Brunello Cucinelli SpA

"First Half 2018 Results Call"

Tuesday, August 28, 2018, 18:00 CET

MODERATORS: BRUNELLO CUCINELLI, PRESIDENT AND CHIEF EXECUTIVE OFFICER

MORENO CIARAPICA, CHIEF FINANCIAL OFFICER

PIETRO ARNOBALDI, HEAD OF INVESTOR RELATIONS & CORPORATE PLANNING

OPERATOR: Good evening. This is the Chorus Call operator speaking. Welcome to the Presentation of the First Half 2018 Results of the Brunello Cucinelli Group. I would like to remind you that all participants are in listen-only mode. Following the initial presentation, there will be an opportunity for Q&A by the financial markets.

The speakers will be Mr. Brunello Cucinelli, President and CEO of the company, Mr. Moreno Ciarapica, CFO and Mr. Pietro Arnobaldi, Head of Investor Relations. In order to receive help from an operator during the conference call, please press "*" followed by "0."

Now, I would like to give the floor to Mr. Brunello Cucinelli. The floor is yours.

BRUNELLO CUCINELLI: Good evening, everyone. So first of all, dear friends, analysts and investors, I would like to thank you on behalf of the company and of ourselves personally. I hope you had a nice holiday. I hope your vacation was nice and you were rested and you have regenerated your energy. And I hope you also found the time to somehow discuss with yourselves.

Now this is a big issue, we no longer have the time to talk to ourselves and discuss with ourselves. I spent about 10 days with my family in Sicily which is a fantastic, beautiful city. But before going to Syracuse, I had read something about Plato, the Greek, who in 400 Before Christ, traveled to this fantastic city.

So he wrote something about Italians at the time and he wrote the following. These Italians and Syracusans, who actually rebelled twice again and never, went to sleep alone. So back then he found that this kind of behavior, this kind of lifestyle was the cause and reason for the political instability of the then government of Syracuse, this is 2,400 years ago. And Plato went on saying that the only way to correct the situation was that of putting in place a class of kings and philosophers who, of course, had to be educated in Plato's doctrine and this sounds very contemporary to me. Now, I told you before, I'm 65 years old now. I have seen 65 governments in Italy, so this appears to be our typical Italian culture. I am sure you understand we're not concerned about pretty much anything by now.

So how would I like to organize this conference call? I will tell you about the big performance data. Then our CFO, Mr. Moreno Ciarapica, will provide you with details. And then I will speak again later and give you some color about 2018. I will give you a visibility on 2019 too, because we actually almost concluded this year's campaign for 2019. Then I would like to talk about the products, the web and this big event we are going to organize on the 04th of September with the press here at Solomeo. So as usual all the stuff is with us.

So I'll read some documents to you, so net revenues stand at €269.5 million plus 11% at current exchange rate plus 11.9% at constant exchange rates as against the lower performance of last year. EBITDA stands at €46.2 million plus 11.2% and net profit…normalized net profit stands at plus 19.7%, i.e., €23.8 million. The net profit includes in the patent box benefit stands at 29 plus 9%. The Italian market increased at 2.4%.

At constant exchange rates this increased a bit more. You know, that the exchange rates actually offset virtually all the growth in North America. We grew virtually in all distribution channels; retail was plus 7.1%, wholesale monobrand plus 12.4%, and wholesale multibrand plus 10.7%. CAPEX stands at around €25.2 million and within the pretty strong plan for 2018-2020 which is very important for us to keep our brand leadership and to support our growth and we'll get back to that later.

Net financial position stands at €44 million as against €59.4 million as of June 30, 2017. So this is my view of this first half. And it is with great, great satisfaction that we disclose the results for the first half of the year…significant figures that report constant growth of both revenues and profit. The good performance of Fall/Winter sales allow us to confirm our positive outlook for the second half of the year, hence, we expect 2018 to close with double-digit growth of both EBITDA and profit.

The excellent performance of the 2019 Spring/Summer collections, both for menswear with the sales campaign now finished and for womenswear which is now in the midst of the selling season prompts us to embrace a very positive outlook for 2019 which we expect to grow double-digit. The product quality always with high manual skills, balanced growth which we envisage as always wisely broken down between menswear and womenswear, amongst sales in Europe, the West and the East and among different sales channels. And our business philosophy which is centered around respect, support and love for our land.

Now, I am supposed to yield the floor to Morena, who is going to provide you with more details. Thank you.

