Third Quarter 2021 Results

Metzingen, November 4, 2021

Yves Müller (Chief Financial Officer)
Christian Stöhr (Vice President Investor Relations)

- The spoken word shall prevail –

Christian Stöhr: Good morning ladies and gentlemen and welcome to our third quarter 2021 financial results presentation. Today's conference call will be hosted by Yves Müller, CFO of HUGO BOSS.

Before we get started, allow me to reiterate that all revenue-related growth rates will be discussed on a currency-adjusted basis, unless otherwise specified. And let me also remind you that during the Q&A session we kindly ask you to limit your questions to a maximum of two. So, let's get started and over to you, Yves.

Yves Müller: Thank you Christian, and also from my side a warm welcome to all of you.

My presentation today will primarily focus on three overarching topics:

- Firstly, and following our pre-announcement from mid-October, I will elaborate in detail on the operational and financial performance of the third quarter.
- I will also spend some time on the progress we have made along our CLAIM 5 strategy, which we presented to you early August at our Capital Markets Day.
- And, last but not least, I will take a closer look at our expectations for the remainder of the year.

But first, let's have a look at our Q3 results. As you have taken notice from our pre-release, we have seen a strong acceleration in our business recovery during the third quarter, as momentum accelerated across all brands, all channels, and key regions. Most encouragingly, sales and earnings exceeded pre-pandemic levels for the first time.

A global store opening rate of around 95% as well as a meaningful uplift in consumer sentiment – particularly across Europe and the Americas – contributed to our strong Q3 results. In addition to that, we have made a kick start when it comes to the successful execution of our CLAIM 5 strategy, which provided additional tailwind and spurred brand momentum. On that, I will elaborate in more detail in just a few minutes.

As a result, Group revenues increased 40% compared to the prior year, totaling 755 million euros in the three-month period. This translates into 7% growth compared to pre-pandemic levels, representing a significant improvement quarter on quarter. Importantly, it also marks the strongest third quarter in the history of HUGO BOSS from a top-line perspective!

So let's take a closer look at the different moving parts of our top line, starting with our brands. Both BOSS and HUGO posted strong double-digit growth in the third quarter, with sales up 38% and 51% against the prior-year period. Compared to 2019 levels, sales increased 6% for BOSS – with a strong contribution coming from both our menswear and womenswear businesses – and 14% for HUGO.

It is particularly encouraging that growth was broad-based with demand having picked up noticeably across all product categories – reflecting the overall return of social life, including the recurrence of events over the summer as well as the – long anticipated – return to the office. On that, our product offerings are perfectly designed to serve the diverse needs of our customers, combining a tailored and modern lifestyle with a strong focus on casualization, comfort, and innovation – to be worn 24/7 across all wearing occasions.

This brings me to our regions, with both Europe and the Americas having recorded particularly strong performances in the third quarter. In Europe, with nearly all stores back in operation, revenues increased 38% on the prior-year level and 9% on a two-year-stack basis. Thanks to a firm rebound in local demand, business in all of the region's core markets – including the UK, Germany, and France – exceeded pre-pandemic levels, posting robust sales improvements against 2019. Equally encouraging, several markets in Eastern Europe, above all Russia, as well as the Middle East continued their strong double-digit growth trajectory compared to pre-pandemic levels.

Moving over to the Americas, where sales almost doubled in Q3, with revenues up 94% compared to the prior year, and 14% on a two-year-stack basis. With virtually all stores back in operation, we recorded strong growth across all of the region's key markets. In the U.S., revenues were up 8% compared to 2019 levels, driven by double-digit improvements in own retail, reflecting a pick-up in local demand, which more than compensated for the persistent absence of international tourism. This development was driven by our many initiatives to accelerate our 24/7 lifestyle brand image, including our recent successes when it comes to substantially improving our overall product assortment at the point of sale and leveraging the casualization trend. This puts us in a strong position to further push ahead with our self-managed turnaround, and accelerate growth in the market in the years to come. And while Latin America posted another quarter of mid-double-digit sales increases compared to 2019, revenues in Canada also returned to growth.

