have shown a clear sequential improvement month by month, with own retail sales in June down only around 35% to 40% as compared to the prior-year level. This compares to almost minus 80% during the month of April. The overall positive trend has also continued so far in the <u>third</u> quarter, as we have recorded further improvements in our global retail operations during the month of July. This became particularly evident in Asia/Pacific, while also most European markets were able to continue their gradual recovery, despite the ongoing weakness in international tourism. On the other hand, business in the Americas continues to be impacted by the further spread of COVID-19 in large parts of the U.S. and Latin America.

And with this, ladies and gentlemen, I am now happy to take your questions.

Okay, ladies and gentlemen, that completes our conference call for today. If you have further questions please feel free to contact any member of the IR team.

And with that: Thank you for your participation and enjoy your summer holidays. Bye-bye.