

Brunello Cucinelli

"First Half 2019 Results Conference Call"

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MODERATORS: BRUNELLO CUCINELLI, CHIEF EXECUTIVE OFFICER
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OPERATOR: Good evening. Chorus Call operator speaking. Welcome to the Presentation of the First Half '19 Results of the Brunello Cucinelli Group. I'd like to remind you that all participants are in listen-only mode. Following the presentation, there will be the opportunity to ask questions.

Speakers will be Brunello Cucinelli, President and CEO, Moreno Ciarapica, CFO and Pietro Arnaboldi, Head of Investor Relations and Corporate Planning. In order to receive help from an operator during the conference call, press "*" press by "0."

And now, I'd like to give the floor to Brunello Cucinelli. The floor is yours.

BRUNELLO CUCINELLI: Here we are and welcome everybody. It's a pleasure to speak to you. I hope you have had some interesting and relaxing holidays.

Well, as usual I'd like to say that personally I am very fond of these conference calls, because it is basically a time when we can basically talk to each other, discuss things and also draw conclusions, positive or negative.

But before starting, this time, I'd like to convey to you my big satisfaction...my satisfaction in particular for this historic agreements that the important list of companies in New York have signed a few days ago, and I'd like to read out what it says.

In order to create value, one needs to also take a look at the environmental impact, the respect of the community and the dignified conditions offered to employees. So I wanted to congratulate all these companies with no

exception, and I think that maybe this is the great step in the 21st century. So it is a great thank you from my behalf, because it is a great gift that you have done to the coming generations.

Well this call is very important for us, because it occurs at a very special time for mankind. So thank you again for being here. So as usual we are all here for you, and I'd like to give you the financial highlights and then the CFO, Moreno Ciarapica will dwell on the details, will give you a bit more of a drill down, then I'll resume the floor again in order to first of all give you a visibility about 2019, so we are at the end of August already. The important initiatives ongoing, and then I'd like to give you quite a solid visibility on 2020 because the spring/summer collections have reached their conclusion and also dwelling on the third...3-year period until 2021.

So I'd like to read out the financial highlights. Net revenues €291.4 million plus 8.1% at current exchange rates, 7.2% plus at constant exchange rates, vis-à-vis €269.5 at 30th of June 2018, EBITDA €49.9 million and 17.1% on sales, net profit €22.8 million with 7.8% incidence on sales. Italian international markets plus 9.5%, Italian market plus 1.1% sales, Europe plus 9.7%, North America 9%, China 15.9% and the Rest of the world 5.3% all plus positive territory. Increase in all distribution channels, retail 12%, monobrand, wholesale, adjusted 1.7% and multibrand wholesale 6.5%. Investments €18.8 million and net financial position €46.6 million. This is my comments on the results.

We are fully satisfied with our first half results in terms of both financial performance and the brand's image and buoyancy. We like to be identified as a Made in Italy ready-to-wear luxury brand. Since it is the end of August, we can very serenely confidently envisage a particularly positive 2019 with revenues increasing in line with our long term

expectations. The well-known [8%, annual growth resulting...well hopefully obviously, in double sales over the next 10 years. Along with more than proportional increase of EBITDA with healthy and rising profits.

The feedback following the order intake for the new Spring/Summer 2020 men's collection, as well as, the first kids wear collection has been very, very positive. The latter is the great project we have put a lot of trust and energy in. The order intake for the Spring/Summer 2020 women's collection has been just as good and it is drawing to a close.

As you know it is very important the fact that we work. In August we are open for business. The current taste of the market a very important element at least for us is becoming very similar to us. So we keep claiming the importance of investments to support the brand and the above strengthens well sounded optimism for 2022, when we expect further growth in revenues and profits in line with our long term guidance.

And now, I'd like to give the floor to the CFO, providing you with the details, and then I will resume the floor again.

MORENO CIARAPICA: Thank you, good evening ladies and gentlemen, and it's a pleasure to hear from you. Following the communication of the preliminary results, on last July the 11th confirm the final results. I'd like to start from Slide #10, highlighting the figures as of 30th of June 2019 have all been reprocessed and presented eliminating the effect generating by the application of the new IFRS 16 principle in force as of January 2019 in order to allow for the comparability of figures with June the 30th 2018. The impact of the IFRS are reported in the slide of the annexe on Page 18 and 19.

As of June 30, 2019, sales grew by 8.1% at current exchange rates and 7.2% at constant exchange rate with a positive impact of currency that was just below 1%, because of our very careful hedging for foreign risk, because as you know it's objective is always that of neutralizing the impact of currency fluctuation on the absolute value of EBITDA.

