First Quarter 2020 Results

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- The spoken word shall prevail –

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

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

Thank you Christian, and good afternoon ladies and gentlemen. Also from my side, a very warm welcome to all of you.

In the next twenty minutes, Yves and I will guide you through our first quarter 2020 operational and financial performance. We will use a considerable part of this call to address the current situation in the context of COVID-19 and elaborate in detail regarding our comprehensive measures to safely navigate HUGO BOSS through these exceptional times.

Allow me to start, however, by also saying a few words about myself. As you are all aware, after 18 years with the company, I will leave the Managing Board of HUGO BOSS at the end of September. I am grateful for the almost two decades that I have been able to serve HUGO BOSS in various roles, and for having had so many talented and passionate people around me who supported me during this journey. Yet, today is not about saying "goodbye."

Our company – just like the apparel industry as a whole – is currently facing an unprecedented situation. A situation that none of us has witnessed before. And a situation that requires the full attention and dedication of each and every person working for HUGO BOSS. I care deeply for this company. And I will continue to serve HUGO BOSS as best as I can in the months ahead. Together with my board colleagues, I will ensure we take all steps necessary to steer HUGO BOSS through this crisis.

Despite major challenges associated with the COVID-19 pandemic, we are fully aware of the social responsibility HUGO BOSS assumes, in particular during the current situation. Prioritizing the health and well-being of our employees, customers, and partners is and will remain our guiding principle for any decision we currently take.

In this context, and already at an early stage, we set up a cross-functional crisis team that closely monitors the development of the pandemic, thereby coordinating all measures to moderate the impact on our people. That includes enabling our corporate employees to work from home, and implementing a variety of precautionary measures relating to distancing and hygiene rules for our global production, logistics, and retail staff.

In order to make a vital contribution to the well-being of the public, we have temporarily dedicated our manufacturing facility in Germany to the production of reusable facemasks. In the meantime, almost 200,000 of these masks have been donated to public facilities. Likewise, we donated protective suits as well as face shields to medical facilities, both of which were produced in our facility in Izmir.

In addition, over the course of the past several months, we have temporarily closed most of our retail stores, including shop-in-shops and outlets, in order to protect our customers and our retail staff, while at the same time complying with regulatory requirements. So let’s take a closer look at the impact of this measure on our global store network.

As of March 31st, approximately 75% of our global retail store network was closed, with the remainder largely operating at reduced opening hours. While the vast majority of our store base in Asia/Pacific had re-opened towards the end of the quarter, Europe and the Americas – by far the bigger regions – were almost entirely shut down, following the implemented lockdown in mid-March.

Since then, the situation has barely changed. And while Europe has seen the first store reopenings in Germany and Austria towards the end of April, the situation that we are confronted with globally continues to put severe pressure on our brick-and-mortar business in most of our core markets. As we speak, more than three quarter of our global store base remains closed.

For HUGO BOSS, the current circumstances led to a significant decline in sales, profitability, and cash flow. After a very promising and successful start to the new year, the global spread of the virus significantly impacted our business – first in Asia/Pacific and, with some delay, also in Europe and the Americas.

Consequently, Group sales decreased 16% to 555 million euros in the first quarter. This corresponds to a currency-adjusted decline of 17% compared to the prior-year level.

In Asia/Pacific, sales for the quarter were down 31% currency-adjusted. Following three weeks of strong double-digit growth in the run-up to Chinese New Year, the rapid spread of COVID-19 and the corresponding store closures put a strain on our business. This was particularly noticeable in the Chinese market, where comprehensive actions were taken at an early stage. As a consequence, Q1 sales in China were considerably weaker as compared to other markets in the region, such as Japan or Southeast Asia.

However, since the reopening of our stores in Mainland China towards the end of March, we have been witnessing an encouraging and steady improvement in this important market. In April, sales in Mainland China were down only 15% to 20% as compared to the prior-year level, after being down 80% and more in February. We are confident that the positive trend we are currently seeing – whether that's customer demand, traffic, or conversion – will continue in the coming weeks and enable us to return to growth in the foreseeable future.