Finally, on Asia/Pacific, where renewed COVID-related restrictions – including temporary store closures – weighed on consumer sentiment in several markets. As a result, sales declined 1% year on year, and 14% on a two-year-stack basis. This was particularly evident in Southeast Asia, where several markets – including Australia, Singapore, and Malaysia – had to cope with long-lasting store closures in the wake of local lockdowns throughout most of Q3. In mainland China, sales fell 9% compared to last year, but were up 15% compared to two years ago. Also here, the overall consumer sentiment was somewhat impacted by COVID-related restrictions and reduced travelling, in particular during the month of August. Importantly, business activity has clearly picked up again towards the end of the third quarter and continued so far in Q4. Also from a structural perspective, our view on the long-term growth potential of mainland China has not changed at all! We continue to firmly believe in the tremendous potential of this important market, and remain fully committed when it comes to leveraging our business opportunities in China, based on our strong brand positioning.

Let's conclude on our top line with a brief review of the performance by channel. Starting with own retail, where revenues were up 40% on the prior-year level, translating into 13% growth on a two-year-stack basis. In this context, I am particularly pleased to report that our brick-and-mortar retail business was able to return to growth, with revenues up 4% on a two-year stack. Also our own online business continued its robust performance, posting yet another quarter of double-digit growth across all regions, with total revenues up 37% versus the prior year. Compared to 2019, sales on hugoboss.com and on self-managed partner websites were up a strong 127%.

Finally, in wholesale, revenues also grew 40% compared to last year, and hence remained only 1% below 2019 levels, reflecting wholesale partners' solid demand for our brands' Fall/Winter 2021 collections. Within wholesale, momentum was particularly strong with online partners – including digital pure players, leading marketplaces as well as bricks and clicks – as reflected by significant double-digit sales improvements versus 2019. Overall, as a percentage of Group sales, we recorded total digital sales within a high-teens range in the third quarter.

And with this, let's now move on to the main P&L items. Starting with our gross margin, which totaled 61.7% in the third quarter. This represents a minor decrease of 20 basis points year on year, and a decline of 160 basis points compared to the level of 2019, largely reflecting the overall rise in freight and duty costs in the wake of ongoing global supply chain headwinds. All other effects – including channel mix, markdown activity, and FX – broadly compensated for each other.

Moving over to operating expenses, which – as a percentage of sales – totaled 50.4% in Q3. Supported by our strong top-line momentum, we generated significant operating leverage as expenses remained 880 basis points below the prior-year level, and 140 basis points below that of 2019.

In absolute terms, selling and distribution expenses were up 19% compared to the prior-year period, but remained 2% below 2019 levels. While rental and payroll costs in own retail have started to gradually normalize with the vast majority of our stores being back in operation, we also recorded higher marketing investments, up 36% versus last year and 6% above pre-pandemic levels. This development reflects key initiatives within our CLAIM 5 strategy, all aimed at driving brand relevancy for BOSS and HUGO. The phenomenal launch event for our second BOSS x Russell Athletic collection was a clear highlight in this regard – something that I will elaborate on in detail in just a few minutes.

Administration expenses, on the other side, increased 26% compared to the prior year, and 21% on a two-year stack, largely reflecting higher payroll costs. This development is mainly attributable to accrued expenses reflecting the recent business performance against our initial expectations.

Our strong top-line development as well as the significant operating expense leverage resulted in an EBIT of 85 million euros in Q3, well above the prior-year level. Compared to 2019 levels, EBIT was consequently up 3%. Now, to conclude on the P&L, net income attributable to shareholders totaled 53 million euros in the third quarter.

Let's now turn quickly to the balance sheet, starting with trade net working capital, which declined 11% versus the prior year. An increase in trade receivables, mainly reflecting the further recovery of our wholesale business in the third quarter, was more than offset by higher trade payables as well as a lower inventory position. The latter saw a decrease of 6%, reflecting our strong top-line performance as well as ongoing tight inventory management.

Now, in terms of capital expenditure, investments in the third quarter totaled 26 million euros, up 40% on the prior year. As in previous quarters, investments were primarily related to our global store network as well as our digital capabilities.

This brings me to free cash flow. Driven by the strong increase in EBIT as well as the improvements in trade net working capital, free cash flow amounted to 171 million euros, up 10% on the prior-year level. Compared to 2019 levels, free cash flow generation even more than doubled! And to finish on our financial position, net financial liabilities decreased to 20 million euros – when excluding lease liabilities in the context of IFRS 16. Consequently, HUGO BOSS was nearly debt-free at the end of the third quarter.

