HUGO BOSS

Transcript – Q&A Session

May 2, 2024

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.

Grace Smalley (Morgan Stanley): Regarding the tough comparison base in Q2, could you comment on the trends seen in the exit rate as we close Q1 and enter April? How should we anticipate Q2 constant currency growth given this backdrop?

On promotional activity impacting Q1 gross margin, could you quantify this compared to Q4 and elaborate on the outlook for the full year?

Yves Müller (CFO/COO of HUGO BOSS): Starting with the exit rate, March more or less mirrored the Q1 performance for our DTC business, and April's numbers show a continued normalization of sales growth, with current trends somewhat below Q1 average.

Regarding gross margin and promotional activity, the tailwind in Q1 – related to reduced airfreight, better product cost, and overall sourcing efficiency – amounted to roughly 200 basis points. Conversely, channel mix effects, currency fluctuations, and promotional activity had a negative impact, totaling between 60 and 70 basis points each. Promotional activity was slightly higher in Q4 2023 than in Q1 2024, yet it's too early to predict Q2's trajectory, traditionally a period with only limited promotions. The good news is that the level of promotional activity impacting our gross margin is reasonably manageable, while our targeted efficiency gains in sourcing are translating into gross margin improvements. That is why we remain confident in achieving our gross margin guidance of 62% to 64% for 2024.

Grace Smalley (Morgan Stanley): Regarding April's normalization, given the tougher comparison base in Q2, is there any particular impact, for example due to the earlier timing of Easter year over year? And can you provide insight into regional changes?

Yves Müller (CFO/COO of HUGO BOSS): April confronted us with a particular tough comparison base, because of our very strong performance last year. And also looking at the full quarter, the comparison base remains challenging. If we assume that the Q1 momentum when comparing to pre-COVID levels of 2019 is maintained in Q2, which means over 50% growth on a five-year-stack, this would mean a continuation of sales growth normalization year over year.

Manjari Dhar (RBC Capital Markets): Could you provide more insight into the factors driving the strong growth in the U.S. in Q1 and how you expect these drivers to trend for the remainder of the year?

Could you elaborate on initiatives to enhance marketing effectiveness? Is the lower percentage of marketing spend relative to sales expected to persist throughout the year?

Yves Müller (CFO/COO of HUGO BOSS): With our performance in the Americas, showing an 11% increase currency-adjusted in Q1, we outpaced competition. Our strategic measures, such as positioning BOSS as a 24/7 lifestyle brand and targeting younger consumers, have yielded positive results, including our campaign "BOSSes aren't born, they're made." Our CRM program, especially in terms of retargeting younger consumers, has shown resilience and increased engagement with both BOSS and HUGO. While we anticipate some normalization going forward, also due to uncertainties like the U.S. elections, it's too early to make definitive forecasts. Nevertheless, we're pleased with our U.S. performance and continue to monitor trends closely.

Our marketing investments came in at 7.5% of Group sales in Q1, fully in line with our target range of 7% to 8%. So we are still investing heavily in marketing, with brand initiatives such as the BOSS campaign, including large holograms at Tower Bridge, collaborations with brand ambassadors like U.S. tennis star Taylor Fritz and Naomi Campbell, as well as our HUGO BLUE launch event in Berlin. Additionally, we're investing in sports, as seen with the inauguration of the HUGO Racing team in Formula One. Last year we had a big fashion event in Q1. This year, our focus was on innovative activations to maximize the impact of our spending. This is what we mean by marketing effectiveness. We remain committed to investing in our brands, with 7.5% of sales being in line with our target range, and we expect this trend to continue in subsequent quarters.

Anthony Charchafji (BNP Paribas Exane): You mentioned the gross margin should be between 62% to 64% for full year 2024. Considering the guidance of a maximum of 90 bps improvement at the EBIT level, does this imply an expectation of operating deleverage? Particularly in brick-and-mortar retail costs, which were up 12% in Q1 on a low single-digit top line. Could you provide insights into the cost base, especially for brick-and-mortar retail, particularly in light of potential inflation in rents?

You confirmed this morning the target of around EUR 500 million free cash flow for full year 2024. Can we expect this to be back-end loaded? Also, do you anticipate any changes in receivables or payables in the near future, or will it remain stable?

