First Quarter 2022 Results

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Yves Müller (Chief Financial Officer)
Christian Stöhr (Vice President Investor Relations)

- The spoken word shall prevail –

Christian Stöhr: Good afternoon ladies and gentlemen and welcome to our first quarter 2022 financial results presentation. Today's conference call will be hosted by Yves Müller, CFO of HUGO BOSS. Before we get started, allow me to reiterate that all revenue-related growth rates will be discussed on a currency-adjusted basis, unless otherwise specified. And let me also remind you that during the Q&A session, we kindly ask you to limit your questions to a maximum of two. So, without any further ado, let's get started and over to you, Yves.

Yves Müller: Thank you Christian, and also from my side a warm welcome to all of you. During the next 25 minutes, I will primarily focus on two overarching topics:

- Firstly, I will elaborate in detail on our strong operational and financial performance in the first quarter, spurred by our highly successful branding refresh initiated at the end of January.
- Secondly, I will guide you through our top- and bottom-line expectations for the remainder of the year, also referencing the current geopolitical and macroeconomic uncertainties.

But first, and before talking about our business performance, allow me to emphasize once again that at HUGO BOSS, we remain deeply concerned by the dramatic humanitarian crisis unfolding in our European neighborhood. The suffering of the people in Ukraine cannot be put into words and our deepest empathy and thoughts are with all those affected by the war. To help the people in need, we are supporting the German Red Cross and other organizations with financial aid and in-kind donations. Looking ahead, we will continue to monitor the situation closely and evaluate the developments accordingly.

Now, from our press release this morning you have already noticed that we can look back on a highly successful start to fiscal year 2022. Following a steady acceleration in top-line growth last year, I am particularly pleased to report that this trend has also continued in the first quarter. Compared to pre-pandemic levels, sales were up a strong 17%, representing a further acceleration of 5 percentage points as compared to the final quarter of 2021. From a year-on-year perspective, Group sales even increased 52% to 772 million euros, marking the strongest first quarter sales in our company's history.

While momentum was broad-based in nature, our two largest regions – Europe and the Americas – have shown particular strength in Q1, recording double-digit sales improvements versus pre-pandemic levels. On top of this, the focused and relentless execution of "CLAIM 5" provided an additional tailwind during the first quarter. In particular, our bold branding refresh resonated extremely well with consumers worldwide, thereby spurring brand momentum around the globe.

Now, as part of our full year 2021 results release back in March, Daniel and I already provided you with a comprehensive deep dive on our branding refresh. Hence, without going into too much detail once again, let me briefly recap on some key highlights around this truly groundbreaking and first iconic move to ultimately becoming a top 100 global brand.

Above all, our brands' star-studded global campaigns "BeYourOwnBOSS" and "HowDoYouHUGO" drove brand momentum and attracted new and younger generations worldwide. Thanks to our international all-star cast, including BOSS brand ambassadors Alica Schmidt, Matteo Berrettini, and Khaby Lame, and the activation of more than 200 diverse talents from all over the world, our campaigns created an overwhelming social buzz. In only three months' time, our various marketing initiatives have resulted into a record 24 billion impressions and almost 1 billion engagements on social media, something our company has not experienced before.

Most importantly, with our marketing initiatives strongly focused on digital, we have seen momentum on social media picking up strongly. In the first quarter, BOSS has been the fastest-growing brand on Instagram in terms of follower development among key premium apparel peers. In the three-month period alone, our brand attracted around 500,000 new followers, growing its fan base by 5% to almost 10 million followers. On top of that, in Q1, engagement rates for BOSS more than doubled to a strong 16%, making BOSS the #1 brand in terms of overall engagement among its core peer group.

Also on YouTube, we have set new benchmarks in terms of reach. With more than 32 million views, our Dubai fashion event for BOSS created tremendous buzz and quickly achieved record-breaking results on YouTube. This is another proof positive for the brand's growing relevance on social media.

Also for HUGO, our consistent focus on social media – and TikTok in particular – has yielded strong results over the most recent weeks and months. Recently in April, HUGO hosted a series of branded events in Palm Springs, getting the HUGO House, a creative hub for TikTokers and talents, on the radar of millions of Coachella festivalgoers and followers from all over the world. In less than two weeks, HUGO achieved more than 1.3 billion impressions on social media, a total of 200 million views on TikTok, and a strong organic engagement rate of 26% on Instagram.

