HUGO BOSS

Transcript – Q&A Session

May 5, 2021

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.

Chiara Battistini (JPMorgan): First, on your guidance on Q2 and the outlook of almost doubling sales in the quarter. How should we be reading this almost doubling sales? Is it like 95% to 100%, or 80% to 100%? So could you please narrow down this range a little bit?

My second question is on the order book for fall/winter. Your comments on the spring/summer were very encouraging. I was wondering, as you are collecting orders for the fall/winter, can you give us an update on what to expect for wholesale for the second half of the year? Also, any color by region from that point of view would be very helpful.

Finally, can you give us any color on what you've been seeing of late in China, since the end of March where the situation around the cotton sourcing emerged.

Yves Müller (CFO and Spokesperson of the Managing Board): On your first question: yes, we expect that sales in Q2 will almost double. This means that you should take last year's performance times 2. And “almost double” means that with “times 2”, we see this as a kind of ceiling, and “almost” means that we will be close to this. Please be aware that we still have ongoing uncertainties, especially in Europe with the extended lockdowns. That's the reason why we are a little bit vague there, but this is the best guidance we can give for Q2.

Regarding the order book, already back in March, we finalized the order intake for our fall/winter collections, which will hit the sales floor beginning of July. We reported back in March that we were very satisfied with the order intake, as it exceeded our own expectations. Right now, we are selling our comparatively smaller pre-spring collections, and it's too early to comment on this one. However, all these initiatives that we implement on the product side – and you have seen that our wholesale business picked up in Q1 as well – arouse our partners' interest, especially when it comes to our collaborations. So our collections are resonating very well with our wholesale partners.

Finally, on China. Over there, we almost doubled our sales in the first quarter. However, we all know that Q1 2020 was affected by the pandemic. But even compared to Q1 2019, sales were up by 29%. And I can assure you that also in April we are clearly keeping this momentum in China.

Chiara Battistini (JPMorgan): One follow-up on wholesale: are you currently seeing different performances in Europe and in the U.S.? Or are you seeing similar momentum in both regions?

Yves Müller (CFO and Spokesperson of the Managing Board): Our wholesale business in APAC is comparatively small. But if you look at Europe and the U.S., we are seeing a similar development, with both regions picking up.

Jürgen Kolb (Kepler Cheuvreux): First of all, on the number of stores. I noticed that the number of factory outlets keeps on going up and has almost reached 18% of your total store base, also in Asia. I would have expected to see some more full-price stores to open as this has been the plan. Can you share with us some thoughts on the number of store openings from a general perspective, and specifically, on Asia, and obviously, with respect to the factory outlets?

Secondly, you mentioned the very strong performance of your online business. Can you provide some additional indications, not necessarily precise numbers, but just in terms of conversion rates, customer retention and new customers? Also, can you provide us the adjusted online growth excluding the 12 new markets?

On your capsule collections with the NBA and Russell Athletic. Can you share some thoughts on the next wave of collections for the second half of the year that you're planning to launch? Is that going to be the same size, or maybe even bigger? Finally, going into 2022, since you've been so successful with your collaborations with the NBA and Russell Athletic, what's in the making? Do you want to stick to this “capsule strategy”, maybe with higher volumes?

Yves Müller (CFO and Spokesperson of the Managing Board): On your first question: overall, we want to keep the number of stores more or less stable. But there will be a geographical shift from Europe and the U.S. towards Asia, in particular mainland China. So in the next quarters and years to come, the number of stores, shop-in-shop and outlets will decrease in Europe and the Americas, and will grow in Asia, in particular in mainland China. The short-term increase in the number of outlets is related to the implications of the pandemic, as we were entering into short-term, temporary outlets.

On your second question on online performance: first of all, it's important to highlight that the dot-com business and concession business account for 60% and 40%, respectively. So 60% is hugoboss.com. In Q1, we have seen very strong like-for-like performances across both businesses. Growth was above 50% in the like-for-like dot-com markets as well as in the concession business, driven by double-digit increases in both traffic and conversion rates. On top of this, something that is very encouraging: also the average basket size increased reflecting that we were doing more full-price sales than discounted sales in comparison to the prior-year period. We perceive this to be a strong underlying performance for both brands, BOSS and HUGO. Finally, it was towards the end of March that we entered into 12 additional markets with hugoboss.com. Consequently, this didn't have a significant financial impact for Q1. But like we always said, we will put strong emphasis on our online business also in the coming months and quarters.

