HUGO BOSS

HUGO BOSS Analyst Conference Call Q1 2018

Transcript – Q&A Session
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Fred Speirs (UBS): My first question is on Europe. I would like to understand how much your retail like-for-like performance was impacted by the bad weather in March. I wondered if you could give us a sense of how much weaker March was compared to January and February? Have you seen a reacceleration in Europe in April?

My second question relates to the operating cost phasing. It sounds like marketing spend was down a bit in Q1. How should we think about the phasing of marketing costs through the balance of the year? Can you confirm that your underlying cost assumptions for the full year are unchanged?

My last question is on the gross margin. You talked about the negative development we should expect in H1, which implies H2 up, of course. What are the main factors that drive the expectation for gross margin to improve in H2? Do you expect a bigger impact coming from lower rebates in the second half or is it perhaps phasing of product quality investments?

Yves Müller (CFO): First of all on Europe: yes, indeed we had less growth in March, in comparison to January and February, due to bad weather conditions. That is it. Actually, we do not give any forecasts regarding the current performance in the course of the year.

The second question was relating to operating cost items. I can confirm the underlying cost assumptions for the full year. Yes, we had some cost savings in Q1: by one-third, these cost savings were coming from phasing effects. The other third relates to lower marketing expenses due to marketing efficiency. The last third is coming from the IFRS 15 change, since marketing contributions into store furniture of our wholesale partners are no longer recorded as marketing expenses, but as net sales reductions.

Coming to gross margin in H2: Overall, our gross margin will improve in H2 because of channel mix effects and lower discounts in own retail. For the second half we also expect that we will no longer have currency headwinds.

Fred Speirs (UBS): Thank you. Just coming back to that Europe question: Could you at least confirm if March was positive for Europe like-for-like?

Yves Müller (CFO): The Group’s retail like-for-like sales were up in the mid-single-digit range in March. Performance in Europe was also positive.

Antoine Belge (HSBC): Three questions please. First regarding your online performance. It was quite strong, but the basis of comparison was much easier than in Q4, where online grew at a similar rate. So can you give us some comments around online please?

Second question: you have invested quite a lot in the products, especially in quality and you have expanded your offer at entry price points. Could you please give us an idea of the impact on volume and on price mix of those initiatives?

Thirdly, concerning the U.S. markets: what are the latest developments regarding your relationship with key accounts in department stores?

Yves Müller (CFO): Starting with question number one, regarding the online performance. Overall, you are right that we had a lower comparison base in Q1 2018 than in Q4 2017. In Q1 2018, we recorded an increase of 43% in comparison to the prior year. We are still very confident that we will achieve double-digit growth rates also for the full year 2018. We see positive momentum. I can assure you that I will be focusing on online development, because this is very crucial for HUGO BOSS.

Secondly, on the investments in product quality: I think the investments in quality really paid off. We did these investments in product quality primarily in the casualwear, which really picked up with double-digit growth in Q1. Hence, we are very much convinced that we did the right in order to reposition the former BOSS Orange as the new BOSS Casualwear. I can confirm that the volume growth overall overcompensated small price declines. This is what we expected, since we are seeing higher conversion rates in our own stores and the collections being well received by the customers. Therefore, I am positive about this, because the customer base is growing going forward.

Coming back to the U.S. market: overall, we saw a split situation. Business with some department stores was up while it was decreasing with others compared to prior year. Overall, the wholesale business saw a slight decline. However, I want to point out that we have one effect at Macy's, where we changed the wholesale business model to concession. In this concession model, we now have BOSS casualwear and athleisure wear under our own product and price control.

Antoine Belge (HSBC): Maybe just a quick follow-up on that: do you see a sequential improvement when you look at your fall and winter wholesale orders in the U.S.?

Back to what you just said about Macy's: is it correct that this had a negative effect in your wholesale sales, and a slight positive effect in the contribution from new stores on your retail sales. Is that correct?

Yves Müller (CFO): That is correct, yes. We do not show the casualwear and athleisure wear sales at Macy's under wholesale any longer, but under retail. I want to point out that without this effect our underlying performance in the U.S. wholesale market was stable in the first quarter.