MORENO CIARAPICA: Thank you, Brunello. Good evening, everyone. We have already disclosed the preliminary sales data on July 12th and confirmed it. And I would like to switch to Slide 11 in our presentation comparing the data of the first half of 2018 with the restated data as of June 30, 2017.

Actually, let me remind you that starting on January 1st, 2018, we implemented the new IFRS 15 accounting principle that required different accounting for some types of contracts. In our particular case, the contracts pertaining to sales made within multibrand locations managed under the concession formula. The implementation of the new accounting principle means we increase net revenues and operating costs, rents, in particular, by the same amount i.e., €3.9 million as of 30 June, 2017, without disclosing any variation in the absolute value of EBITDA, operating profit and net profit.

Let's now start with my comments on revenues. Sales at June 30th grew by 9% at current exchange rates and plus 11.9% at constant exchange rates, meaning that nearly 3 percentage points were lost because of negative FOREX impact. Once again, let me point out that we carefully had FOREX, and as you know, this is aiming at neutralizing the impact of currency fluctuations on the absolute value of EBITDA. In order to reach that objective, the total revenues estimated to be held in foreign currencies are hedged right when we set the price list for our collections, net of the costs sustained in foreign currencies.

So the FOREX impact for revenues is related with the part of sales that are un-hedged which is more or less the same amount of the costs we estimate to sustain in foreign currencies. So this undergoes foreign exchange fluctuations and this is counterbalanced and offset by the same and contrary input that foreign exchange has on cost. So the absolute level of EBITDA doesn't change substantially. Considering the current exchange rates and the current hedging situation, it is reasonable to expect by the end of the year, a negative impact of FOREX which is decreasing slightly vis-à-vis the first half of 2018, anyway it will be anywhere between 2 and 3 percentage points. And the sales are going to increase double-digit at constant exchange rates in 2018.

EBITDA for the first 6 months of 2018 stands at €46.2 million with an improvement of margins of about 40 basis points from 16.7% to 17.1%. This increase in margins is what we consider to be ordinary for the yearly…on an yearly basis for the abovementioned aspects on the impact of foreign exchange. The EBITDA performance increased by 11.2% vis-à-vis the €41.6 million of EBITDA as of June 30, 2017.

We had an absolute value increase of €4.6 million because of the good performance of like-for-like sales, plus 3.8% as of June 30, 2018, and the excellent silhouette of sales. The impact was suffered by the channel mix and the wholesale revenues from the multibrand wholesale increased the incidence from 42.3% to 43%, also because of good growth in the Greater China geography.

All of the above means that the first margin stands at 65.3%, basically in line with the first half of last year. And the incidence of operating cost was reduced from 48.7% to 48.2% and the relative amount as of June 30, 2018 stands at €130.1 million as against €121 million last 6 months. Depreciation with an incidence, which is stable at 4.4% increased by €1.2 million, up to €11.8 million as against €10.6 million in the last 6 months.

Net financial charges are decreasing. They are now at €1.2 million as against €3 million of June 30, 2017. This drop was favored by the reduction of financial burdens and the drop in the average net financial position, mainly because of the accounting of foreign exchange hedging, meaning that profits on foreign exchange counterbalance and offsets the previous losses, unrealized losses on foreign exchange, which was connected to intercompany financing in non-euro currency, which were temporary by nature because they are subject to the evaluation of exchange rates at the end of the accounting period.

Now excluding for estimates, the net…the fiscal benefits coming from Patent Box, as you see in the bottom right corner of Slide 11, net income normalized for the first half of 2018 stands at €23.8 million, up 19.7% as against the €19.9 million of 2017 as of June 30 with the tax rate, which is about 28.5% as against 29.1% in last 6 months.

The Slides 12 and 13 shows margin and operating costs, the costs of personnel from 17.5% to 17.4% grew by €3.6 million up to €47 million as against €43.4 million last year, mainly because of more personnel hired in the new DOS's for new boutiques and two conversions were operated in the last 12 months and a limited increase of human resources in the headquarters, which sustains the important ongoing development projects and in particular the digital project.

Rents account for 12.7% as against 13.2% last year. They increased by €1.5 million as against the first half of 2017. And this increase is also due to the growth of the retail network and some important expansions of some locations, store locations. We always attach a lot of importance to investments in communication, which are fundamental to strengthen and protect the brand image, both in the physical and in the digital world. The relative incidence goes up from 5% to 5.5%, meaning €2.2 million more for the increase of digital communication activities, in particular.