Perhaps one additional remark on our wholesale performance in Q1, as the growth of 1% may have been somewhat surprising. There have been several factors: first, the very robust order intake for the spring/summer collections. Secondly, as we pointed out, there have been delivery shift effects from Q2 into Q1. These shifts had an impact of around EUR 20 million to EUR 25 million. They were aimed at ensuring product availability after the lifting of lockdowns, as wholesalers requested merchandise to be delivered earlier than expected. Finally, we have also seen strong growth with our online wholesale partners, such as breuninger.com, ASOS, ABOUT YOU, and Nordstrom, similar to the growth rates that we have disclosed for our own online business. Overall, when combining online sales for wholesale and own retail, online accounted for 23% of our total sales in Q1. This reflects a strong improvement in how we manage our business, expanding our online business in both wholesale and retail, thus becoming less vulnerable to lockdowns affecting brick-and-mortar.

Finally, on our collaborations with Russell Athletic and the NBA. Yes, we will have second capsule collections both for Russell Athletic and NBA. We expect that, in retail, the size of both collections will be bigger than for the first drops. On the wholesale side, we are just about to sell these capsules to our partners. The first NBA capsule, which we launched back in February, was limited to the Americas, while the second capsule will also be available in Europe, as we see that especially younger customers are very keen on buying our BOSS x NBA products also in Europe. Therefore, it is fair to assume that the second wave of both Russell Athletic and NBA is going to be bigger than the first wave. However, 2022 is too early to call. Let's surprise you with some new and exciting collaborations for 2022.

Thomas Chauvet (Citigroup): First, on gross margin. Can you comment more broadly on BOSS, HUGO, as well as casualwear and formalwear? In the past, you said that BOSS and HUGO, casualwear and formalwear had more or less the same gross margin. Could you update us on how this will evolve? You've done pricing adjustment at HUGO a few years back. You seem to have much better production volumes in casualwear than formalwear today. And especially as your new CEO, Daniel Grieder, is likely to make a further push into casualwear. How do you see the evolution of these two categories and the two brands?

Secondly, still on gross margin and the promotional environment, which impacted your gross margin in Q1. I understand the impact of the pandemic on markdown activity in Europe and the U.S. However, are you're seeing a more aggressive promotional environment for BOSS also in China? We see that consumer behavior is shifting towards online, also reflecting aggressive social media marketing. How do you expect markdown activity in China to evolve?

Finally, a follow-up on your comments about turnover doubling year-on-year in Q2, as this would imply sales around 20% below Q2 2019 levels in constant currencies. So not too dissimilar from the 2-year stack in Q1. If several stores in the U.K. are already above 2019 levels, and some other European markets are about to reopen soon, isn't that “almost doubling” way too conservative?

Yves Müller (CFO and Spokesperson of the Managing Board): On gross margin, it's more kind of a strategic question regarding casualwear versus formalwear. The driver here is the product group, not the brand, as BOSS and HUGO have more or less similar margins. The gross margin is usually higher for casualwear than for formalwear, which should give us some kind of strategical tailwind once the casualwear share continues to grow.

On your question regarding the promotional environment in China. Compared to Europe and the U.S., China is the least promotional market for our brands. In Q1, we have seen no significant differences as compared to prior quarters. This means that sales in China were predominantly full-price sales. The discount rates were fairly low.

Regarding our Q2 guidance on sales “almost doubling”. Please be aware that we are still operating in an environment with a lot of uncertainties. As you know, the month of April still saw lockdowns in key markets such as France, the Netherlands, and Germany. Therefore we have to be prudent and conservative. It is one thing to have the pandemic under control in terms of new infections. However, the political decisions are to a certain degree unforeseeable.

Thomas Chauvet (Citigroup): One follow-up on the gross margin for casualwear. When you do collaborations with the NBA and with Russell Athletic, would all related costs be in included marketing expenses, while your gross margin would be no different, whether this is a BOSS casualwear product or a Russell Athletic product?

Yves Müller (CFO and Spokesperson of the Managing Board): It depends. If you enter into a collaboration, you might have license payments that also might affect your COGS. But once you create a lot of buzz, like we did it with these two collaborations, all related cost are marketing expenses. By the way, although we decreased our operating expenses by 17% in Q1 as compared to the prior year, marketing expenses remained broadly stable, in order to support our brands, meaning that we did not cut back on marketing expenses in Q1.

Elena Mariani (Morgan Stanley): Starting with OpEx. As usual, you're showing an incredible cost control ability, and I was personally impressed by what you showed in Q1. I appreciate that for the rest of the year, you're not giving a precise outlook. But maybe on these items and the main cost line items, you might have a view on what to expect. So if the business picks up over the coming quarters and we're going to go through a progressive ramp-up also in the number of store reopenings, how should we expect the OpEx inflation to follow based on this progressive top-line pick up? You've already elaborated on marketing expenses. Could you remind us what's the percentage of sales, which has remained stable versus last year, and also the rent-to-sales ratio and how we should expect this to develop?