The Fall/Winter 2018 collection has been very well received by our customers and there was a slight increase in comparison to the Spring/Summer 2018 collection.

Edouard Aubin (Morgan Stanley): On your free cash flow and the negative EUR 47 million in Q1: In Q4 2017 you had a positive impact of around EUR 20 million due to timing effects in trade payables. Was there a reversal of this effect in Q1, which would explain the negative free cash flow in Q1?

In terms of your inventory, should we be worried about a higher markdown risk due to the increase, or is that in line with what you had budgeted?

Finally, on the gross margin guidance for Q2: you said the evolution should also be negative in Q2. Should we assume a comparable magnitude of 40 basis points for Q2?

Yves Müller (CFO): First regarding the cash flow: we saw a decline in Q1 of EUR 47 million. Yes, the timing effect of Q4 2017 has reversed in Q1 2018. The increase in inventories that you mentioned also contributed to the negative cash flow development.

Your second question related to the inventory increase. Overall, the inventory increase was expected. It is mainly due to a higher retail buy that aims at supporting sales growth in the further course of the year.

Regarding your question on gross margin, it is too early to tell. We already said that due to currency headwinds caused by the strong euro, we will see some negative effect also in Q2. Overall, we are confirming that our gross margin for 2018 will roughly remain stable as compared to 2017. Additional effects for Q2 – such as rebates and channel mix – cannot be confirmed yet, because May and June are still open. Overall, we want to limit the discounts. That means we want to shorten the sales periods and this will also apply to the June sales in own retail.

Thomas Chauvet (Citi): I have two questions, please. The first one is on HUGO: I guess the negative performance was in line with your expectations, as you were cleaning up wholesale and closing some outlets. Can you perhaps quantify the impact of these closures? How long are you expecting this disruption to continue? Could you provide us with a retail like-for-like view for HUGO in Q1?

Secondly on the retail network: your shop-in-shop count is down by about 30 units net, that is about 3% year-on-year, but sales contribution from space seems to be plus 1%. Can you give us a bit more color on that? What is your plan for gross openings and closures for the remainder of the year?

Yves Müller (CFO): Starting with the second question on openings and closures: overall, there will be no major impact from openings and closures and the overall store network will remain broadly stable. There will be no major space expansion in the course of the year. We are really focusing on sales density and sales productivity. Besides this, there will be some store optimizations: some relocations here and there and further optimization of the store portfolio. However, overall, there will be no space expansion. We will rather be focusing on productivity.

Regarding HUGO, we recorded a sales development of minus 6%. This is what we have expected, because we are limiting HUGO's exposure to the outlet channel. In addition, on the distribution side, we have to fulfill and execute our two-brand-strategy with BOSS and HUGO. There are some stores, which currently still sell both BOSS and HUGO. To have a clear proposition to the HUGO consumer, we will get HUGO out of some BOSS stores in the course of this year. I expect these distribution changes to be accomplished by the end of this year. In addition, we will be opening new HUGO stores e.g. in Amsterdam and in London, where we are piloting our new HUGO concept.

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Thomas Chauvet (Citi): Just to clarify: are you expecting that level of disruption to continue until Q4?

Yves Müller (CFO): We will continue with these distribution changes in the course of the year. The distribution change will end at the end of 2018.

Thomas Chauvet (Citi): What was the like-for-like sales development for HUGO in Q1?

Yves Müller (CFO): Overall, the underlying sales development for HUGO has been slightly positive in Q1.

John Guy (Main First): My first question is on the IFRS 15 accounting treatment of marketing expenses. What was the EUR million reduction to marketing expenses in Q1? Was it around the mid-single-digit to high-single-digit EUR million range?

Sticking with marketing, you have moved from Formula 1 to Formula E sponsorship. I think that there is a seasonality and timing effect on marketing from Q1 and Q3 to Q2 and Q4, respectively. So first, has the overall budget changed with the change in sponsorship? If so, by how much?

Yves Müller (CFO): In Q1, overall marketing expenses were down by a mid-single-digit euro amount. As I said earlier, there have been three effects: one is the IFRS 15 change, which covers one-third of the change. The other one-third is marketing efficiency. The last one-third is related to marketing shifts, which relates to your second question.

