

# 2019 Second Quarter Results

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Christian Stöhr (Head of Investor Relations)

### **- The spoken word shall prevail -**

Good afternoon ladies and gentlemen.

My name is Christian Stöhr, I am heading up the Investor Relations activities at HUGO BOSS and I would like to welcome you to our 2019 second quarter financial results presentation.

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

So let's get started and over to you, Yves.

Thanks Christian and good afternoon ladies and gentlemen. Welcome to our second quarter results conference call. In the next twenty minutes or so, I will present to you our most recent financial and operational performance and take a closer look at our initiatives for the remainder of 2019 before opening the floor to your questions.

I am pleased to report that despite an overall challenging market environment, we were able to deliver both top- and bottom-line improvements in Q2, thus delivering on what we had promised back in May. Importantly, Group sales experienced a slight acceleration, up 2% currency-adjusted. In euro terms, sales grew 3% to 675 million euro as currency effects provided a 1% tailwind to revenues.

I am particularly encouraged by the fact that all our four strategic growth drivers made further progress in the second quarter:

- Our own online business continued to grow disproportionately in Q2, recording its seventh consecutive quarter of double-digit growth.
- Retail productivity grew 3%, supported by our many initiatives to optimize our physical store network.
- Asia/Pacific continued to outperform from a regional perspective, as sales growth accelerated in Q2, led by ongoing strong momentum in Mainland China.
- Last but not least, HUGO sales grew 3%, supported by double-digit increases in the important casualwear business.

So let's take a look at the regions, and starting with Asia/Pacific, where sales grew a strong 8% currency-adjusted. The increase in Q2 was once again driven by our strategic growth market China, where momentum accelerated in Q2, as reflected by double-digit comp store sales improvements.

In particular, Mainland China saw ongoing strong momentum in the quarter, benefitting from the repatriation of local demand. This said, I am also encouraged by how our brand activation initiatives and various execution measures are resonating with our customers, both in brick-and-mortar retail as well as through our online partnerships with Tmall and JD.

As expected, the performance in Hong Kong and Macau was somewhat weaker in Q2. While this development is partly related to the aforementioned repatriation of Chinese spend as well as political uncertainties, both markets were also impacted by store optimization measures. The latter resulted in several store renovations, aimed at further enhancing the profitability of our store network in the market.

Coming to our largest region, Europe, where sales increased 2% on a currency-adjusted and reported basis. With sales up 6%, France saw a strong recovery in Q2 following a rather difficult start to the year. Here, the development was supported by robust comp store sales improvements, as the negative implications from the yellow vest movement have started to fade in the second quarter.

Looking at Europe's other key markets, sales in the UK were up a solid 2% despite ongoing political uncertainties. In Germany, sales were down 5%, broadly in line with the overall market environment, which remained rather unfavorable in Q2. And although a number of

macroeconomic indicators are not overly supportive at the moment, we are confident that the second half of 2019 will show a sequential improvement. In this context, the remainder of the year will not only be supported by a fairly low comparison base – in particular in Q3 – but also benefit from the upcoming opening of our new outlet in Metzingen, scheduled for late September.

This brings me to the Americas, where revenues declined 3% on a currency-adjusted basis, reflecting sales declines in both the U.S. and Canada. While this development reflects a slight improvement compared to the first quarter, the performance in Q2 was still below our expectations.

In particular, the important U.S. market, where sales were down 5% currency-adjusted, continued to face a number of challenges during the quarter. Notably, the non-recurrence of positive effects related to the U.S. tax reform, lower tourist spend as a result of ongoing trade tensions, as well as the general promotional market environment put a strain on our business.

The decline in tourist spend also weighed on our second quarter performance in Canada. Latin America, in turn, continued to enjoy a robust momentum, up high single digits in Q2, led by a particular strong performance in Mexico and Brazil.

As a result of the weaker than expected performance in the Americas, and in light of the current market dynamics, we now expect the Americas to experience a “slight decline” in 2019. This said, we continue to expect an improvement in our performance in the Americas during the second half of 2019.

Moving over to our channels, own retail sales grew 3% on a currency-adjusted basis, reflecting a 2% increase in comp store sales as well as a 1% contribution from space. While comp store sales remained stable in the Americas, they were up at a low single-digit rate in Europe and increased even at a low double-digit rate in Asia/Pacific.

