HUGO BOSS

Transcript – Q&A Session
August 4, 2020

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.

Thomas Chauvet (Citigroup): Two questions on the online business. First, earlier this year, you said online was now clearly margin-accretive, thanks to the higher share of variable cost, the higher average basket and low returns. I guess the profitability in Q2 must have increased further. Can you share with us your expectations on the mid-term margin differential between online and physical retail, based on a fair allocation of costs?

Secondly, in light of your high online growth, do you feel the need to make changes to your online strategy, or adapting for structure before your new CEO joins in June 2021 to make sure you don't miss on revenue and profit opportunities?

Yves Müller (CFO and Spokesperson of the Managing Board): I can confirm that among our retail sales channels, our own online business – which includes hugoboss.com as well as online concessions – has a higher EBIT margin than physical retail which includes freestanding stores, shop-in-shops and outlets. Depending on the different models, the differential is up to a range in the mid-single-digits. And as the online business is usually more based on variable costs, its risk profile is less pronounced than that of brick-and-mortar retail. Therefore, we will continue to strategically push our own online business.

You were referring to structural changes. Based on the strength of our online business in recent quarters we decided to continue investing in online. In our press announcement published at the beginning of July we confirmed having rolled out hugoboss.com to 22 additional countries. In addition, tomorrow, we will launch hugoboss.com in Canada and Mexico. On top of that, we will add further online concession partners. For the second half of 2020, for example, you can expect us to add Amazon Europe to our online concession business.

There are a lot of initiatives that we are executing in order to further strengthen our online business. We are very confident that by the year 2022, our own online revenues will exceed EUR 400 million. I'm convinced that we can even overachieve this target, doing everything to accelerate our online growth. I often get the question whether there are additional investments required regarding the fulfillment: our fulfillment capacities are good for EUR 0.5 billion of sales.

Jürgen Kolb (Kepler Cheuvreux): You said that your Q2 gross margin was impacted by higher markdowns. However, they were just slightly higher. How shall I understand that because we all noticed heavier discounting, especially on your website. Also, in that regard, how long will this kind of rather aggressive discounting last?

Secondly, on the online business. How much of the 74% growth in Q2 was due to additional concession business?

Yves Müller (CFO and Spokesperson of the Managing Board): Regarding gross margin and its decline in Q2 year-over-year: Almost 90% of the decline can be explained by inventory valuation effects, i.e. the EUR 25 million write-down that we had in Q2 2020. Based on the relatively small sales basis, this has a big effect. This in turn means that higher markdowns explain the remaining 10% of the gross margin decrease. However, regarding the absolute amount of gross profit, the impact from higher markdowns was fairly low. Of course, we saw some promotional activity. Plus, you also have to consider channel and regional mix effects. Especially the recovery in mainland China, a highly profitable market for us, was kind of a tailwind.

In our industry, there is a lot of inventory in the books, and the sales period in Q2 will probably last longer, with more markdowns to come. But I don't expect this to be a tremendous issue for HUGO BOSS in the second half of the year.

On your second question: our .com business saw strong double-digit growth, while our online concession business even more than doubled in Q2.

Jaina Mistry (Deutsche Bank): First, the comments that you gave around growth rates in June were really helpful. Can you also quantify growth rates for your key regions. Also, did growth rates in mainland China further accelerate in July?

Secondly, on potential cost savings in the second half of the year: how much of the savings that you saw in Q2 will be recurring? As a result, would you expect OpEx to decline year-on-year also in the second half of the year?

Yves Müller (CFO and Spokesperson of the Managing Board): As I said, the decline in single month June was between 35% and 40%, while we clearly recorded a sequential improvement that started already back in April, week by week. And I can confirm that this sequential improvement continued also in July. Of course, there are differences among regions. APAC, driven by mainland China, is the first region which has started its recovery, and currently it is the best-performing region. Now, since our important market of Great Britain is back to business, this helps us to further recover in Europe, which is doing fairly good overall. In the Americas, on the other hand, where we still experience some regional lockdowns like in California, we are still suffering. However, regarding mainland China, I can confirm that our performance further accelerated in July.

Regarding cost savings: Back in May we said that we want to save OpEx in the amount of EUR 150 million in full year 2020. EUR 100 million of this saving has been achieved already in Q2, and we expect the remaining EUR 50 million to come in the second half of the year. A high share of the savings in Q2 was related to short-time work and turnover-based rents. Once the business now recovers, our clear focus is on accelerating our sales growth, while at the same time having a clear cost focus and making cost savings sustainable.

Our top priority during Q2 was to secure cash. And we delivered, having generated free cash flow of plus EUR 39 million, as we executed the measures as planned. We also secured additional credit facilities. We are operating out of a position of financial strength, something that we want to leverage in the upcoming quarters as there are always opportunities in this crisis. We will manage those opportunities and try to maximize our sales while remaining a strong focus on the cost side.