Actually, the marketing shift predominately relates to Formula E, because you are right, we are starting in Q2.

John Guy (Main First): So the absolute amount of marketing spend is unchanged from Formula 1 to Formula E. It is just a question of timing?

Yves Müller (CFO): Actually, marketing spend on Formula E is a bit lower than it was for Formula 1.

Volker Bosse (Baader Bank): I have got three questions. First, could you please provide us with an update on your process in introducing omnichannel services on a global basis? Where do we stand and what is still to come in the course of this year?

My second question would be on online concessions. As you stated earlier, you want to roll out this business model. So can you please give us an update on what is done and what can be expected for the rest of the year?

Finally, on the margin decline in the Americas. Can you give us some background, as you pulled out of the discounting department stores?

Yves Müller (CFO): Starting with your first question, we are in the course of rolling out our omnichannel services “click & collect” and “order-from-store”. In Q1, we rolled these services out to Belgium and Italy. In addition to this, we will have the order-from-store roll-out completed in the U.S. by Q4.

Coming to online concessions, where we are making a great progress overall. We have already some department stores in Europe – especially in the Netherlands and in Denmark – where we converted the online business from wholesale to a concession model. Besides that, we are in recent negotiations – as I already told you at our Analyst Conference back in March – and we are making big progress there.

Regarding the margins decline in the U.S.: actually, our margin was not affected by the discontinuation of off-price businesses with U.S. wholesalers. Besides, our own U.S. retail performance grew double-digit, which is the right way to improve our U.S. business. The margin decline on an EBITDA basis in Q1 was predominantly coming from the translation effect from U.S. dollar to Euro.

Mark Josefson (equinet): I want to explore the sales decline of 5% in Germany in Q1. How did that vary between wholesale and retail? You mentioned some Outlet renovations, but what was the performance retail vs. wholesale in Germany?

Yves Müller (CFO): Overall, the sales decline was minus 5% in Germany. The wholesale performance was in line with the retail performance – there were no big differences. Like-for-like, we had a low single-digit decline in own retail, so the retail like-for-like was better than the minus 5%.

Warwick Okines (Deutsche Bank): I have three quick questions please. Firstly, you said that market conditions had deteriorated at the end of the quarter in Europe. I just wanted to check that was purely a weather comment, rather than anything else.

Secondly, returning to Macy's and the conversion to shop-in-shops. How many units did you do, and when did that happen? Will that be an effect that will continue all the way through the year?

Thirdly, when will the license performance return to the mid-single-digit growth that you have guided for the full year? I am trying to understand how the timing effects will phase through the year.

Yves Müller (CFO): On your first question, I talked about the market deterioration and you asked me whether this was a weather comment or not. And I can say: yes, primarily.

Secondly on Macy's: yes, we will see this effect throughout the year and we talk about 30 to 40 doors that have been converted at Macy's.
Regarding the license business, we will see some small positive effects in Q2. But the license business will move on further in H2, in order to achieve our guidance of mid-single-digit growth.

Jürgen Kolb (Kepler Cheuvreux): First on your conversion rates: you said that the conversion rates improved. I would assume that is both online and in the physical stores?

Secondly, on the like-for-like growth, which obviously was very strong and impressive. How did like-for-like growth develop excluding the online business?

Thirdly, on the wholesalers' feedback on your Spring/Summer 2018 collection, but also on the Fall/Winter 2018 collection. You have mentioned that there was a good feedback also for the Fall/Winter 2018 collection. Now given that your own stores performed so strongly, wouldn't you have expected maybe an even stronger feedback or order from the wholesalers? Because as it looks, your collections are selling well. So that should be a very strong statement then also for the wholesalers to order both HUGO and BOSS?

Yves Müller (CFO): Regarding your question on conversion rates: our store conversion rates improved by high-single-digit rates while the conversion rate improvement in our online business was in the double-digits. The new two-brand-structure of our site that we have launched in mid-March contributed positively.

On your question on the like-for-like performance without online: the like-for-like performance of our physical retail network increased by 5%.

Then, when it comes to the collection, yes we are optimistic about the order intakes. We know the order intake for Fall/Winter 2018 and we know that they were better than those for the Spring/Summer collection. The next big order intake will be that for the Spring/Summer 2019 collection. Overall we see a positive development and we will update you again in August.