The gradual recovery in China is accompanied by a consistently strong performance of our online business in that market, in particular during the month of April. This includes significant double-digit sales growth recorded on important e-com platforms such as Tmall and JD. We are also in the midst of strengthening our social commerce capabilities on WeChat and the likes, in order to further accelerate online sales growth while, at the same time, driving brand momentum among the Chinese clientele.

Moving over to Europe, where the strong momentum from the final quarter of 2019 continued at the very beginning of the year. Many key markets, such as the UK, Spain, and Italy recorded robust sales growth in January and February, while others, such as France, already began suffering from a lower share of tourism in particular from Asian countries.

As the spread of COVID-19 intensified also in Europe, we acted quickly by temporarily closing virtually all of our stores and points-of-sale at wholesale partners in mid-March. This led to an overall decline in currency-adjusted sales of 14% in the first quarter.

While retail sales saw a decrease of 10%, wholesale sales were down even 19%. The latter mainly reflects lower deliveries to wholesale partners in light of the ongoing uncertainties of COVID-19, but was also driven by two conversion effects:

- Firstly, although on a technical note, the successful expansion of our online concession model over the course of 2019 keeps burdening our wholesale performance in the short term. This is particularly relevant for our European business, following the successful conversion of our BOSS business on Zalando from wholesale to retail, which largely took place during the third quarter of 2019.

- Secondly, starting on January 1st, 2020, we have fully consolidated our Group entity in the United Arab Emirates. Together with a strong local partner, we are now successfully running five BOSS stores and one HUGO store in the market. The generated sales have previously been accounted for as wholesale revenue and are now fully included in retail.

Looking ahead, we are mindful that the economic environment in Europe will most likely remain challenging in the short term. While we have taken the first steps to get some of our freestanding stores in Germany and Austria back on track, we have to acknowledge that it will be a long way back to "normal" operations. With only a few days' trading again, it is also too early to provide you with a first indication on current trends in these two markets.

In the Americas, the situation in the first quarter was quite similar to that in Europe. Both January and February played out very well, particularly in our important U.S. market, where comp store sales re-accelerated and posted very solid growth, after having stabilized in the previous two quarters.

Against the backdrop of the pandemic, however, momentum in the U.S. and Canada deteriorated sharply in March. This resulted in a 17% currency-adjusted revenue decline for the Americas in the first quarter, with retail and wholesale performing broadly in line.

In contrast, our business in Latin America was affected by the pandemic only later. We were hence able to record sales growth for this market in Q1, reflecting robust momentum in both Brazil and Mexico. At the end of March, however, retail stores and shop-in-shops in these two markets have also been closed in order to protect our customers and employees.

While the vast majority of our stores, shop-in-shops, and outlets have been affected by temporary closures in the first quarter, our own online business continued its double-digit growth trajectory. With an encouraging currency-adjusted sales increase of 39%, the first quarter of 2020 marked the tenth consecutive quarter of strong double-digit growth for our e-com business. This not only reflects the growing importance of our own website hugoboss.com, but is also proof positive for the success of our online concession business implemented with many of our core partners.

As a result of its strong outperformance versus physical retail, the share of our own online business increased from 7% in the prior-year period to 11% of own retail revenues in the first quarter of 2020.

We are absolutely confident that the strong momentum of our e-com business will also continue in the second quarter. In this context, we are encouraged by the further acceleration in online sales growth in the month of April, with revenues more than doubling as compared to the prior-year period.

In total, retail sales were down 17% currency-adjusted in the first quarter. On a like-for-like basis, currency-adjusted revenues decreased 20%. The non-like-for-like part of our retail network was somewhat more resilient, benefitting from the aforementioned expansion of our online concession business in 2019, as well as around 50 store refurbishments completed in the prior year.

Wholesale revenues declined 18% in the first quarter, reflecting lower deliveries to wholesale partners due to order cancellations as well as a softer replenishment business towards the end of the quarter. Besides this, the conversion effects that I mentioned earlier also weighed on our wholesale performance in the first three months.

Ladies and gentlemen, that concludes my operational review of the first quarter of 2020. Before I hand you over to Yves to guide you through the most important P&L and balance sheet items, allow me to conclude very briefly.