Taking a closer look at the like-for-like performance in the quarter, let me point out that our brick-and-mortar business saw a broadly similar growth rate compared to the first quarter. The slight deceleration in total comp store sales growth compared to Q1 is therefore mainly attributable to our online business, where the clear focus in Q2 was on further improving

the quality of our business by tightly managing markdowns. While those initiatives unsurprisingly weighed on the top-line performance in the second quarter, they in turn had a positive impact on profitability. Altogether, on a currency-adjusted basis, online sales were up 16% in Q2, benefitting from ongoing strong momentum in the concession business.

Let me also spend a minute on our non like-for-like business, which, as I mentioned before, had a positive impact on retail sales in Q2. The optimization of our store network – including store renovations, relocations or rightsizings – has become a fundamental part of our strategy. This in turn means that the share of our non like-for-like business has become increasingly important over time and will continue to do so in the foreseeable future. Another contributor to non like-for-like growth is the further expansion of our online concession business, which as you know is a key element of our digital strategy. Already today, non like-for-like represents a good third of our total retail sales and is likely to grow even further in the coming years.

The roll-out of our new BOSS store concept continues to be an important component when it comes to the ongoing optimization of our store network. In the second quarter, we renovated and upgraded a total of eight stores, bringing the total number of stores offering the new atmosphere to a total of 52 BOSS stores worldwide.

Besides the further roll-out of the new BOSS store concept in Q2, we also opened three new HUGO stores in Tokyo, Singapore, and Moscow, making it a total of 26 HUGO freestanding stores globally. As mentioned before, we will continue to grow HUGO's store network consistently, yet also diligently in the years to come.

Turning to the wholesale channel, where sales remained stable on a currency-adjusted basis. While currency-adjusted revenues in Europe and Asia/Pacific increased 1% and 14%, respectively, sales in the Americas were below the prior-year level, largely reflecting the ongoing challenges that department stores were facing.

Similar to previous quarters, Q2 saw ongoing strong momentum with either online marketplaces or online platforms of leading department stores, while stationary retailers continued to suffer from ongoing traffic declines.

Finally, our license business grew 8% in Q2, driven by significant improvements in fragrances and eyewear. The former continued the positive trend from Q1, supported by successful product launches for both BOSS and HUGO. We are confident that the positive performance of our fragrance business will continue during the remainder of the year, driven by new product launches that are planned for Q3 and Q4.

Let me conclude my remarks on the top line with a review of the performance by brand. Starting with BOSS, where revenues increased 2% on a currency-adjusted basis, as a result of low single-digit improvements in both businesswear and casualwear.

While our casualwear business continued to benefit from the ongoing trend towards casualization, importantly, our businesswear offering returned to growth in the second quarter. The latter is not only proof positive that businesswear remains relevant for the BOSS customer, but also that innovative concepts such as “mix and match” or “broken suit” provide a robust foundation for future growth.

In Q2, we have also made further progress when it comes to enhancing the personalization of our product offering, as we introduced “BOSS Made for Me” as a new tailoring service. It allows our customers to personalize and customize different elements of a suit including fabrics, linings and buttons.

In addition, for a truly personal touch, individual details such as the name, chosen words, or a date can be stitched in the inside label of the garment. Beyond suits, as of today customers can also personalize their own sneakers with the “BOSS Made for Me” service and we are planning to extend this concept to outerwear jackets during the upcoming Fall/Winter season.

On the marketing side, in Q2 BOSS celebrated the latest addition to its existing line-up of brand ambassadors, as Taiwanese-Canadian actor Mark Chao has become the new face for BOSS in Asia/Pacific. In his role as an official brand ambassador, Mark Chao will not only become a key face for future marketing campaigns, but also be closely involved in the creative process of specific collections going forward. In this context, Mark, together with our Chief Brand Officer, Ingo Wilts, has already co-created a limited ‘BOSS x Mark Chao’ travel collection, which has been available online, in selected BOSS stores, as well as via a WeChat Mini Program as of April 2019.

Moving over to HUGO, where the positive trend from previous quarters continued in Q2, as reflected by a 3% increase on a currency-adjusted basis. In line with the brand's positioning in the contemporary fashion segment, sales in casualwear continued to grow disproportionately and were up by a double-digit rate, driven by ongoing strong momentum around HUGO's logo-inspired product offering.