Fueled by these successes, both our brands recorded significant double-digit sales improvements year on year. Revenues grew 53% for BOSS Menswear and 41% for BOSS Womenswear, spurred by growth across all wearing occasions and clearly emphasizing our ambition to establish BOSS as a true 24/7 lifestyle brand. On a three-year-stack basis, sales for BOSS Menswear exceeded pre-pandemic levels by 17%, while remaining on par with 2019 levels for BOSS Womenswear.

HUGO also posted very robust growth and continued its strong double-digit growth trajectory, thereby gaining further market share across key geographies. Revenues increased 52% year on year, translating into strong growth of 26% compared to pre-pandemic levels. Importantly, sales for the brand's casualwear offering more than doubled as compared to 2019, reflecting HUGO's strategic focus on modern and commercial styles to ultimately establish itself as the first touchpoint among younger consumers, in particular Gen Z.

This brings me to our regions, with both Europe and the Americas having once again recorded particularly strong performances in the first quarter.

In Europe, revenues increased 69% on the prior-year level, reflecting ongoing robust local demand, as well as the successful execution of important strategic initiatives along "CLAIM 5." At the same time, the prior-year period was marked by long-lasting temporary store closures, as reflected by an average store closure rate in Europe of around 50% in the first quarter of 2021.

On a three-year-stack basis, revenues in Europe consequently increased by 21%, representing a strong acceleration of 10 percentage points as compared to the final quarter of 2021. Great Britain and France performed particularly well with three-year-stack growth of 32% and 13%, respectively, while sales in Germany came in broadly in line with 2019 levels.

Also in Eastern Europe, momentum remained robust in Q1, as reflected by high double-digit growth versus 2019 levels, despite the war in Ukraine and our decision to suspend our business activities in Russia, early March. Allow me to point out that, beyond these two markets, we have <u>not</u> seen any negative implications from the war on our European business as of today.

Moving over to the Americas, where sales were up 56% as compared to the prior-year period. As a result, sales grew 17% versus 2019 levels, with all of the region's markets recording strong improvements versus pre-pandemic levels. In the important U.S. market, where both BOSS and HUGO continue to successfully foster their 24/7 brand image, revenues increased 9% versus 2019. This, in turn, means that our comprehensive initiatives to substantially improve our overall product assortment at the point of sale have clearly started to pay off. Our brands' casual-inspired collections – also including the third edition of our BOSS x NBA collection – resonate extremely well with the U.S. consumer, thus putting us in a strong position to further push ahead with our self-managed turnaround and accelerate growth in the U.S. market in the years to come.

And while trends were similar in Canada, with revenues up 10% versus 2019, our business in Latin America continued its particularly strong momentum in Q1, as reflected by high double-digit sales growth compared to 2019 levels, driven by both Brazil and Mexico.

Finally, on Asia/Pacific, where we also recorded a promising start to the year, as reflected by double-digit sales improvements across key markets, including mainland China in the run-up to Chinese New Year. Towards the end of the quarter, however, renewed COVID-19-related restrictions started to weigh more meaningfully on consumer sentiment and on store traffic in key provinces, first and foremost in Shanghai.

Towards the end of March, around one third of our store network in mainland China had been affected by either temporary closures or reduced opening hours, resulting in significantly lower traffic. Consequently, for the quarter as a whole, around 10% of our points of sale in mainland China were impacted by the lockdown, leading to first quarter sales in mainland China being 13% below the prior-year period. This translates into growth of 12% versus 2019 levels.

To conclude on Asia/Pacific, while business in Hong Kong and Macao continued to be impacted by lower tourism flows, markets such as Japan and Australia made further progress along their overall business recovery, recording high single-digit and low double-digit growth versus 2019 levels. Overall, revenues in Asia/Pacific came in 3% above the prior-year level and only 1% below that of 2019.

Let's conclude on the top line with a brief review of the performance by channel, with both digital and brick-and-mortar contributing to growth in the first quarter.

Starting with our important digital business, which successfully continued its double-digit growth trajectory in Q1. Despite being up against a particular strong comparison base from the prior-year period, sales increased 22%, with double-digit improvements across all regions and all digital touchpoints – including both hugoboss.com as well as partner websites.

This development was supported by the relaunch of hugoboss.com, successfully implemented at the end of January, as well as the tremendous digital buzz our two brands created in the wake of the branding refresh, leading to higher traffic, an increase in average order value, as well as a higher share of full-price sales. Compared to 2019, our digital business even more than doubled, with revenues up 145%, leading once again to a digital sales share of around 20%.