Antoine Belge (HSBC): First, on your comments on casual tailoring: this is a good thing, but you're facing quite strong competition. What's your level of confidence of having a product in casual tailoring differentiating itself from peers?

Secondly, on gross margin: have you taken enough inventory provisions in Q2 also for the second half of this year? Or should we expect a significant gross margin decline also in H2 due to more markdowns and further depreciation?

Yves Müller (CFO and Spokesperson of the Managing Board): Starting with the gross margin: regarding the second half of the year, of course, there are a lot of uncertainties in the market. We don't know if there will be a second wave of infections. However, we are convinced that lockdowns would rather be regional. Still, this is uncertain. But from today's point of view, we are convinced that the inventory devaluation of Q2 will be sufficient. We also cut our fall/winter retail merchandise inflow. Therefore, we feel well balanced in terms of sales opportunities and inventory risks for the second half of the year. This said, I do not expect a margin hit from inventory devaluation in H2. On the other hand, we expect the environment to remain overall promotional. As we cannot exclude ourselves from the environment, there could be some slight impact from markdowns also in H2.

Regarding casual tailoring: there are a lot of examples of younger customers combining sportswear with affordable luxury, like wearing a jacket with a t-shirt, or a tracksuit with sneakers. These combinations represent the modern interpretation on how to dress up in a very nice "BOSS way." We are among the trendsetters in this regard. There will be a lot of examples coming with our fall/winter and spring/summer collections as we are clearly pushing this casualization trend; and we will interpret this the "BOSS way."

Antoine Belge (HSBC): Was the inventory write-down in Q2 all related to the spring/summer collection, or did it also include write-downs for fall/winter?

Yves Müller (CFO and Spokesperson of the Managing Board): It was related to the spring/summer collection.

Elena Mariani (Morgan Stanley): First, on your wholesale outlook. By now, you should have visibility into the second half of the year. How should we think about sales progression? Also, some of your peers have taken the chance this year to further rationalize the network given the situation. Should we expect similar measures from you as well, given also that the business in this channel has been difficult for quite a while? Should we expect you to take a tougher approach versus some of your partners?

Secondly, on the casualization trend. How do you plan to strategically balance the strong cost savings you've been achieving with further investments to further push your brands towards casualization? What are you going to do over the next 12 months given that the new CEO is going to join in June 2021? How do you plan strategically to develop your brands over the next few months; and what are the investments needed in this regard?

Yves Müller (CFO and Spokesperson of the Managing Board): First, regarding the question on wholesale outlook: For the fall/winter collection, back in April and May, we accepted some cancellations because at that time we were still capable of responding to our suppliers, cutting orders without any harm for the business. So we cut the wholesale orders by between 15% and 20% for the fall/winter collection. For the spring/summer 2021 collection, however, it is too early to call, as we just started the sale to wholesalers.

Regarding your question on the brick-and-mortar network. We are managing around 600 contracts, as we are basically running around 430 freestanding stores and 170 outlets globally. On average, we are therefore touching 150 contracts per year. During the COVID-19 crisis it became evident that due to lower profitability we have to look at some stores and their rebound very closely. Of course, there will be some closures, but we have already been in the middle of optimizing our global store network even before COVID-19. On the other hand, you also get some rent reliefs in these times, so this has to be balanced out on a location-by-location basis and you cannot generalize this overall. To sum it up, store optimization will move on like it did already during the last years, and we will continue to have a rigid view on this.

Regarding your question on casualization and our strategic measures in this regard: I will be in charge for the next 10 months, and I will be there as a CFO afterwards. Clearly, I will not only administer this time period, but we want to attack, and we will strategically align with our newly elected Supervisory Board. So by the end of September, we expect to have a clear strategic framework to ensure that we are working on the right things, which will last even after Daniel Grieder will join, and which will pave the way back to growth. There will be a lot of things that we have to do in terms of further pushing the casualization of our brands, emotionalizing the brands, and also to further invest into the brands, including enforcing our business units such as BOSS Menswear to ensure that we get back to growth.

Elena Mariani (Morgan Stanley): Just one clarification: my question on the network has been also on wholesale. So I was wondering whether you're happy with where you are in terms of your network of wholesale partners, particularly in the U.S. If I remember well, your business over there is 50% retail, 50% wholesale. Are you happy with that? Or would you expect to cut some partners over the coming months?

Yves Müller (CFO and Spokesperson of the Managing Board): The wholesale business in the U.S. only represents 30% of our business over there, and it mainly consists of four to five major accounts. Also, there are one or two accounts that might be converted to a retail concession model, as we are in talks in order to better control the brand. At the other doors, we are clearly not "over-distributed." Let me give you one example: at Macy's, we are operating 8 shop-in-shops in the concession model, clearly indicating that we are not over-distributed in U.S. wholesale.

Melanie Flouquet (J.P. Morgan): First, on your progress in casualwear. What is the split of your inventory, or your commitment to production, for fall/winter 2020 between casualwear and formalwear? And how does this compare to the level last year?

