HUGO BOSS

Transcript – Q&A Session

August 1, 2024

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.

Frederick Wild (Jefferies): My first question is about the trading pattern in your DTC business through Q2 and how it has developed so far in Q3?

My second question is about the cut in 2024 guidance. How has this affected your outlook for delivering on your 2025 financial ambition?

Yves Müller (CFO/COO of HUGO BOSS): Regarding current trading or the exit rate, the trends are more or less the same as in Q2.

As for our guidance, I want to emphasize our determination to focus on 2024. We've been accelerating our cost-saving measures, which we started at the beginning of the year. These measures are already yielding results in terms of gross margin improvements due to sourcing efficiencies. And our cost increase has dropped from 13% in 2023 to 7% in H1 2024, while we aim to further reduce this in the second half of the year. Our full management focus is firmly on 2024.

Manjari Dhar (RBC Capital Markets): Firstly, on the acceleration of the cost efficiency program. Could you quantify the additional savings you're expecting in H2 compared to the original plan?

Secondly, what is your view on pricing in the premium segment? Given the tough environment, do you think there is a need to reduce prices to reengage consumers and drive the top line?

Yves Müller (CFO/COO of HUGO BOSS): Regarding cost efficiency, it's crucial to adjust our measures according to current market developments. We've seen a slowdown in sales; we grew by 6% in Q1 but now, in Q2, are at minus 1%. It's normal to react to such changes. We are determined to get our costs under control, focusing on what we can manage ourselves, for example through our measures to drive sourcing efficiency. Our fixed costs grew by 13% in 2023, and by 7% in H1 2024. Now, we aim to reduce this to a low single-digit increase in H2 2024. We're accelerating our cost-saving measures due to the current market environment.

As for pricing, our brands remain strong, and we are gaining market share. We are convinced that we have a superior price-value proposition in terms of quality and price, and we are not considering any price reductions at this time.

Grace Smalley (Morgan Stanley): First, about the promotional environment: you mentioned current trading is similar to Q2. Can you comment on the promotional environment in July and your gross margin guidance for the year, specifically regarding promotional headwinds in the second half?

My second question is about the 2024 guidance. It sounds like you have strong conviction on gross margin, OpEx control, and wholesale growth. Does the wide range in EBIT guidance stem from uncertainty around brick-and-mortar retail? What does your guidance assume for brick-and-mortar retail sales in the second half, particularly regarding like-for-like growth, which should have been negative in Q2?

Yves Müller (CFO/COO of HUGO BOSS): Regarding the promotional environment, keep in mind that, overall, promotional activity was quite elevated in the second half of 2023. For H2 2024, we expect no significant improvements. We anticipate that the gross margin will be affected by elevated promotional activity, and this is included in our assumptions. From a sourcing efficiency perspective, however, we are benefiting quarter by quarter. We are sourcing 50% more volumes compared to pre-COVID, which provides economies of scale and helps improve our gross margin. We are forecasting a gross margin above 62% for the full year 2024. Regarding our bottom line, we are focused on reducing fixed cost growth to a low single-digit increase in H2 2024. We have also factored in an elevated promotional environment and higher freight rates, which we are mitigating by significantly increasing ship freight while reducing airfreight.

Regarding brick-and-mortar retail, we have taken a prudent approach and do not expect a significant pickup in H2. At the same time, we are confident when it comes to our wholesale business, as our order book is strong and should provide stability to our business.

Michael Kuhn (Deutsche Bank): Firstly, regarding the performance gap between wholesale and retail, is this due to different regional focuses? If you compare the same region and markets, does wholesale still outperform retail? If so, why?

Secondly, about regional performance, the deepest cut in sales growth guidance is in Asia/Pacific, particularly China. Given this, would you consider reducing your focus on China? More broadly, what are your thoughts on China and its future development for your company?

Yves Müller (CFO/COO of HUGO BOSS): Regarding the wholesale versus retail performance, the key reason is higher traffic in a multi-brand environment, like department stores. Both our brands, BOSS and HUGO, outperform other brands in these settings. In freestanding stores, particularly in shopping malls, traffic tends to be lower, affecting retail performance. Wholesale partners see our investment in the brand, and sellouts remain strong. The order books for the next three seasons are promising. This pattern also holds true in our concession business, where shop-in-shop environments outperform freestanding stores.

In terms of regional performance, Asia/Pacific saw a swing in revenue growth from +4% in Q1 to -4% in Q2. Despite this, the SEAPAC region, especially Japan, showed stellar performance. However, business in Greater China remained muted. Our position in China is underpenetrated, presenting strategic opportunities despite the current low consumer sentiment and footfall. Chinese consumers are saving heavily, with a saving quota between 30% and 40%. Currently, Greater China accounts for around 6% of group sales, so its impact is relatively small. In summary, there are mid- and long-term strategic opportunities in China despite the current downtrend in consumer sentiment.