Let me now talk about working capital. Slide 14 shows a reduction from €141.6 million in the last 6 months to €137.9 million as of June 30, 2018, with a drop of €3.7 million. The management of inventories is also very positive. The percentage on net revenues in the last 12 months is 30.2%, which is basically in line with the performance of 31st of December 2017, when the amount was 29.8%, which we consider to be healthy and structural for our business model.

Inventories account for €161.5 million as against €158.6 million as of last year. So it's a limited and structural increase of the absolute value due to the select new openings of new direct stores, some conversions to the DOSs expansions and new spaces directly managed within the department stores, luxury department stores, which is well offset by the positive impact of sellouts.

Trade receivables stand at €64 million as against €54.4 million as of June 30, 2017. This increase is mainly due to a €6.8 million increase in the second quarter, because of the bigger incidence of wholesale sales as compared to the second quarter of 2017. Also, we decided to extend to the important and historic multibrand Russian customers the same payment conditions we use in established markets. Whereas, in the past, a part of the payment had to be paid as early as when orders were passed.

For this reason, the performance of trade receivables as of June 30, 2018, should be seen on in the light of the credit position we have with wholesale, Multibrand and Monobrand customers that are still having to pay their invoices, and we actually stand at a physiological level.

Trade payables stand at €69.8 million as against €61.9 million of June 30, 2017, because of the physiological increase, which happened mainly in the second quarter of the main costs related to an increase in the business volume in the raw materials, third-party manufacturers and communication. Other net credits and debts are negative by €70.8 million as against €9.5 million of June 30, 2017, and they are mainly related to the fair value assessment of the currency hedging instruments.

Now let me talk about CAPEX and net financial position. In the first 6 months of 2018, and we're at Slide 15 here, CAPEX invested was €25.2 million and they are a part of the multiyear plan that we managed to make the company contemporary over the long run. Commercial CAPEX in the first 6 months of the year was €18.1 million, mainly for select store openings, the expansion and renovation of showrooms that are always very contemporary, the increase of sales service in luxury department stores, and the expansion of prestigious boutiques in the most important shopping streets in luxury capitals globally.

In particular, I'm referring to the opening of the new and bigger Monte Carlo boutique that opened in July. The CAPEX invested for production, logistics, IT and digital was €7.1 million of which €3.3 million for digital and IT infrastructure whereas the remaining €3.8 million was invested in constant renovation of product facilities which allowed us to make all activities managed with very renewed and state-of-the-art logistics facilities.

On June 30, 2018, we also acquired a minority stake in our Russian subsidiary for €6.5 million so that the parent company now holds 100% of the Russian subsidiary against 62% before this deal. So this had an impact of the net financial position of June 30, 2018. The size of this deal has been accounted for under the net assets reserves in line with IFRS accounting principles.

Slide 16 shows that net financial position goes down to €44 million as against €59.4 million of June 30, 2017. This decrease is mainly related to the generation of cash from operating businesses and a healthy management of the net working capital. Net financial position is normally at its peak between June and September because of the season performance in sales and as usual, it will go down in the last part of the year.

Considering what I have illustrated so far with the investment level for 2018, which is in line with what we explained last March, plus the purchase of the minority stake of the Russian subsidiary considering the improvement of the working capital, because of all those reasons, we expect the financial debt for 2018 to be in line with 2017. Let me remind you that as of December 31st, 2017, the net financial position was €16 million.

Now, that's all for me, and I'm happy to yield the floor back to Brunello.

BRUNELLO CUCINELLI: Thank you. I would like to give you some brief overview of the bigger issues for 2018. Now 8 months have gone by, things are doing very, very well. The winter connections in multibrand stores that are always very important for us to understand consumer taste and in monobrand stores too have an impact which is very young and it's about luxury, it's about chic, but we are very happy to see younger and younger customers. So as far as the brand is concerned, we think it's commanding a very good atmosphere around itself.

I would like to point out that, as Moreno said, we bought a 38% stake in our Russian subsidiary. We are very happy with that deal, you know, these customers are very, very important right now. They tend to be in their 20s…mid-20s and at times, they were a bit displeased when we asked them to pay 30% in advance.

Let me tell you something, which I found very interesting, again, nice. There is a very important customer of ours, he only buys from Italians, and he has a company in Italy. And during luxury meeting in Milan, he said something interesting. He said, you know, I've been buying from you Italians for 25 years now, and you always ask me to pay 30% to 40% upfront and I know you are not asking your other clients to do the same and I don't understand why? You know, treating Russian customers just like the other customers we serve globally is much, much nicer for us. And also, you know, for us personally, payments have never been a problem in the company. I know it's a privilege to work without any kind of problem in payments. We did incur losses on credits in our history, but it was always contained to something like 0.1% or something. So this is a privilege for us. And so we imagine 2018 is going to be healthy, good and strong and we expect profit to grow and EBITDA grow too.

