Brunello Cuccineli Group

"Full Year 2017 Results Presentation Conference Call"

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OPERATOR: Good evening, Chorus Call operator speaking. Welcome to the Presentation of Year Results for the 2017 Fiscal Year for 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 some Q&A from the financial markets. Speakers will be Brunello Cucinelli, President and CEO of the company, Moreno Ciarapica, CFO and Pietro Arnobaldi, Head of Investor Relations. In order to receive help from an operator during the conference call, press "*" followed by "0."

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

BRUNELLO CUCINELLI: Good evening, ladies and gentlemen. Well, first of all, I would like to thank you all first and foremost, investors, analysts, journalists, and we really want to thank you warmly from the deep of our heart for everything that you have given us in the last six years when we have been a listed company, and also forty years of us as a business, as a Company because we celebrated our 40th anniversary just a few days ago.

In my opinion, we have enjoyed the experience of life and work marked and fought with humanity, a team respect and the way that we have to speak to each other, to interact with each other, has always brought us to make important decisions whilst respecting the creation along the process and also respecting the great values of the human being, because our life has always been human centric. And I say that the great values are always the same, justice, truth, beauty and love.

Last night, I was playing with my granddaughters, Ricardo's and Camilla's daughters and I always have so much fun with them, they amuse me. And then immensely I was hit by this beautiful piece of music, two Koreas are meeting to make peace. So I basically rediscovered a lesson that I had read some time ago of a Russian, I think at the beginning of the 20th century who at a certain point sent this letter to his children. And I'd like to read out a couple of paragraphs for you. And I was really touched by these words, he said look at the stars more often, when you feel sorrow in your soul, look at the stars or at the blue sky. When you feel sad, when someone offends you, when you struggle to accomplish something or when you are overwhelmed by your inner storm, get out and stare at the sky. That's when your soul will find peace. Pavel Florensky. And I have to say it is a really beautiful expression and statement.

So thank you for your attention and I'd like to do the following. I will give you just the highlights of the Company, then Moreno Ciarapica who is sitting just opposite me will drill down to a few more colors and details, then I resume the floor and I'll give you some visibility on 2018, some visibility on 2019 and '20 planning. Then we will be talking about products and markets, and last but not least, the fascinating world of the online business.

So net revenues, €503.6 million, plus 10.4% at current exchange rates versus 31st December 2016, 10.9% was the improvement because of exchange rates, EBITDA €87.5 million, plus 11.8%, Net profit €42.1 million, plus 15.4% excluding the patent box benefit. And I'd like to make a digression or an addition here. You see from the aesthetic point of view, we prefer to highlight the 13.4% adjusted profit and not the 41.4% including the patent box benefits because you see frankly speaking, it would not look good to show the great leap of profit in a year whereas we have always been supporting chasing a fair profit and moderate growth. So this is what I wanted to say about profit.

Then we enjoyed significant growth in revenues in all geographies, Italian market plus 11.2%, Europe plus 10.6%, North America 6.6%, but it's because of the FOREX situation, Greater China 36.2%, rest of the world 5.2%. Then sales improved in all distribution channels, retail monobrand 19.6% plus, wholesale monobrand plus 1.6%, wholesale multibrand plus 6.2%. And then there was an important reduction on the net financial position which dropped to €15.7 million as of 31st of December vis-à-vis €51 million last year. Investment plan, CAPEX €35.7 million, mainly commercial in nature always focusing on safeguarding our brand both in the brick and mortar channel and the online one, but we will be dwelling on this later on. And the BoD will propose the distribution of €0.27 a dividend per share equal to 35.9% payout ratio.

So this way I think that I have given you an overview and I'd like to close by saying that 2017 has ended reporting once again a particularly pleasing results and showing a growth path that is consistent, moderate but sound year in, year out. This growth is pursued hopefully both in the physical and online world in a balanced manner and it has resulted in our business crossing the €500 million revenues threshold, an achievement that makes us very, very satisfied.

Then another important point, the good performance in our Spring/Summer sales, the excellent sales campaign in Fall/Winter 2018 which is now coming to an end, and the very special feedback from the national and international trade press seem to indicate that yet another positive year lies ahead featuring double-digit growth in terms of both revenues and profits. Our appealing development projects and the great brand protection efforts on line are the pillars of our daily work, a work that fascinates us and enables us to enthusiastically pursue and seek a good life.