Secondly, on gross margin. Could you please be a little bit more precise about the moving parts? For Q1, you've mentioned that you've had markdown activity, increasing freight costs and a negative channel mix. What was the magnitude of these effects? How should we expect them to develop over the coming quarters? I would expect that in Q2, we will probably see a reversal given that wholesale is expected to be less strong as compared to Q1.

Finally, a follow-up on current trading. You said that you've seen the business picking up in those markets that have reopened, such as the U.K. Can you be a bit more precise about the type of pick-up you're seeing there? Can you also comment on the U.S. market, which remains difficult? Would you expect that market to move up to positive territory relatively soon, or are you already in positive territory?

Yves Müller (CFO and Spokesperson of the Managing Board): First, OpEx and the prospects for the year. Overall, given the uncertainties associated with the pandemic and having still some markets with stores which have not opened yet, we will remain under tight cost control. We have shown this for the last 3 quarters. On the other hand, we try to support those markets that are opening up with marketing activities, and we see that this is really picking up. That's the reason why we kept the marketing expenses on the same absolute level as compared to Q1 2020. Just to be precise, my previous comments were not related to a percentage of sales. The underlying logic is to invest into the brands to support our business going forward. This means entering into some kind of variable costs while being very strict on fixed costs when it comes to rental expenses, personnel costs and other overhead costs. Regarding the assessment of our store portfolio in Europe and in the U.S. As we always said, we aim at rightsizing stores in particular. This will have a sustainable positive effect on our fixed cost structure going forward.

On gross margin and its moving parts in Q1. Gross margin declined 250 basis points in Q1. 50% of this decline was related to higher markdowns, 25% was related to higher freight cost and another 25% was related to channel mix effects, as the performance of wholesale exceeded that of own retail. From a full year perspective, gross margin in 2021 is expected to be somewhere in between the margins of 2019 and 2020. Finally, for Q2, please be reminded that we recorded significant inventory valuation effects back in Q2 2020, which is not expected to repeat in Q2 2021.

On the pick-up of certain markets, especially the U.K. We are witnessing that, once the lockdown is lifted, like in the U.K., people really enjoy shopping and going out. Vaccination has reached a certain level where people feel much more secure. The consumer sentiment is much better as compared to Q3 2020. We even noticed some first pent-up demand here for smart casual products, and also for formalwear as people enjoy meeting again. This is very positive. We have seen this in several markets already, and we expect that this will be no different for other major markets like Germany, France and the Benelux, which will either reopen soon or have reopened recently, such as the Netherlands and Belgium.

Elena Mariani (Morgan Stanley): One follow-up on OpEx and D&A. We've noticed that D&A decreased by EUR 16 million in Q1. What is behind that drop? Because if annualizing this decrease, it would be around EUR 60 million.

Yves Müller (CFO and Spokesperson of the Managing Board): The decrease in D&A is mainly related to the store impairments that we recorded in full year 2020, and the fact that CapEx in 2020 and in Q1 2021 has been fairly low.

Antoine Belge (Exane BNP Paribas): First, on the imminent arrival of Daniel Grieder. I know he has a non-compete clause. Can you comment on any further recruitments that have been made or could be announced pretty soon?

My second question relates to your comments on collaborations like the one with Russell Athletic attracting younger consumers. Is there also a sort of halo effect, i.e., that these younger customers tend to buy not only the collaboration product, but also the rest of the product range?

Yves Müller (CFO and Spokesperson of the Managing Board): Yes, Daniel Grieder has a non-compete clause. That's the reason he will start on June 1. Regarding possible new recruitments, it's up to Daniel to decide. The latest additions to our team, however, regarding the marketing and the womenswear functions, were recruited by the existing Managing Board, including Oliver Timm. We have hired two high-profile persons and I'm very confident that we will make progress on the marketing side as well as on the womenswear side.

On our collaborations with Russell Athletic and the NBA. Yes, I can confirm that there is a halo effect. We saw a lot of new customers that have not been in contact with the BOSS brand before. Sell-through for both capsule collections in online is 3x higher. The new customers put additional products into their basket what we perceive as a clear positive sign.

Thierry Cota (Société Générale): First, on the 17% SG&A drop in Q1. What proportion is temporary and directly linked to the store closures, and how much will be kept going forward? Can we assume that a good half at least would be sort of temporary?