Now, ladies and gentlemen, this concludes my remarks on our Q3 operational and financial performance. Before moving over to our expectations for the final quarter of 2021, let's now dig deeper into CLAIM 5 and the progress we have made when it comes to executing our 2025 strategy.

Only three months after our strategy presentation in early August, I am pleased to report that the execution of CLAIM 5 is literally in full swing, with the first great strides being made along key initiatives – be it from a brand, product, or sales perspective.

Starting with THE undisputed highlight from a brand and marketing perspective, which was the phenomenal launch of our second BOSS x Russell Athletic collection back in September. Fully in line with our strong strategic pillar of 'Boosting Brands' among younger consumers, we celebrated the collection's launch phygitally, aimed at generating as much excitement on social media as possible. And I can assure you, the results have surpassed even our own high expectations!

The physical collection presentation in a baseball stadium as part of Milan Fashion Week featured numerous celebrities such as Gigi Hadid, Irina Shayk, and TikToker Khaby Lame, while setting the stage for an extensive activation on social media. With several high-profile influencers taking center stage – among others Chiara Ferragni and Fedez – we created tremendous digital buzz around the globe. And with nearly 4 billion impressions and over 25 million engagements across all social media channels in only 4 days, it was the largest social-first event in our Company's history and one of the biggest social media events in the fashion industry to date.

Most importantly, and in line with our strategic pillar 'Product is King', the collection strongly emphasizes our clear ambition of establishing BOSS as a true 24/7 lifestyle brand. Therefore, exceptional collaborations like the one with Russell Athletic will not only be decisive for creating strong buzz among younger consumers, but also for further strengthening our position in the crucial casualwear segment.

The partnership of BOSS and Russell Athletic is our blueprint of how we will fully unlock our brands' great potential in the future – enabling BOSS and HUGO to become THE leading power brands. And believe me, there is much more to come in the coming weeks and months! In January already, we will kick off brand-new marketing campaigns for BOSS and HUGO, presenting our brands on a truly global scale by strongly emphasizing a new boldness, confidence, and attitude, in line with our highly anticipated branding refresh! So stay tuned!

Speaking of our branding refresh, the upcoming Spring/Summer '22 collections – which will hit the shelves from January onwards – will be the first collections to fully incorporate the complete new look and feel of BOSS and HUGO, with a clear point of difference aimed at strongly elevating brand relevancy. And, as we already highlighted at our Capital Markets Day back in August, initial feedback on these collections from our wholesale partners has been overwhelmingly positive, as reflected by a double-digit increase in the overall order intake for Spring/Summer '22. Importantly, the branding refresh, goes far beyond our products and spans up until our consumer touchpoints – from our brands' logos over marketing and social media, to new designs in retail and digital.

Speaking of digital, our CLAIM 5 strategy also contains a strong commitment to 'Lead in Digital,' enabling us to deliver on our vision to become THE premium tech-driven fashion platform worldwide. In this context, execution at our recently established Digital Campus is already running at full steam! One of our first priorities will be the global relaunch of hugoboss.com, scheduled for early 2022. Following a clear mobile-first approach, our new online flagship will offer various state-of-the-art functionalities, all strongly enhancing the online customer journey and accelerating traffic as well as conversion, to fully exploit the digital opportunity in the years to come.

This brings me to our brick-and-mortar business, where we are about to roll out our new store concept, starting with some first pilots in Dubai in the coming weeks. Early in 2022, we will then open our first fully rebranded flagship store on London's Oxford Street – one of our future global anchor stores – and celebrate the official launch of the branding refresh at our points of sale. We are convinced that our new store concept will contribute significantly to developing our stores from points of sale to true points of experience – more emotional, more welcoming, more digital, and – importantly – more productive than ever before!