Let me know speak of 2019-2020, the projects, investments, expectations. Generally speaking, we would like to confirm everything we have been reporting during the May conference call. I'd like to dwell on 2019 for a while now. For 2019, the Spring/Summer collections are nearly finished in terms of sales campaigns. Womenswear is halfway through the sales campaign, menswear is completed. And our impression is that customers think the collection is young and sophisticated.

Let's talk about menswear first. I think menswear is a very, very interesting collection right now. So we have completed the sales campaign for menswear. Our impression is that the collection is young. It's sophisticated, it's very Italian. There are many details that really speak of an Italian collection. And this is really important, especially for what is a bit tricky right now which is suits. Businessmen suit is very difficult right now, I mean, people always ask themselves what will men wear in the next few years.

What I think is…during the weekend people are quite sporty in the way they dress, of course, wearing sporty things make people look younger, but then Monday morning comes and people need to wear an elegant suit to go to the office. But an elegant suit would actually make people look a bit less young, a bit more conservative. So this is why we decided to work hard on this. We want to work on the actual cut of suits, of the styling with a tie, without a tie [technical difficulty] temporary fabrics suitable for each season, even the sales associates that work in stores need to actually provide customers with advice on how to style and how to wear suits a bit like consultants. We do feel that suits are going to go through a renewed success in the near future.

You know that recently an American publication interviewed us and in their best-of-best section they compared us and their beloved Ralph Lauren. And what they said eventually was that Ralph Lauren and Brunello Cucinelli have shaped the last 30 years of fashion which is extremely pleasing for us, of course. So this American magazine said that us and Ralph Lauren were the 2 fashion designers who redefined the boundaries of menswear in the last 30 years. Ralph Lauren is the main supporter of the iconic American style, whereas the latter, that to say ourselves, is the pioneer of shaping the 21st century. And of course, we are very pleased to read that.

Now, I'd like to report also on a small new very important project, which is the Solomeo Sartoria, the tailor shop of Solomeo. So what do we mean when we speak of the tailor shop of Solomeo? Actually, we do made to measure garments, but in a way, we are trying to make them look younger. So if you go to a store, the tailors you find at the stores are people who are in their mid-30s. So normally, they tend to be younger in terms of their attitude towards tailoring. Tailoring bespoke tailoring is classic by nature. Actually, bespoke tailoring was first created and first invented to hide the defects of people's bodies. But normally, suits were so wide that you didn't see the body at all.

Now, we started this beautiful project in our top stores globally, but the idea is that of doing bespoke tailored suits, especially for younger customers because I feel there are many, many clients in their 30s or mid-30s or 40s that are hyper rich, and they want bespoke suits not because they need to hide their body, but because they like the idea of having a suit, which is tailor-made for them. So you walk into the store, you find a young tailor, who is going to provide you with the right advice and may want to tell you that this year a tacked suit is more fashionable than a pinstripe suit. So this is the idea.

Personally, I'm 65 years old and I would not really like to receive advice from someone my own age. I would be much happier to talk to a younger tailor who can actually advice me whatever is younger and more contemporary. It's a kind of friendly suggestion that we expect from the tailors. And so this is the menswear project, which we call La Sartoria di Solomeo, will be present in 25 stores. Now the womenswear collection has been presented about a month ago. We're particularly pleased with it.

The multibrand stores assessment is very, very important. Then, of course, at the end of September, during the Milan Fashion Week, we'll receive the assessment of the press, which is just as important. However, the first assessment we had from the multibrand stores are very, very favorable. The monobrand stores were very favorable too, but you know we value the judgment of multibrand stores even more.

And I'd like to point out again that many people felt this is a very younger collection. Just like in menswear, we have the possibility and the desire to dress a young person, who is chic and, of course, pretty wealthy because the average price is pretty high. So we expect the press to come to the Milan Fashion Week and to pass a judgment on our collection. But we would like to convey you the very positive outlook we feel for 2019. So we still look at good growth. We're looking at double-digit growth for EBITDA and sales alike. However, I'd like to say something on CAPEX, on investments in general, and not just for this month over next year in general.