Moving over to our brick-and-mortar retail business, which recorded strong double-digit sales improvements in Q1, with revenues up 76% year on year. While this development was also supported by a fairly easy comparison base from the prior-year period – considering that around 25% of our global store network was closed on average during the first quarter of 2021 – it was in particular the successful execution of "CLAIM 5" as well as robust consumer sentiment across key regions that drove overall momentum. On a three-year-stack basis, revenues in brick-and-mortar retail were up 5%, led by the Americas recording double-digit sales improvements versus 2019 across all major markets, as well as mid-single-digit growth in Europe.

Finally, sales in brick-and-mortar wholesale grew 44% compared to the prior-year period, marking the channel's return to pre-pandemic levels with an increase of 2% as compared to 2019. This development mainly reflects robust demand of wholesale partners for the Spring/Summer 2022 collections, fully incorporating the branding refresh. At the same time, delivery shift effects from the first quarter into the second quarter weighed on wholesale revenue growth by around 10 percentage points or 25 million euros. Now, with this ladies and gentlemen, let's move on to the main P&L items.

Starting with our gross margin, which totaled 61.6% in the first quarter, representing an increase of 120 basis points year on year. This development mainly reflects a generally lower markdown activity and thus a higher share of full-price sales in both our digital and brick-and-mortar businesses, which more than compensated for the persistently high level of global freight and transportation costs. Besides that, in Q1 we also recorded slight positive effects from both channel mix as well as inventory valuation, largely offset by negative currency effects.

Moving over to operating expenses. Fully in line with our strategic claim "Boost Brands" aimed at driving brand relevance, we strongly stepped up our marketing investments in the first quarter. Consequently, as compared to both 2019 and 2021, marketing investments effectively doubled to 80 million euros. Also in percentage of sales, marketing investments grew substantially to a level of 10.4%, which is somewhat above our target range of 7% to 8% as set out in "CLAIM 5." Unsurprisingly, this development is predominantly related to our comprehensive marketing campaigns as part of our global branding refresh, initiated during the first quarter.

At the same time, we also continued to invest in the further digitization of our business model, representing another key lever of our journey towards 2025. In the first quarter, total digital investments were up 43% or 15 million euros year on year, with the relaunch of hugoboss.com and our recently established Digital Campus in Porto being two prime examples of our digital investments in Q1.

Overall, operating expenses increased 45%. Besides the significant step-up in brand and digital investments, this also reflects a normalization in rental and payroll expenses, given long-lasting temporary store closures in the prior-year period. As a percentage of sales, however, operating expenses decreased 380 basis points to a level of 56.5%. And while selling and distribution expenses increased 49% in the reporting period, administration expenses came in 34% above the prior-year level, driven by higher payroll and digital investments.

Now, in light of the strong top-line performance, the increase in gross margin, as well as operating leverage generated in the first quarter, we were able to realize significant bottom-line improvements, as reflected by an EBIT of 40 million euros in Q1. This is all the more noteworthy, considering our ongoing commitment to significantly investing in our business to successfully deliver against our "CLAIM 5" targets. And to conclude on the P&L, net income attributable to shareholders totaled 24 million euros in the first quarter.

Let's now turn quickly to the balance sheet, starting with trade net working capital, which, as a percentage of sales, saw a significant decline year on year. At a level of only 15.0%, trade net working capital came in below our target corridor for 2022, which is between 18% and 19%. The overall improvement in trade net working capital was largely driven by a 3% decline in inventories, attributable to the accelerated sales growth in the first quarter, as well as a strong increase in trade payables, reflecting a higher utilization of our supplier financing program.

Now, in terms of capital expenditure, investments in the first quarter totaled 18 million euros, up 13% on the prior year. As a percentage of sales, however, CapEx amounted to only 2.4% and was thus well below our targeted range as part of "CLAIM 5". As we will push ahead with our store optimization initiatives and the rollout of our new store concepts for BOSS and HUGO, let me point out, however, that we anticipate a more significant step-up in CapEx during the remainder of the year.

Overall, we remain fully committed to implementing our new store concepts in at least 100 points of sale globally in fiscal year 2022. As of today, customers can already experience the new "look and feel" in around 30 of our own stores and shops. In this context, the highly anticipated opening of our new anchor store on London's Oxford Street in just a few weeks' time will mark a particularly important milestone in further elevating our customer experience in brick-and-mortar retail.

This brings me to free cash flow. Driven by the strong bottom-line performance as well as further improvements in trade net working capital, free cash flow turned positive quarter on quarter, amounting to 1 million euros, and thus effectively on par with 2019 levels.