Now, at the end of the day it all comes back to the successful execution of all strategic pillars, to ultimately make CLAIM 5 a winning formula and to deliver on our vision and ambition. Consistent and rigorous execution is therefore firmly embedded within our CLAIM 5 strategy. In this context, we have made a number of key personnel changes over the last weeks and months, thereby further strengthening our diverse and highly experienced senior management team:

- With Kristina Szász and Christopher Körber we have added strong competence to our global brand organization, as both look back at extensive, global experience in brand management and product development. Going forward, Kristina will drive the realignment of our important BOSS Womenswear business. And Christopher, on the other hand, will ensure that we will make the most out of key product categories such as shirts, bodywear, and shoes & accessories.
- On top of that, Miah Sullivan joined our Company in mid-2021, driving our global marketing and brand communications activities. With many years of international marketing experience in the fashion industry, Miah brings tremendous expertise in brand building and brand strategy. She will therefore strongly contribute to our ambition of becoming a top-100 global brand by substantially growing brand value for BOSS and HUGO in the coming years.
- To further strengthen our global sales organization, Luigi Boiocchi and Judith Sun have recently joined HUGO BOSS. Luigi, a proven sales expert within the premium apparel industry, will lead our newly created sales hub 'Emerging Markets & Russia'. And under the leadership of Judith, who brings broad and multi-year expertise in fashion and luxury-related industries,

we have every confidence we will leverage the full potential of the important Chinese market in the years to come.

Ladies and gentlemen, as you can see, we haven't wasted any time, but instead put the pedal to metal straight away when it came to the execution of CLAIM 5. Importantly, we have the right organization and the right people in place, to ensure we will deliver on our 2025 ambition!

In this context, the year 2021 marks a first important milestone in achieving our ambitious mid-term goals. Like in many aspects of life, getting out of the blocks quickly and strongly is important as it will provide further momentum to our strategy execution. Let me therefore guide you through our expectations for 2021 and the important final quarter in particular. As you have taken notice from our pre-announcement in mid-October, we increased our outlook for the current fiscal year, reflecting the strong top- and bottom-line performance in the third quarter as well as our confidence for the remainder of the year.

From a top-line perspective, we now forecast Group revenues in 2021 to increase by around 40%, as we are confident to carry over our strong momentum from the third quarter also into Q4. At the same time, we are factoring in persisting levels of macroeconomic uncertainty. In particular, when it comes to COVID-19, we continue to be confronted with ongoing volatility. As we speak, we are facing impacts from renewed lockdowns in some Eastern European markets, including Russia, where we have been enjoying strong momentum so far in 2021. In addition, several Asian markets – among others Singapore and Malaysia – remain impacted by ongoing store closures.

Another topic we must not ignore is the ongoing global supply chain headwinds that our industry is currently experiencing – something we are not immune to, considering our global business activities and global sourcing infrastructure. Having said this, let me also be very clear that we are in the fortunate position of benefitting from a well-balanced regional sourcing mix as well as a comparatively high share of own production. Around half of our merchandise value is currently sourced in Europe, and our own production sites, including our large plant in Turkey, account for more than 15% of our total sourcing value. We are therefore confident of being able to mitigate most of the potential short-term supply-chain headwinds from a top-line perspective.

Now, with regards to our bottom line, we are now forecasting EBIT to come to a level of between 175 and 200 million euros in fiscal year 2021. Also here, we have already factored in some of the ongoing uncertainties, in particular when it comes to the overall rise in global freight and duty costs, which is expected to continue to weigh on our gross margin development for the time being.

Besides this, allow me to reiterate what we already highlighted during our CMD in August. While we are fully committed to delivering strong improvements in profits over the next five years in line with our CLAIM 5 strategy, we are also committed to stepping up our investments in the months and quarters ahead, in particular in the areas of marketing and digital. Starting in Q4, these investments will therefore lead to a substantial increase in operating expenses, most certainly even beyond pre-pandemic levels!

To complete the picture on our outlook for the current fiscal year, we now expect trade net working capital as a percentage of sales to improve to a level of between 19 and 20%. At the same time, we continue to forecast CapEx to increase to a level of between 100 and 130 million euros.

I would like to conclude today's presentation by emphasizing once again that, with CLAIM 5, we have laid out a clear strategic roadmap until 2025, and we are already in 'full execution mode'! Our strong third quarter results are proof positive of that. We are fully committed and prepared to further drive strong top-line growth in the quarters and years ahead, claim our position in the consumers' minds, and win market share with our unique brands BOSS and HUGO.

And with this, ladies and gentlemen, I am now happy to take your questions.