Jürgen Kolb (Kepler Cheuvreux): Very good. Regarding the sell-through that you have heard from wholesalers with respect especially to HUGO, but also to BOSS: was that picture positive throughout? Or did you hear anything which may leads you to change anything on the collection side?

Yves Müller (CFO): No, we have received positive signs.

Melanie Flouquet (J.P. Morgan): My first question is related to the performance of casualwear versus formalwear. Casualwear appears to have accelerated in Q1. Is this mainly due to space allocation? So, to what degree is casualwear outperforming its higher space allocation since Q1?

My second question is on online. On a two-year basis, online was up a lot more in Q4 2017 than in Q1 2018. What did you do differently that may have hampered somewhat the growth in online and what can you do to reaccelerate it moving forward?

My next question is on inventories. You are guiding for a like-for-like increase on a full year basis in the mid-single digits, which is actually a bit more muted than the growth that you achieved in Q1. Your inventories are up 11%, so actually up quite markedly. Why are you comfortable that this carries a limited markdown risk?

My last question is relating to the depreciation charge, which is down 13% year-on-year in Q1. Should we expect this rate also for the full year? And what about next year? Do you expect D&A to go back up because CapEx will pick up in 2018?

Yves Müller (CFO): As I pointed out, we saw a double-digit increase in our casualwear offering in Q1. Roughly half of this increase was coming from space allocation. The other half was actually the underlying performance.

When it comes to online, we are very satisfied with the performance as we are well in line with our expectations. Q1 was well above our guidance for the full year. We will maintain good momentum in the further course of the year to achieve a double-digit growth of our online business in 2018.

Regarding the depreciation charge: D&A will go down also in the full year, but to a lesser extent than it went down in Q1. There will be some positive effects coming from capital efficiencies. There is some efficiency potential with regard to shop construction when it comes to the construction costs of new openings, and especially when it comes to renovation costs.

Inventories were up 11% in Q1. I am not concerned about markdowns so far, looking at the underlying performance and the fact that markdowns have been well under control in Q1.

Melanie Flouquet (J.P. Morgan): Is there anything that you did differently with regard to online? I appreciate you are satisfied, but as you were facing a comparison base of minus 27% from Q1 2017, the 43% growth in Q1 2018 translates to only a 4% growth over two years.

Yves Müller (CFO): In Q1 this year, we changed the structure of our website. We had some limited promotion activity during the course of this four week period. Therefore, we operated online with lower discounts. This was what we expected. Overall, we grew our customer base and we see a good development in online.

Piral Dadhania (RBC): Firstly, let me please follow-up on your casualwear versus formalwear performance. Could you please provide a bit more color on the formalwear business and the trajectory for 2018? I appreciate that you are allocating less space to the category, but just in terms of your expectations as we progress throughout the year.

My second question is on potential benefits from poor weather in relation to your outerwear business. I appreciate that selling conditions were difficult in March, but did you see any pickup in sales to your outerwear categories? And could you just remind us how much of the mix that is for the brand?

Finally, just in terms of traffic: you have spoken a lot about conversion and ASP. However, could you just give us an indication of traffic trends, both for your physical retail stores and your online store?

Yves Müller (CFO): Let me start with the last question regarding traffic trends. In our brick-and-mortar business, we saw a slight increase in traffic overall, that is a low-single-digit increase in visitors in our stores. Regarding online, we saw a double-digit increase in visitors.

Regarding the potential of outerwear due to bad weather in March, I will have to come back to you later on. However, overall this should have had a negligible effect only.

Regarding casualwear and formalwear: we stick to our guidance and we see double-digit growth in casual and a low-single-digit increase in formalwear overall for the full year.

Piral Dadhania (RBC): Have you seen any changes in your demographics? Obviously, with the growth rates you are seeing in casualwear, are you seeing any trend downwards in the average age of your customer? Could you also maybe give us an update on the CRM activities that you are conducting online and offline?

Yves Müller (CFO): Yes, I can confirm that due to our CRM activities, due to our increase in online sales, and due to the expansion in our casualwear offering, we see that the customer base is getting slightly younger.