Yves Müller (CFO/COO of HUGO BOSS): Regarding the gross margin, it depends on various factors. While Q1 showed some leverage in OpEx positions despite sales growth normalization, we're focused on cost control. Administration expenses decreased, demonstrating operating leverage. Our aim is to continue reducing fixed costs in brick-and-mortar retail, which we managed to bring down from 26% pre-COVID to around 21%, while targeting a level of 20% by 2025, with also renovation pace and store expansions influencing our retail expenditures.

We are pleased with the improvements in free cash flow generation, having generated EUR 133 million more compared to last year, including IFRS 16. The significant swing primarily comes from trade net working capital. And while receivables may remain elevated, it's likely that trade payables will increase in the coming quarters.

Frederick Wild (Jefferies): Could you provide an update on your thinking regarding the scenarios within your 2024 guidance range? What factors would be required in your business and the macro environment to achieve either end of the EBIT range?

Your inventory reduction is impressive. What do you consider to be the margin-appropriate level for your inventories? Also, do you have visibility on inventory levels among your wholesale partners?

Yves Müller (CFO/COO of HUGO BOSS): Our guidance range of sales growth between 3% and 6% in reported currency is relatively narrow. So is our range for EBIT growth of 5% to 15%. Delving into specific scenarios might be too granular at this point. However, it's important to note that we have factored in various macroeconomic uncertainties into our 2024 guidance.

Regarding wholesale inventories, a key indicator of their appropriateness is the status of forward orders. I'm pleased to confirm that our forward orders align well with our Q1 performance, indicating strong sellout. This positive trend in forward orders will support our business development going forward.

Rogerio Fujimori (Stifel): Could you provide more insight into the growth drivers for brick-and-mortar retail, particularly in terms of volume and mix evolution in Q1, given also benefits from mid-single digit price increases in the prior year.

What are your observations regarding the performance of the Chinese market in April, and how does this performance align with the growth outlook embedded in your full-year guidance?

Yves Müller (CFO/COO of HUGO BOSS): In Q1, the growth in brick-and-mortar retail primarily stemmed from volume increases, with some minor positive effects from pricing. Going forward, it's essential to anticipate that growth will continue to be primarily driven by volume. We've observed market share gains, particularly evident also in our strong performance with wholesale partners. And we don't consider any price adjustment for the remainder of the year.

With regard to China, it's important to consider that the comparison base in China is exceptionally high in the first four to five months of this year, particularly due to the reopening story last year. It's noteworthy that when compared to pre-COVID levels in Q1, our numbers in China have been up against 2019 levels.

Thomas Chauvet (Citi): Could you provide insight into the contribution of space expansion to the 3% growth in brick-and-mortar retail? Additionally, how does this growth compare to like-for-like performance?

Last year, administration expenses were around 10% of sales, but in Q1, there was an 80 bps reduction. Can this reduction be extrapolated for the rest of the year, potentially leading to significantly lower admin charges compared to consensus estimates?

Yves Müller (CFO/COO of HUGO BOSS): In terms of brick-and-mortar retail performance, the 3% growth was driven by both space expansion and volume growth. Approximately half of the growth can be attributed to expansion in retail space, while the other half is driven by volume increases. This said, it's worth noting that negative developments in China and the UK slightly impacted overall performance in Q1.

In Q1, we indeed observed a reduction in administration expenses, representing an 80 basis points improvement. This reduction is attributable to structural enhancements, particularly in streamlining back-office operations. While we're focused on managing overall operating expenses throughout the year to support margin improvements, we prefer not to delve into specific line items at this stage.

Jürgen Kolb (Kepler Cheuvreux): Could you provide insights into the current performance in the UK, particularly in terms of exit rates and footfall in your own stores?

Considering potential normalization of sales growth also in the U.S., are there additional initiatives planned to manage OpEx? Could you elaborate on any strategies to enhance efficiency or introduce new measures?

Yves Müller (CFO/COO of HUGO BOSS): In the UK, we experienced weaker performance in Q1 driven by subdued consumer sentiment and high interest rates impacting footfall. This decline in traffic primarily drove the overall sales decrease. It's also important to note that the comparison base in the UK was quite high, with our revenues still up double-digit compared to 2019. While Q1 presented challenges, the comparison base should get a little bit easier as the year progresses.