The situation we are confronted with is by far the biggest challenge our industry has faced in recent history, in particular as it did <u>not</u> allow us – nor anybody else – to fully prepare for it. We at HUGO BOSS were going into the year with high confidence. We were committed to further executing our strategic initiatives and driving the strong momentum from the final quarter of 2019. Now, the priorities have changed and our focus will be on protecting the long-term well-being of our company and ensuring that we rebound even stronger once the crisis is over.

I am fully convinced that HUGO BOSS will successfully overcome these challenging times. Thanks to the great passion and dedication of our more than 14,000 employees worldwide, the strength of our brands, as well as our Group's solid balance sheet, we are well equipped to safely navigate HUGO BOSS through this pandemic. And we are in the middle of implementing numerous measures that will help us safeguard the financial flexibility and stability of HUGO BOSS. Regarding the latter, Yves will provide more color.

Yves, over to you!

Thank you Mark, and good afternoon ladies and gentlemen.

As Mark has already alluded to, the challenges associated with the pandemic inevitably weighed on our financial performance in the first quarter.

At 62.9%, the gross margin was down 90 basis points versus the prior-year level. Against the backdrop of the pandemic, increased markdown activity weighed on the gross margin development in Q1. All other effects, including channel mix, currencies, and inventory valuation, only had a minor impact in the first quarter.

Speaking of inventory valuation, let me be very explicit when I say that we expect a meaningful impact of the ongoing store closures on our inventory position in the coming quarter. Consequently, the gross margin development in the second quarter will most likely be burdened by a significant negative inventory valuation effect.

Moving over to operating expenses, which saw a 1% decline in the first quarter. Within operating expenses, selling and distribution expenses developed broadly stable in the first three months of the year. While we recorded some first cost savings from the various measures we implemented to protect our cash flow – something I will talk about in detail in just a few minutes – we also had to post valuation allowances for specific wholesale accounts in the magnitude of a high single-digit million-euro amount. Besides this, also the full consolidation of our subsidiary in the Middle East that Mark mentioned earlier led to the inclusion of costs in the mid-single-digit million-euro range. These cost are associated with our six stores in Dubai and Abu Dhabi. Last, but certainly not least, negative currency effects impacted selling and distribution expenses by a low single-digit million-euro amount.

On the other hand, we were able to bring our administration expenses down 6% in the first quarter, mainly reflecting our continued strict cost-management approach. In addition, lower personnel expenses also contributed to the decline in admin expenses.

To complete the picture on the P&L, both EBIT and net income came in below the prior-year level, mainly reflecting the double-digit sales decline, which unsurprisingly weighed on the bottom-line development.

Now, let's move over to the key balance sheet and cash flow items.

Trade net working capital increased 1% year on year, currency-adjusted. Lower trade receivables contributed positively, as a result of the wholesale performance in the first three months. Our inventory position, however, was up 6% currency-adjusted, reflecting the aforementioned store closures. The 12-month moving average of trade net working capital therefore increased by 60 basis points to 20.9%.

During the course of the first quarter, we adjusted our capex budget for the full year to the current environment. This in turn meant, suspending the majority of store renovations and new openings until further notice. As a consequence, capital expenditure in the first quarter was 41% below the prior-year level at 18 million euros. A major project that we finalized just before the store closures in EMEA and in the Americas took place, was the relocation of our BOSS flagship store in New York's SoHo district, which is now shining in new splendor at an even better location close by.

Finally, free cash flow in the first quarter came in at minus 86 million euros, as the earnings decline was only partly compensated for by the first successes of our various measures initiated to protect our free cash flow.

Ladies and gentlemen, the current global health crisis and its financial implications represent an unprecedented situation for the industry as a whole as well as for HUGO BOSS. However, thanks to our healthy balance sheet and the comprehensive measures we have initiated to protect our cash flow, I am fully convinced that we are well equipped to navigate this exceptional situation.

So let's take a closer look at the various initiatives aimed at securing our liquidity and hence preserving the viability of our company. I will focus on the four most important ones, as they together will lead to an additional protection of free cash flow in a magnitude of around 600 million euros.

Starting with operating expenses: on top of our already consistent approach to strictly managing overhead cost, we have meanwhile mobilized all levers that will enable us realize additional savings, in particular in the area of selling and distribution. In total, we are targeting incremental cost savings of at least 150 million euros in fiscal year 2020 compared to our initial budget.