To further raise HUGO's brand awareness in the contemporary fashion segment, in May we introduced British singer and artist Liam Payne as HUGO's future brand ambassador – the first partnership of its kind for HUGO.

As part of this collaboration, Liam will not only take center stage in future marketing campaigns, but equally importantly will become the face of exclusive 'HUGO x Liam Payne' collections – inspired by the singer's personal style.

Together with a live appearance from Liam, some of these new styles were showcased digitally at an event during Berlin Fashion Week, after which they were immediately made available online – exclusively on Instagram first, followed by hugo.com as well as in selected HUGO stores. And although early days, initial results following a good three weeks of trading have been rather promising, with sell-through rates twice as high and online revenues clearly outperforming brick-and-mortar sales.

With this, ladies and gentlemen, let's take a look at the remaining P&L items. Starting with the gross margin, which saw a decline of 100 basis points in Q2 to 66.0%. It is crucial to understand that this development is largely due to the non-recurrence of inventory valuation effects that benefitted our gross margin development back in Q2 2018. The non-recurrence of these positive effects has now weighed on the gross margin development in the second quarter of 2019.

Importantly, this inventory valuation effect is purely timing related and will reverse in Q3 already. To complete the picture on the gross margin, negative currency effects – although to a lesser extent compared to Q1 – put some pressure on the gross margin in Q2. These negative effects combined more than offset a slight tailwind from a favorable channel mix. All other effects, including the effect from markdown management, were broadly neutral in the second quarter.

In terms of operating expenses, I am pleased to report that we managed our costs tightly in Q2, as reflected by a very moderate increase of only 2% in the quarter, despite a slightly negative impact from currency effects. As a percentage of sales, operating expenses declined a strong 90 basis points. In detail, selling and distribution expenses increased only 3%, as we are starting to realize the first positive effects from our various initiatives to optimize our store network, resulting in improvements of pay-to-sales and rent-to-sales ratios. Marketing expenses declined slightly in Q2 mainly due to timing shift effects between the first and the second quarter. Last but not least, administration expenses were also below the prior-year level, as tight overhead cost management overcompensated continued investments in the digitization of the business model.

As a result of the strong operating leverage achieved in Q2, EBIT returned to growth and increased 3% in the quarter. The Group's net income ended the second quarter 1% below last year, as negative currency effects resulted in an increase in the financial result.

Let's now turn to the balance sheet, starting with inventories, where we have made further progress in bringing inventories down to a normalized level. At the end of June 2019, inventory growth amounted to 3% currency-adjusted – a further 6 percentage points improvement compared to March 2019! As we will continue to show highest discipline in managing inventories, we are committed to further reducing inventory growth during the course of H2 – just as we have done over the past few quarters.

Mainly due to the increase in inventories, but also reflecting temporarily higher trade receivables, trade net working capital was up 6% on a currency-adjusted basis. This, however, is expected to reverse in Q3 already.

Before taking a look at our initiatives for the remainder of 2019, let's quickly review our free cash flow development. Investments increased 45% in the second quarter or by 15 million euro to a total of 48 million euro at the end of June 2019, largely driven by the step-up in store renovations as well as ongoing investments in IT and digitization. As a result of the increase in capex and trade net working capital, free cash flow declined 9% or by 7 million euro to 72 million euro. As we project a significant step-up in EBIT-growth during the second half of 2019 and further improvements around trade net working capital, we remain

confident to reach our guided free cash flow range for the full year of between 210 million euro and 260 million euro.

With this, ladies and gentlemen, let's change perspective and look ahead at our expectations for the remainder of the 2019 fiscal year. We remain confident of achieving our full-year top- and bottom-line guidance as communicated in early March and reconfirmed today, as we forecast sales and earnings momentum to accelerate during the second half of 2019.

At the same time, we now expect both sales and EBIT to reach the lower end of the respective guidance ranges of a mid-single-digit and high single-digit increase. In doing so, we take into account the persisting challenges in the U.S. market in particular.