Considering the current level of exchange rates and hedging...exiting hedging, it is reasonable to expect a positive FOREX impact in line with the trend of the first half. The EBITDA in the first half of 2019 amounted to €49.9 million with €3.7 million growth and margins in line with last year and amounted to 17.1%. The first margin increased significantly i.e. 130 basis points from 65.3% to 66.6% due to a positive impact of like-for-like growth i.e. 3.7% as of June the 30th 2019 and the incidence of the retail channel shifting from 49.7% of last June to 51.5% of this June.

This figure increased, thanks to the new direct spaces among which 3 boutique openings and 2 convergence the last 12 months, some extensions of existing boutiques and 5 new spaces directly operated in concession within the luxury department stores. These spaces were previously managed with the wholesale formula.

Operating cost also increased mainly personnel and rent and these costs have to do with the development of the business, the higher incidence of the retail channel and the new initiatives, in particular the natural extension of the collection offered to kids wear starting from the next seasons and also the made-to-measure suits initiatives and the digital investments.

The incidence of DNA increased from 4.4% of June last year to 4.8% June this year, and this...the latter value is in line with our expectations for the

full year vis-à-vis an incidence at the end of 2019...2018 that amounted to 4.6%.

The incidence of net financial charges amounted to 1.0% vis-à-vis 0.4% of last June, this value had been positively impacted by devaluation of put options and minority stakes of subsidiary companies. We'd like to highlight the incidence of net financial charges had been of 1.1% of 31st December, 2017 and 0.8% in the 31st December, 2018, in line with a full year expectations.

If we exclude the estimated tax benefits ensuing from the so-called Patent Box highlighted in the box on the bottom right on Slide 10. The adjusted net income in the first half 2019 amounted to €22.8 million vis-à-vis €23.8 million last year with a tax rates adjusted at 31.1%. This adjusted tax rates at the end of last year amounted to 29.5%. At the end of the year 2019, we expect an adjusted tax rate in line with the incidence reported as of 30th of June 2019.

As you know, our group...most of the group's taxable income is generated in Italy, and the increase of the taxes in the first half was impacted by the affects of the repeal of this...started this year repeal of the ACE legislation which is the Economic Growth Aid.

And then now moving on to the working capital on Slide 13, there was an increase of its incidence from 25.8% to 27.9%. As to inventory incidence from 30.2% to 31.3%, is linked to the openings of new direct boutiques extensions, conversion from the monobrand, wholesale channel to the direct channel, and the new spaces directly managed within the luxury department stores.

On top of this, there was...they were the following factors, an expansion of collections to children, kids-wear starting from Spring/Summer 2020, but with an initial capsule collection for Winter 2019 in selected spaces starting from the end of October, then made-to-measure suits and the digital initiatives.

Considering the healthy management of cash collection, the increase in trade receivables incidence from 12.0% to 13.9% is ascribable to the development of the wholesale business whose sales as of 30th of June 2019 improved by 6.5%, and it is also due to the increase of retail sales within the luxury malls and the payment terms.

The organic increase of trade payables incidence from 13.1% up to 13.9% has to do with the increase in the business volume in the first half, and in particular it is due to the new initiatives besides the new important investments including communication investments.

As to the other credits and debts, negative by €19.8 million vis-à-vis €17.8 million last year and they have to do the valuation at far...fair value of the outstanding hedging derivatives.

Investments and net financial positions, investments on Slide 14 of our presentations amounted to €18.8 million included in the multiyear plan to maintain our company modern over the long time supporting our presence on the market, and availing ourselves of the most innovative and modern productive logistic and IT structures.

Commercial Investments amounted to €12.9 million, other investments €5.9 million and the latter includes investment for production logistics and IT digital.

In 2019, the bulk of investments happens and occurs in the second half of the year, with an incidence of investments on the total revenues amounting to 8% approximately as already mentioned previously.

On July the 29th, as our long standing North American partner has accepted to sell their minority stake, we have acquired 30% of the share capital of the subsidiary company Brunello Cucinelli USA retail amounted €4.5 million and 30% stake of the Brunello Cucinelli Canada company €2.2 million. These transactions enabled the parent company to hold 100% stake in both companies and the effects will be accounted for in the equity reserves in compliance with IFRS. And the level of expected debt as of 31st December, 2019 will increase by the same amount.

The net financial position as of June the 30th, 2019, Slide 15, amounted to €46.6 million against €44 million 30th of June last year with a positive cash generation of the operating activity and a very healthy management of working capital.

The NFP achieves its usual peak in between June and September and then it drops towards the end of the year, therefore the debt expected at the end of the year including the new ongoing initiatives the impacts on the working capital. So the debt is expected to be between 5% and 6% of total sales.

So this is the end of my presentation, I give the flow back to Brunello. Thank you for your attention.