- This includes payroll savings via implementing short-time work in Germany as well as other countries, reducing working hours in retail, postponing all planned salary increases for 2020, as well as putting a global hiring freeze into immediate effect. Our goal is to maintain our workforce during this challenging time while, at the same time, staying as flexible as possible.
- We, as the Managing Board, will also participate in the measures to secure cash flow. Consequently, we will waive 40% of our basic remuneration for the months of April and May 2020.
- Besides personnel expenses, our initiatives also include savings resulting from successful negotiations with our landlords, as well as individual agreements to temporarily reduce rental expenses for several stores over the next months.
- We have also reviewed our marketing budget and canceled or postponed various marketing events and campaigns. Savings in this regard relate to cutting back on media and print advertising, visual merchandising, as well as physical events. At the same time, we will continue to invest in digital marketing, with a strong focus on our e-com platforms and social media, in order to keep driving brand momentum for BOSS and HUGO.
- Last but not least, we are also eliminating all further non-business critical operating expenses, including reducing external third-party services, reducing travel expenses, and halting non-essential system implementations.

On top of the aforementioned OPEX savings, we are cutting our capex budget for the current year by around one third as compared to our initial plan of around 150 million euros. This mainly includes postponing planned store openings and renovations when <u>not</u> perceived to be business critical. In addition, we have decided to halt all non-essential IT investments.

To limit the increase of our trade net working capital position in the quarters to come, we will reduce the inventory inflow by at least 200 million euros in fiscal year 2020. In particular, the upcoming Fall/Winter collection will see a significant reduction in the overall order volume. That includes agreeing with our key suppliers on significantly reducing orders, as well as adjusting our own production in Izmir, Turkey, to the lower demand in the short term.

In addition to that, we are taking a very conservative approach when it comes to the replenishment business for the current Spring/Summer collection, while at the same time planning to carry over a higher share of styles between the two seasons.

Last but not least, as already announced last month, we as the Managing Board, together with the Supervisory Board, decided to propose to the Annual Shareholders' Meeting on May 27th the suspension of the dividend payment for fiscal year 2019, except for the legal minimum dividend of 4 cent per share. The retention of net profit will further strengthen our financial flexibility in the 2020 fiscal year.

I am absolutely convinced that the execution of all these measures will enable us to protect our otherwise very healthy balance sheet and provide us with the right amount of financial flexibility. Securing sufficient liquidity is, and will remain, our top priority in the short term.
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 quarter in particular. As you would expect, the ongoing temporary store closures will continue to weigh on our top- and bottom-line performance in the short term. At the same time, the level of uncertainty remains elevated as we speak, as nobody ultimately knows today how long the situation will last and how quickly we will be able to return to growth.

This in turn means that it is still impossible to quantify the resulting negative effect for the 2020 fiscal year at this stage. Nevertheless, we have to be prepared for a challenging second quarter. This is particularly true with regard to our business in Europe and the Americas, which under normal circumstances represents a good 85% of Group revenues, and which remains heavily affected by the ongoing store closures.

Consequently, we expect both top- and bottom-line declines in the second quarter to be more severe than those recorded in the first quarter, with currency-adjusted sales projected to be down by at least 50% in Q2. The latter will of course heavily depend on how long the lockdown will last and how quickly the brick-and-mortar business will be able to return to a more normalized trading. The expected top-line development, together with a more pronounced impact from inventory write-downs that I mentioned to you earlier, will significantly weigh on our operating result, which at this stage is estimated to be negative by more than 100 million euros in the second quarter.

Despite the current situation and a rather difficult second quarter ahead, we are confident that from the third quarter on, the retail environment will gradually improve. This should also positively impact the Group's sales and earnings development in the second half of the year.

Until then, the key priorities we are focused on and executing against remain clear:

- working with highest discipline on our measures to secure the financial stability of HUGO BOSS, while at the same time
- driving and exploring our huge opportunities within our growth drivers Online and China.

And with this, ladies and gentlemen, Mark and I are 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, I would like to thank you for your participation and wish you a very good day. Bye-bye.