Regarding OpEx, we're focused on leveraging our existing platform and driving effectiveness and efficiency across various functions. This includes optimizing marketing spend by prioritizing activation over content production. Similarly, in back-office operations, we're emphasizing shared service functions to enhance efficiency over the years. These measures aim to structurally improve our OpEx position and contribute to EBIT margin growth, even amidst normalized sales trends.

Michael Kuhn (Deutsche Bank): On gross margin, you mentioned a positive effect of 200 basis points from sourcing and logistics efficiency in Q1. Could you provide insights into what to expect from this factor in Q2 and for the remainder of the year, especially considering tougher comps?

Would you consider M&A moves over the remainder of the year, given previous indications and considering potential future activities aligned with your long-term strategy?

Yves Müller (CFO/COO of HUGO BOSS): Regarding gross margin, our visibility into product costs for upcoming seasons positions us well. Efficiencies gained from increased volume enable us to secure better prices without compromising quality. And we are further reducing the airfreight share. This visibility allows us to anticipate achieving a gross margin between 62% and 64% for 2024. In Q1, we already experienced a positive impact of 200 basis points from these factors, which could serve as a benchmark for the remainder of the year.

For M&A activities in 2024, given current uncertainties in the market, we're focusing on our core business. Any potential M&A moves would be more aligned with long-term strategies, possibly extending until 2030, as mentioned in recent comments. Therefore, short-term M&A activities are not expected this year.

Andreas Riemann (ODDO BHF): Looking ahead to the next two years, what is your outlook on the potential growth of HUGO BLUE? How significant do you anticipate its contribution to be by 2025?

Could you provide insights into the growth trends of wholesale preorder and reorder business? Are both segments experiencing similar growth rates currently?

Yves Müller (CFO/COO of HUGO BOSS): We are pleased with the performance of HUGO BLUE, particularly its success on online platforms leading to some significant sell-outs. For this year, we anticipate a mid to high single-digit share in terms of HUGO BLUE's contribution to total HUGO sales, which would be a notable success. Looking forward, we expect this share to nearly double by 2025.

In terms of wholesale, we observed 8% growth in Q1. While preorder business, which amounts for around 80% of total wholesale sales, demonstrated stronger performance compared to replenishment business, we also noted positive developments in replenishment towards the end of the quarter.

Ben Rada Martin (Goldman Sachs): Despite challenging macro conditions and negative updates from peers, European wholesale saw improvement in the quarter. Could you provide insights into the drivers behind this improvement, particularly between new and existing doors? Were there any timing impacts within the first quarter?

You mentioned being content with the order book for the remainder of the year, with similar growth expected to that of the first quarter. Can you confirm if this growth expectation is relative to the 8% growth achieved by the Group overall?

Yves Müller (CFO/COO of HUGO BOSS): The improvement in European wholesale can be attributed to both new and existing doors. Importantly, there were no timing impacts or delivery shifts within the quarter. The performance reflects a genuine improvement, with around three-quarters of the growth being comparable year-on-year. Additionally, approximately 25% of this growth can be attributed to our continued expansion within department stores as well as in our franchise business. And I can confirm the high single-digit growth for our preorder books.

Zuzuanna Pusz (UBS): You mentioned that Q2 is facing tougher comps. Could you provide clarity on the expected growth magnitude for Q2 if the momentum from April continues? Will it be around 1-2% growth, or could you provide an indication?

Considering the composition of growth and tougher comps, how much room is there to control costs, especially if like-for-like growth remains mildly positive or slightly negative? Will delivering on margin improvement in H2 become more challenging?

Yves Müller (CFO/COO of HUGO BOSS): Regarding Q2 growth expectations, it's essential to note that while there are tougher comps, the exact magnitude of growth is still uncertain. If we maintain a similar level of 5-year-stack growth to that seen in Q1, the year-on-year growth rate for Q2 would likely be in the low single digits. However, it's important to recognize that it's still early to make precise projections for Q2. We're only a month into the quarter, and market volatility remains a factor to consider.

Regarding cost control and margin improvement, our focus remains on leveraging gross margin improvements to drive operating margin expansion.