BRUNELLO CUCINELLI: So here we are...what about 2019, because, of course, it is drawing to a conclusion. In terms of products, it is a very important momentum for us. There is a very good momentum as I was saying the winter collection sales have set-off to a good start. And an important thing is that we are

shifting towards men's and women's wear taste that is very suitable to what we feel is proper.

You see, following many years of strong taste, we are now moving towards something that is less garish, more chic, more understated, and this is basically our nature and we are happy with that because this way we can work with more serenity, because for the less young among you at the end of the 80s there were 2 exceptional Italian brands, Armani and Versace whose taste was exactly the opposite between the 2 and 5 years, one was winning the following 5 years the other one was.

So we believe...and you see this is a very strongly perceived feeling, there is a lot of demand for luxury ready-to-wear. Ready-to-wear mind you and for us, of course, this is very positive news. So we can say that in the coming years...well in terms of taste, these years should be very favorable, very much in keeping with our taste. So we have just started our first discussions on the 2020 winter collection and we have stated the same. We have to keep pursuing novelty a special visual merchandising, able to describe your world, stores and showrooms must be very fresh new and stepping into a store must be a great experience, experiencing the product, the manual skills, the creativity.

This morning, we said something that I find very special. Undoubtedly, you see as time passes basically objects acquire, take on more value and this is true, and this is something that you especially you young people value you see. I'll just give you an example just a couple of seconds, there's someone here in the village who loves cars, and he says to me Brunello, I really like this car, because I changed one of its lights, I changed this and that some different parts. But now since it is more difficult to actually act up on things with your own hands, you feel that

these things belong to you a bit less. And the fact of being able to touch things is very important.

Then the internet, we have a great organization, we are very much poised and prepared for the coming years. This is actually a culture for us not so much a technology. And we would like this technology not to steal our soul. We keep repeating this.

And now, I'd like to devote 3 minutes to the value of physical stores. We actually attach a lot of importance to the brick and mortar stores, especially for the luxury segment. Of course, it must be very welcoming, but what really matters is that the people working at the store must be fascinating and charming.

We basically called them our brand ambassadors, the sales assistance associates and because of this we have started a school here at the village. You are well familiar that with arts and crafts schools and by the...by the way we're going to start this course for the Fashion Lady...women's wear fashion it is so-called Premier in French. So basically premier are those who are given the sketch by the designer and then they produce the garment. So we have started this brand ambassador classes. Now for the time being just for men's because it is very important that when you basically step into the physical store, you are met with someone who is very friendly, elegant, refined, representative, and brand ambassador, someone who knows the brands down well, so this is a new initiative.

And I'd like to mention 2 further important initiatives. The Sartoria di Solomeo that you are already familiar with and it has already...it is already developing nicely. We are already very satisfied with this initiative, because we have many young people who opt for a made-to-measure suit or jacket, which means that maybe if you have a patent

textile, so not the whole suit just the jacket you are 35-year-old and you wanted made-to-measure. This is precisely...this was precisely our aim last year. You see the New York Times defined us as those who were able to dress the new 21st century CEOs. So we were very pleased, so the Scuola Sartoria di Solomeo is really developing nicely, taking on its suitable identity.

So as you might know 2.5 years ago, what we started conditioning...reconditioning garments. We have a great team, skilled team, and we are also very pleased to recondition the garments made by other brands and we're very happy with that because if you actually recondition them you have a new garment in your hands. Of course, this is especially true for menswear because if you have a great coat dating back to 8, 10 years ago, maybe the lining is ruined, we can replace the lining and the coat is brand is new, is as good as new. For example, I usually wear the same 2 coats, 1 is 18 years old, the other one 20, I change the lining twice because that's what's basically lasts less.

I started my business with colored cashmere. But also because I wanted to make products that were never to go to waste. I do not like to throw away things. I bought a bicycle and my hope is for my granddaughters to use this bicycle one day. So maybe you have a small flaw a small defect and you go to the Beverly Hills tailors shop. But since we have our true factory here you send...you ship your garment to us, it takes one day to mend and then we ship it back to you. And this is very interesting.

Another project ongoing, we have devoted a lot of energy to it. It is the kids wear collection. We have dealt with this project in a very serious manner 250 items for boys and 250 for girls. But numbers aside, I believe that this line is very important for the brand for its image. There will be some dedicated spaces in stores for these items and at run rate we believe

that kids should account for 4%-5% of revenues. But what really matters besides sales what really matters is the identity of the taste. And we have tried to achieve some sort of mini-me ready-to-wear. So we are very happy with this children collection for the identity for the taste and hopefully for sales too.