Secondly, the right-of-use asset impairment charges in Q2 will likely lead to a benefit in your D&A for the coming quarters. Do you encourage us to factor this into our numbers? Or should we assume that this right-of-use asset impairment was fairly cautious and could be reversed at some point?

Yves Müller (CFO and Spokesperson of the Managing Board): Starting with the second question: in Q2, we mainly impaired right-of-use assets in the amount of EUR 88 million and fixed store assets in the amount of EUR 33 million, with total impairments summing up to EUR 125 million. Accounting-wise, as you bring forward the depreciation, of course, you will have less depreciation in the quarters to come.

Melanie Flouquet (J.P. Morgan): Yes. But do you think this is a consequence of an accounting for the impact of COVID-19 that can reverse fairly quickly when times resume to normal? Or do you think it's a lasting impact on your D&A and will benefit your D&A for the next 4 to 5 years?

Yves Müller (CFO and Spokesperson of the Managing Board): This is very difficult to judge. Usually, we do impairment testing in Q4. However, due to IFRS and ESMA requirements, we were obliged to do the impairment testing in Q2 as COVID-19 was perceived to be a triggering event. Secondly, conducting impairment tests for the right-of-use assets under IFRS 16 is the new normal and will put kind of higher volatility to the impairment charges and our results. If our business will recover faster than anticipated, there even might be some reversals of impairments. But for the time being, we booked these kind of “extraordinary D&A” in Q2 based on our best knowledge. We also compared our practice with those of our peers, of which the majority did basically the same. And clearly, this will lead to a decrease in D&A in the next quarters, ceteris paribus.

Your first question was related to casualwear. Yes, there will be a continuing shift. In the U.S., Stephan Born, who is our manager for the Americas since November, adjusted the assortment as we are still perceived to rather be a suit-only company in the U.S. He adjusted the retail assortment by around 20 basis points between formalwear and casualwear. For the whole group, the split is 40% formalwear, 50% casualwear, 10% shoes and accessories. In the United States, it was more like 60-30-10 towards formalwear. So there will be a big shift over there. Of course, this will be underlined with marketing activities. We're talking about fall/winter 2020, as Stephan Born was capable of implementing this change already as he joined in November. But of course, it's a rather gradual development that will take place.

Kathryn Parker (Jefferies): First, on the order intake: Can you provide a percentage on the reduction of the fall/winter collection that you have ordered? Secondly, on marketing and whether you can give an update on your strategy going forward? What share of your marketing spend is on digital marketing?

Yves Müller (CFO and Spokesperson of the Managing Board): Regarding your second question: Around 70% of our marketing spend is allocated to digital already. Due to the growing online business, this share will increase further. And this is the way to approach younger customers in particular.

On your first question: we cut inventory inflow for the fall/winter 2020 collection by around 25% including retail and wholesale.

Philipp Frey (M.M. Warburg): Did I get you right that overall retail during June was down 35% to 40%, and that this is basically based on around 80% of your stores opened on average?

Secondly, if I got it right, you had some EUR 40 million rental savings during Q2. Could you please elaborate on how much of this is temporary relief during COVID-19, and how much is related to permanent reduction of rental rates?

Yves Müller (CFO and Spokesperson of the Managing Board): You are right – retail sales in June were down 35% to 40% based on an average store opening rate of around 80%. But clearly, at the end of the month, we were close to a 90% opening rate. Also, retail sales trends improved further in July.

On your question regarding rental expenses: there have been different factors contributing to the lower expenses in Q2, including lower variable rents, savings with regard to minimum rents, as well as some rent deferrals. For now, however, it's difficult to judge which of those savings are sustainable as we are still in the middle of discussing further rent reliefs.

Philipp Frey (M.M. Warburg): But it is clear that the overall rental level and prices in the market are going down further. So time is in your favor.

Yves Müller (CFO and Spokesperson of the Managing Board): That's true, and that's the reason why I'm saying this. We are heavily working on this subject to get the rents down. Even with further opportunities that might come up, like in mainland China, or in other Asian markets. Now it's the time to react. The most important thing is that we take fast decisions, in order to fully exploit this situation.

Volker Bosse (Baader Bank): First, on the concession model with Zalando: can you confirm that in the meantime you tapped all of Zalando's markets with the full collections of BOSS and HUGO? If not, what are the next steps?

Secondly, sales were down by 59% in the second quarter. How much was April, May and June down year-on-year?

Yves Müller (CFO and Spokesperson of the Managing Board): First, regarding BOSS, we are operating in all of Zalando's markets except Spain and Poland. Poland is a very relevant market. Once we will have our own .com website in Poland, we are going to also convert Zalando over there. During the first half of the year, we converted the Nordics and the U.K.. HUGO, on the other hand, is still operating in the wholesale model. However, we are in negotiations with Zalando to also convert HUGO.

Regarding your second question, retail sales in April were down by around 80% year on year. In June, retail sales were only down by minus 35% to minus 40%. This said, you can somehow draw a line between.