Finally, the strong free cash flow generation over the last twelve months as well as the associated lower utilization of credit lines resulted in a net financial position of plus 120 million euros – when excluding lease liabilities in the context of IFRS 16. Consequently, HUGO BOSS continues to be effectively "cash rich" at the end of Q1.

Ladies and gentlemen, this concludes my remarks on our first quarter operational and financial performance. Let's now move over to our expectations for the remainder of the year.

As highlighted back in March, fiscal year 2022 represents the first full year along our journey towards our 2025 ambition. As a result, all our initiatives in the current year – be they from a brand, product, or operational perspective – have one common goal in mind: fostering the strong top-line momentum gained over previous quarters. With our successful start into 2022, we have already reached an important milestone and laid the foundation for another successful year. We therefore confirm our top- and bottom-line outlook for the current fiscal year as issued on March 10.

This being said, we must not forget that the overall market environment remains quite volatile. Our industry is currently facing disruptions from several factors, which all for themselves pose a risk to consumer sentiment: from the terrible war in Ukraine, to ongoing COVID-19-restrictions in China, to persisting macroeconomic headwinds, including heightened levels of global freight costs as well as the overall cost inflation.

Regarding the latter, we have decided to increase our prices globally, starting with the upcoming Fall/Winter 2022 season in the second half of the year. Overall, we are targeting a mid- to high-single-digit price increase, to be implemented over the next two seasons. In light of our accelerated brand momentum and given our superior price-value proposition in the marketplace, we have every confidence that these price adjustments will be well accepted by our customers.

Consequently, regarding our top line, we continue to expect revenues in 2022 to increase by between 10% and 15% to a new record level of between 3.1 and 3.2 billion euros. Importantly, growth will be broad-based in nature, with all brands, all channels, and key regions set to contribute to our growth target.

Our confidence is underpinned by the persisting strong brand momentum generated by BOSS and HUGO in the wake of the successful branding refresh. In particular, we remain optimistic that the robust momentum in Europe and the Americas will continue, with the month of April having further strengthened our confidence in this regard. And, not to forget, our strong order book for the upcoming Fall/Winter 2022 season, which should provide additional tailwinds for the second half of the year. Together, all these developments should enable us to more than offset the ongoing pandemic-related implications in mainland China.

Based on the anticipated strong top-line growth and a more or less stable gross margin development year on year, we continue to forecast robust bottom-line improvements in fiscal year 2022, with EBIT expected to increase within a range of 10% to 25% to an amount of between 250 and 285 million euros. This holds true despite the significant step-up in product, brand, and digital investments, which are a firm element of our "CLAIM 5" strategy and which will continue to lead the way throughout the remainder of 2022.

Now, like I already mentioned, and as you are all aware of, the environment continues to be characterized by a high degree of geopolitical and macroeconomic uncertainty. And by nature of things, it is extremely difficult to predict precisely how these uncertainties will further evolve and ultimately weigh on our business in 2022. We will therefore continue to very closely monitor these developments in the coming weeks and months. We will also continue to act decisively and determined when it comes to implementing measures to counteract their impact on our business.

Thanks to our accelerated top-line momentum and our strong position in the market, we have every confidence that we will be able to cope with these macroeconomic uncertainties. At the same time, we will continue to push ahead with our various strategic initiatives to ensure we make further strong progress along our "CLAIM 5" strategy – in 2022 and beyond!

Now, before opening the floor to your questions, let me briefly recap on our key highlights for the first quarter.

First of all, we have made a true kick start to fiscal year 2022, with record first quarter sales that exceeded pre-pandemic levels by a strong 17%. This represents a further sequential improvement as compared to the final quarter of 2021, driven by broad-based growth across both our brands, all channels, as well as key regions.

Secondly, around the globe, growth was spurred by our bold branding refresh that we successfully implemented during the first quarter – from new products, to record-breaking marketing campaigns, up to exciting events inspiring fans worldwide for BOSS and HUGO. Our brands are enjoying tremendous momentum, while still having so much more in the pipeline for the coming months and quarters.

Finally, in light of our successful start to 2022, and underpinned by very robust brand momentum around the globe, we confirm our top- and bottom-line outlook for the current fiscal year, notwithstanding the fact that the environment we operate in continues to face some heightened levels of geopolitical and macroeconomic uncertainties.

Ladies and gentlemen, this concludes my prepared remarks for today. I am now very happy to take your questions.