From a top-line perspective, the acceleration in sales will be largely driven by our retail business, for which we forecast mid- to high single-digit growth for the full year. Besides the anticipated acceleration in comp store sales growth, we also project important stimuli from the non like-for-like business. Regarding the latter, three factors will be decisive for the second half of 2019:

- Firstly, we are fully committed to further expanding the concession model within our online business. New e-concessions, and those we initiated back in 2018, will clearly contribute to strong double-digit growth in our own online business also in H2. As you all know, our Zalando partnership will play a key role in this regard, as we are not only about to roll out the concession model with Zalando to further European markets, but will also start converting our BOSS Casual- and Athleisurewear business to the concession model starting in Q3.
- Secondly, we will continue to expand our .com business to new geographies. In this context, Q3 will see the "go-live" of hugoboss.com in additional markets such as Denmark, Sweden, Finland, and Ireland – markets that will be fulfilled via our existing distribution center close to our headquarters in Metzingen.
- Last but certainly not least, we will continue with our initiatives to optimize our store network. In the second half of 2019, a number of important BOSS stores will be upgraded to the new store concept and reopen on time before the important pre-Christmas season. Starting with our biggest flagship store worldwide, on the Champs-Élysées, where the

renovation of our BOSS store is in full swing. Besides Champs-Élysées, major store renovations for the second half include some strategically important stores in key U.S. cities, such as Chicago, San Francisco, and Miami. In Asia/Pacific, we are about to finish the renovation of our Macau stores as well as that of our biggest store in Singapore at Ngee Ann City.

Beyond the distribution side, we are looking at a well-stocked product and marketing pipeline, which will ensure we create a further buzz around the BOSS and HUGO brands in the second half of 2019. Let me therefore share with you some highlights on our product and marketing calendar for the upcoming months.

We are particularly excited that in the second half of 2019, BOSS will take centre stage twice at two of the world's most important fashion shows: Milan and Shanghai. While we are all very excited that BOSS will enter the fashion metropolis Milan in September to showcase the upcoming Spring/Summer 2020 collection, we are equally thrilled that in October BOSS will – for the first time in history – also present itself at Shanghai Fashion Week. Showcasing the Pre-Fall 2020 collection in Shanghai at the beginning of Q4 clearly underlines the importance of the Chinese market for BOSS. Both shows will be broadcasted live via boss.com and will also be accompanied by dedicated social media campaigns.

Talking of social media, let me shed some light on our current global 360° marketing campaign to promote our iconic BOSS suit business. Via the hashtag #SuitChallenge, our BOSS brand activates influencers and athletes globally to master the toughest challenges in a suit, while being impeccably dressed in head-to-toe by BOSS. The Suit Challenge is not only creating a tremendous buzz on social media but is also helping us to further drive brand desirability. As of today, the Suit Challenge has already generated more than 200 million impressions on social media, with a particular emphasis on Instagram.

Another important building block for growing brand desirability is our ongoing focus on exclusive collaborations. In this context, the upcoming Fall/Winter 2019 season will see the second drop of the unique collaboration between BOSS and Porsche, which is soon about to hit boss.com and selected BOSS stores worldwide.

The capsule collection will consist of twelve menswear styles reflecting the high claim to design, innovation, and performance that both brands – BOSS and Porsche – share. Inspired by the latest Porsche Panamera E-Hybrid, our design team has developed a collection that stands out for its ergonomic lines and iconic details.

Let me conclude today's presentation with a detailed look at our full-year bottom-line expectations. Regarding our EBIT outlook for the full year, we are confident that H2 will see a strong acceleration in earnings growth and forecast double-digit improvements in EBIT for both Q3 and Q4.

Beyond the anticipated acceleration in top-line growth, there are two factors in particular that will contribute to the anticipated bottom-line improvements in the coming quarters:

- Firstly, we expect a strong improvement in the gross margin in the remaining two quarters. This development will be supported by easing currency headwinds, a reversal of the negative inventory valuation effect, as well as positive effects from a more favorable channel mix. Q3 will most likely represent a peak in this regard, simply due to the relatively low comp base.
- Secondly, our efficiency program, introduced to you back in November last year, is expected to result in further operating leverage during the second half of the year. In particular, we expect the tailwind resulting from our improvements in retail efficiency to continue in the coming quarters. In addition, administration costs should also continue to develop at disproportionately low rates.

With that, ladies and gentlemen, I am now happy to take your questions.

OK, 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, I would like to thank you for your participation and wish you a very good day. Bye-bye.