My second question relates to your comments around casualwear and full-price sales online. Regarding the 17% like-for-like sales decline of Q1, can you provide us the mix effect? Has it been negative, more or less neutral, or did it actually become positive?

Yves Müller (CFO and Spokesperson of the Managing Board): On the 17% OpEx decline in Q1: more than half of this is temporary.

Christian Stöhr (Vice President of IR & Corporate Communications): On you second question. There has been no material negative impact from mix. As growth has been stronger for casualwear than for formalwear, I don't see where that should be coming from. Take, for example, the most recent casualwear launches that we had during the quarter. They have sold at 100% full-price. So just by having casualwear outgrowing formalwear, this won't immediately lead to a negative mix effect from a full-price perspective. It is at least neutral.

Volker Bosse (Baader Bank): First, on rental costs. Have you already been able to renegotiate store rents also on a sustainable basis? Other retailers see 10% to 25% rental cost reduction potentials for inner city locations. Would you agree on that?

Secondly, on online. You mentioned that 59 markets are meanwhile connected to hugoboss.com. Where will this number stand at the end of 2021 or 2022? What is the rollout plan?

Finally, what is your full year guidance for CapEx?

Yves Müller (CFO and Spokesperson of the Managing Board): Regarding rental costs. As we always said, we continue to optimize our brick-and-mortar retail business. We renegotiate every store contract once it is about to expire. But it depends on the location. There are some locations which are running very well and where rents might even increase. Overall, however, during the pandemic, with brick-and-mortar suffering, rents are coming down. We will continue to strive for a lower rent-to-sales ratio. But it's not only negotiations, it's also the structural size. There are some oversized stores, especially in Europe and in the Americas, with our brands operating on two or even three sales floors in some locations. We try to get those to one sales floor. We aim at exploiting the current situation from a retailer point of view to renegotiate every contract. Overall, we therefore expect that the rent-to-sales ratio is coming down. We intend to flexibilize the business, to get into shorter deals, and to have the possibility to get out of contracts earlier.

Secondly, on online sales. Yes, hugoboss.com is now available in 59 markets and we will roll out our online flagship to more markets – with possibly around 20 more markets to follow towards the end of this year. However, with these 59 markets, we are already covering all major markets. We are very satisfied with the initial results of our online expansion.

Regarding CapEx: we won't provide a specific CapEx guidance for now as uncertainties are still high, but we aim at keeping CapEx under control. On the other hand, there is still potential for increasing the efficiency of our store format, i.e. reducing the euros spent per square meter without reducing the quality of our stores.

Rogerio Fujimori (Stifel): First, on the gross margin outlook. During a previous call, you've mentioned that the expectation for gross margin this year would be between 2020 and 2019 levels. Is this still the case?

Secondly, a follow-up on China. It is very encouraging to hear about the strong April trends. My question is on the situation with your brand ambassadors in China, and your thoughts on social media share of voice to sustain the strong top-line momentum in H2.

Yves Müller (CFO and Spokesperson of the Managing Board): I can confirm that our gross margin in 2021 is expected to be between 2019 and 2020 levels.

Regarding China, yes, we are looking for new brand ambassadors, together with a public relations agency. It is very important for us to have local brand ambassadors to transport our brand values to the Chinese consumer.

Christian Salis (Hauck & Aufhäuser): Again, on the OpEx level. As already mentioned, you were able to keep tight cost control in Q1 with selling and distribution expenses down 20%. Also, G&A down 9%. How much of this is sustainable? Could it mean that this implies some structural upside for your operating margin in the mid-term?

Secondly, on formalwear. How do we have to think about this segment from a mid-term perspective? Do you expect any sustainable negative impact on your general revenue level from the working-from-home trend in the mid-term?

Finally, when do you expect to return to the 2019 revenue level?

Yves Müller (CFO and Spokesperson of the Managing Board): Starting with your last questions regarding sales. Please understand that this is a topic for our Investor Day in the second half of this year. That is why I have to ask for your patience regarding our growth ambitions going forward.

Regarding OpEx and our tight cost control. There are a lot of different factors. However, around 2/3 of these factors are of temporary nature and 1/3 are somehow sustainable.

On formalwear, we also expect some pent-up demand once lockdowns are lifted and social distancing measures will fade away. Even pre-COVID, we recorded positive results with new and innovative, performance-driven materials and product combinations. This means that there are opportunities to even grow our formalwear business in the future. On the other hand, in casualwear, the dynamic is much higher. But on both sides, formalwear and casualwear, we are confident and optimistic to grow.

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