Jürgen Kolb (Kepler Cheuvreux): First, regarding the brick-and-mortar wholesale business on a regional basis: Europe was down 1% in Q2. Is this due to department store situation in Germany? And in the Americas, which saw a 20% increase, did you add doors at Macy's or other department stores, or enter new ones?

Secondly, on inventories: they are down year-on-year but up EUR 20 million versus Q1. How has the share of never-out-of-stock (NOS) products developed compared to year-end 2023? Where do you expect inventories to be at the end of this year?

Yves Müller (CFO/COO of HUGO BOSS): In Germany, you see kind of an effect, but, overall, both KaDeWe and Galeria are somehow recovering from the lows. Regarding Macy's expansion, there are two aspects. First, for the BOSS brand, we are operating in the concession business, which drives our retail business. Due to our 24/7 lifestyle image and strong brand momentum in the U.S., we are gaining more doors with existing partners like Nordstrom, Dillards, and Macy's. BOSS is growing through the concession model, and HUGO through the wholesale model at Macy's, driving our strong wholesale performance in the Americas.

On inventory management, our strategic goal is to reduce the inventory-to-sales ratio to below 20% over the next 18 months. However, seasonality affects our inventory structure: winter merchandise, which is heavier compared to summer, is now in our books. This seasonality means the inventory value is generally higher at mid-year compared to year-end. NOS inventory has decreased versus 2023 as promised, and the aging looks healthy and has even improved compared to prior-year levels. Everything is under control regarding inventories.

Andreas Riemann (ODDO BHF): On operating leverage: what sales growth is needed to achieve operating leverage currently?

Also, regarding cost savings, are these one-time reductions, or can you make costs more variable, such as adjusting store personnel costs to lower the hurdle for operating leverage going forward?

Yves Müller (CFO/COO of HUGO BOSS): A low single-digit increase in sales, or even a flat scenario, can generate operating leverage due to the cost measures we're implementing for H2 2024. We're focusing on improving our pay-to-sales ratio by adjusting sales staff to the reduced footfall we are experiencing.

In the retail environment, there is a standard fluctuation of 15% to 20%, which we can use to adjust our staffing accordingly. Our cost measures aim to not only impact 2024 but also to structurally optimize our cost base for long-term improvements. These measures are intended to provide stable cost benefits in the years to come.

Thomas Chauvet (Citi): First, on CapEx: the guidance for FY 2024 was initially between EUR 300 million and EUR 350 million but is now around EUR 300 million. Are you canceling or just postponing some projects, and if so, which ones? Is EUR 300 million a good proxy for next year's CapEx? The guidance for the last years of the "CLAIM 5" plan was 6%-7% of sales. With a consensus of EUR 4.5 billion in sales next year, that would also be around EUR 300 million CapEx.

Secondly, regarding sourcing and optimizing your sourcing platform, can you share the breakdown of freight between air, sea, road, etc.? Where is the biggest pressure on freight rates currently? Is it mainly air, or all types of transport?

Yves Müller (CFO/COO of HUGO BOSS): Regarding CapEx, we initially guided between EUR 300 million and EUR 350 million and have now reduced it to around EUR 300 million. There are two main factors: Firstly, CapEx efficiency: we're aiming to reduce CapEx per square meter by 15% in our retail investments through optimization initiatives. Secondly, prioritization: we are focusing on Best and Halo stores, such as the new flagship store in Düsseldorf, Germany. We are delaying and reducing investments in smaller cities and Good and Better locations due to current market trends. We are making progress, with 50%-60% of our stores remodeled. In the future, around 2026 and beyond, CapEx as a percentage of sales will most likely decrease from 6%-7% to 4%-6%. "CLAIM 5" includes higher investments in the first years, which will normalize in the outer years.

On the sourcing platform, the pressure on freight rates is primarily from sea freight, which is currently elevated, as seen in transportation indexes. However, this is compensated by reducing our airfreight share. We have reduced airfreight from the high 20s to the low teens and will continue to decrease it in the coming quarters, more than offsetting the increased sea freight rates. When it comes to Europe, around 50% to 60% is truck, the rest is ship. And in Asia, it is of course more by ship.

Martin Ben Rada (Goldman Sachs): First, on wholesale: how is the order book looking for the second half of the year? Back in May, you mentioned a high-single digit growth rate.

Second, on OpEx efficiencies into 2025: is the 1%-3% growth rate you mentioned for the second half the right baseline for FY 2025, or do you expect a bigger impact from the changes next year?

Yves Müller (CFO/COO of HUGO BOSS): Regarding wholesale, we continue to see a robust and solid order intake, ranging from mid- to high single digits for the next three order books. This gives us confidence in the wholesale segment.

As for OpEx efficiencies, the cost measures we are implementing will indeed provide some tailwind into next year. Our goal is to not only improve the bottom line for the second half of 2024 but to ensure these measures have a lasting impact, benefiting us in the years to come.