And then the internet, you are already familiar with it. We still attach a lot of importance to this culture. In China, we have our own warehouse China, on China. And so, we...at the end of July, we decided to restyle the web site we had created 2.5 years ago, so 7 years for the first web site and the second one we felt the need to upgrade it to revamp it 2.5 years down the road.

So at the end of September beginning of October there will be the e-commerce on the one side, and then on the other side we have tried to clearly identify the great themes that we value human sustainability, harmony with creation, and the idea of humanistic capitalism, because I don't want to repeat myself, but what happened 4-5 days ago in America, you see, I was very, very favorably impressed by it, I was struck by it. So this website will show very clearly what the values are on which our company rests. And that's basically what you know, and those investors were asking from us because at the end of the day, I have the following impression.

We're just talking about it today; we want to make a fair profit. But we also want to be useful and in Italian useful, and profit is the same word, we wanted to do something useful for the world, we wanted to make profit for the world to profit from it, because maybe the positioning of the company comes before the positioning of the product, obviously. So progress and work, the company doesn't work either. But if the product

works, the company positioning has an extremely important value. We have made a great investment in London, a store to be opened next year.

We are very happy, very pleased. And we are so happy with the surface, 500 square meters. And this is the typical size for a great store in great position, a great prime position. And of course, the rent was not that low, but we never had this degree of low rents in Milan or New York either. But I believe that that great location is very important for brands because it will resonate also in the rest of the world.

Another important transaction, well Moreno told you about, we required 30% of the American Company. So the...you see the ideal conditions happened to with Massimo, Massimo is 52. Now he's been with us for 20 years, he has always been a man in the United States, in North America. And he's been with us for 20 years, as I said, and we hope that we can keep managing together this great market, top markets, 33%, by conveying this culture, this Italian American culture that is always very much appreciated.

So to wrap up, we think that 2019...we think that 2019 can be a very positive year. But for us, it is a year with great change for mankind. You see, I think that this overall idea of sustainability pervades everything. So we expect €600 million revenues in the years ahead and more than proportional EBITDA and a fair profit.

And just a couple of words on the tax rate, on average of the last 7 years of as a listed company, we paid 30% more or less, Moreno, right? But over the last 5 years, the Patent Box, thanks to Patent Box, we saw the tax rate drop to a 22% to 24%. What I mean is that we do our business in Italy. And you see I'm very much in love with my Italy, I want to keep manufacturing in Italy, and so I'm very pleased with this tax rate. So if at

the end of the day, the result is approximately 30%, it's fine by us, then dividend 2019, the 10% more, and they should represent a 45%...account for 45% of our profits.

So investments around 8% for the year. But as we said a year and a half ago to remember when we mentioned that may be luxury and fashion, maybe because of technology or others, well. I think that it needs massive investments. And then personally speaking, I'm always scared of my brand aging. So I keep saying, that I've always been scared of debt. As you know, my father says that debt works on Sundays too. But be careful, we must always be modern and contemporary. We very often mentioned the fact that you need to revamp your showrooms every 6 months, your website, we thought it would last for 5 years, whereas we have to upgrade it up 2.5 years down the road. So the net financial position could be around 5%, 6% of revenue.

But honestly, speaking, we do not feel that we carry that much debt, which means that if an important opportunity arises, we might seize it. For example, it's been...we have been looking for spaces in Paris for many, many years. And we haven't achieved results yet. But if it does happen overnight that a space becomes available, then of course, we will seize the opportunity. Of course, you can't always budget for unexpected opportunities. So 2019, a very interesting year.

And now a couple of words on 2020 because we have a very high important numbers, in terms of orders for men's, women's and kids. Since the collection has been extremely successful by...with multibrands and the press, we feel that the collection is very well liked. And if the collection receive a positive feedback, then you basically face the following year with a smile on your face because of the positive feedback. That's why we feel that we're very confident about 2020.

For 2020, we envisage the following, plus 8% revenues, more than proportional EBITDA, more than proportional profits. Yes, I wanted to mention something on this. When I talk about net income, of course, that's because I believe my consideration of the tax rate, but of course, if the government changes something this does not depend on us. So 8% investments, as for dividends, we would like to achieve 50%, the optimal level and net financial position improving in 2020. Because 2019 is the most important year for investment, then 2021 and of the 3-year period and we keep envisaging for this year plus 8% sales, more than proportional EBITDA, the same for-profit, dividend 50% as established and an improving net financial position.

So to conclude this call and before leaving the floor for questions, we'd like to say that '19, '20, '21 the first 3 years of this 10-year plan are very important years in terms of numbers. But my dear friends, they're also very important in terms of taste, because we are moving towards that kind of taste that really represents the identity of the brand. So we work at peace knowing full well that there are great changes taking place in the mankind at large and we have to go with the stream. So thank you very much and we open floor for questions. We are available.