So we believe that generally speaking, the web tends to mystify things, so showrooms need to be renovated and refreshed every 6 months or so. Otherwise, the collections we are presenting doesn't look fresh because the showroom doesn't look fresh enough. So what happens is that clients walk in, they take pictures or videos of the showroom and if there's nothing new, next time they walk in, even though the products are new, the whole look of the collection wouldn't be that fresh.

Let me just make a practical example here. You know the famous pretty menswear show, 4 to 6 years ago, those were redesigned at an average every 3 years, whereas, today, they are redeveloped and redesigned every single season and the same is true for our stores. We need stores to be modern, to be chic, to be contemporary at all times and this to true for collections and this is true for 2019 in general.

Now, I would like to talk about the digital project we're embarking on. We're particularly happy with the whole project. And we know we are artisans and we love to be artisans of the web too. So we have built ourselves the Western market, which is now very good and we are starting work on something special to properly tackle China and Russia. Both markets have some commercial issues and logistics difficulties and administration challenges. Of course, 6, 7 months down the road, we are supposed to be more or less ready.

We know from the website traffic that the Chinese customers are extremely interested, but we should now have an opportunity to ship to that market as easily as to other markets too. We are very, very pleased to go back, in September. I was personally invited to go back to that very important meeting in San Francisco, where both of us will be invited and once again, we'll talk about human privacy and technology. And I'm extremely proud of that and very happy of that, also because the connection with Marc Benioff has become stronger and stronger in all markets.

So before we part, I would like to say a couple of words on this event, which is so important for us, which is going to be held here on September 4, with the national and international press. We expect about 500 journalists here, which is certainly not bad. So the first thing we hope is, it's not going to rain, because hopefully, everything is going to happen outdoors. And so both in the countryside and in the piatza, we will enjoy a beautiful outdoors. As you may know, the restoration works both for the hamlet and the periphery are nearly finished. I would also like to point out as usual that all those works have been performed by my family's foundation, because we would like the company to work exclusively in its headquarters and in its gardens, whereas, all the rest is being taken care of by my family's foundation.

So this way, getting, frankly, pretty extensive. It's been going on for 30 years. But today, we're really happy to see that these 500 journalists will come and see the outcome of this work. And they will see both the town and the periphery. So they will be able to see both the town and the valley. So you know that the most burdensome thing here was the acquisition of those 50,000 square meters, 100,000 cubic meters of industrial sheds. But this actually totally changed the look of the periphery around our little town, around the hamlet.

So if I look at the company for next 200 years, of course, it's not little, I see that as a possible engine of development for the whole valley. So what have we built in the Valley? And by the way you are all invited to come see the valley as soon as you can. So first of all, we have built a theater which is a kind of a layman's temple and then in the center of the valley, we have built a vineyard, which is a bit like a symbol of Mother Earth, and I think in 1,000…1,500 year's time, it will be still standing there. So we think it's a kind of a monument to men's dignity. And I think it's going to stand there in the next 1,500 years, like Victorious [indiscernible] told us it's built with a technique which is a bit like the colosseum, with the same technique and I am sure it's going to stand there forever.

So I always come around and look at it, and I tell my people, wow, keep it going well because I came around and walk around it at nights. If there is anything that doesn't go well, I notice immediately. So I really hope it's going to be a special evening. It's going to be a special communication event, but it's also going to display our company's culture to the whole world. We wanted to show you the way we work, the place where we work, the value of our land and what it means to work in a little town, in a little hamlet, because I think we can actually go back and work in little towns because we are fully connected. It might have been more difficult to do that before the Internet. But why can't we work in small towns now? I mean, it's easier to get there. It's more quiet and silent, we're connected anyway.

So we would like our 500 journalists to bring back home an idea and a vision for the next 500 years of the company. We would like our guests to go back with some ideas on the big issues of life, the white balance between profit and the common good, a kind of humanistic contemporary capitalism and we would like our guests to take back home our concept of being custodians of old creation, may be because of my age, but I think we are a temporary custodians of the places we inhabit.

So at the end of everything, we would like to convey something to our guests. We are trying to do our things well. We are trying to work in full respect of human dignity. So even before September 4th, we would like to thank you all, maybe some of the journalists are listening to us now. And I would like to thank you for supporting our corporate culture. We would like to thank analysts for sharing our corporate culture too. We would like to thank shareholders and hopefully, we will be able to meet their expectations at all times. We actually always try to work based on those big ideals on which we have based our company and our great ideals are a beauty, humanity and truth.

So this is pretty much everything from me now. I wish to extend all our thanks and warmest thanks to you. Come and join us and see as soon as you can. Thank you. And hopefully it won't rain.