So I'd now like to give the floor to Moreno Ciarapica, who will be giving you more colors and then I'll resume the floor later on. Thank you.

MORENO CIARAPICA: Thank you, Brunello, and good evening, everybody. Following the release of preliminary revenues on January the 8th that were confirmed by the final data, we now move to Slide 11 of our presentation. And I would start from the improvement of EBITDA margins that went from 17.1% last year, an adjusted figure excluding the non-recurring personnel cost amounting to €1.5 million and then move to the current 17.3% with an increase of 20 basis points approximately. We consider this 11.8% growth of EBITDA a healthy one and this growth goes together with the 10.4% increase of net revenues in line with the indication that we have always communicated to the financial market. The increase of EBITDA margin is strictly linked to the first margin increase that went from 65% to 65.2% against an incidence of operating cost on sales stable, 48.8% [indiscernible]. Amortization amounted to €22.7 million increasing by 13.3% versus €20 million in 2016 with an incidence and impact that moved from 4.4% to 4.5%. We expect a slight increase of incidence at the end of the year 2018 due to higher amortization and depreciation that will be in the financial statement due to the investments in 2018. The impact of our net financial expenses moved from 0.7% to 1% considering a significant reduction of the average net financial position and this increase has to do with the FOREX development.

We would like to remind you that this increase is mainly due to the accounting of FOREX hedging and in particular, the accounting of the unrealized losses on FOREX having to do with an inter-company funding in foreign currency that are temporary in nature because they are subject to the valuation based on the exchange rate. As to 2018, considering the forecast of all financial institutes whereby the volatility of FOREX could not be as strong as in 2017, where it reached its peak, we expect a reduction of net financial charges.

Let’s now take a look at 2017 net profit excluding as Brunello was saying the benefits ensuing from the patent box linked to the agreement with the Italian inland revenues authority for 2015-2019, benefits for 2015-2017 amounts…have amounted to €10.4 million, €4 million of which having to do with the last year. 2017 net profits excluding the tax benefits of the patent box amounted to €42.1 million, as shown in the box bottom right on Slide 20…11 and it displays 13.4% growth vis-à-vis the net profit of €37.1 million in 2016 with an ordinary tax rate that dropped from 30.5% to 29.2%. We consider this tax rate as ordinary and foreseeable also for the next few years net of the future benefits relating to the patent box. And for 2018 and 2019 they will be accounted for in the relevant year and they will only be quantified when drafting the relevant financial statement. We could imagine more or less the same amount as in 2017.

Now moving on to Side 12, we take a look at the first margin operating costs, with an increase of the first margin driven by the business evolution, the like-for-like sales results, they were very positive and the channel mix. The weight of retail revenues went from 49.6% to 53.7%.

2017 like-for-like amounted to 4.4%, whereas the like-for-like of the first half of the year…the early month of the year between the January the 1st and February the 25th amounted to 4%, performance in line with the very same level between 3% and 5% that we have always considered as sustainable and appealing. The like-for-like developments as already anticipated they fully represent the performance of our collections on half year basis, and this is the reason why starting from this year, we will share the like-for-like performance as of June the 30th and December the 31st.

The operating cost increase was in line, the business performance and the incidence is stable at 48%. The incidence of personnel costs went from 17.5% to 17.6% upwards, and the reason was the arrival in the 2017 consolidation perimeter, the arrival of the people staffing, the new direct managed spaces 4 conversions and 4 net openings and the 5 shop-in-shops in the luxury department stores of Holt Renfrew in Canada which were previously managed with the wholesale formula.

Rents…the incidence of rents went down from 12% to 11.7%, and the increase by €4 million from €55 million to €59 million has to do with the development of the retail network including the aforementioned 4 opening and 4 conversions besides some extension of shops.

Investments in communication went up from €24.7 million to €28.7 million with an incidence on sales moving from 5.4% to 5.7% with acceleration in the second half of the year driven by the investments on the digital channel.

Other general operating costs went up from €59.8 million to €65.7 million and the incidence on sales stayed unchanged at 15.0% on revenues. The increase has to do to higher IT and digital costs development and maintenance. On top of the costs needed to in-source the online boutique.

Now, moving on to Slide #14, we and the income statement…sorry balance sheet, we take a look of the net working capital, and there is incidence on the sales from 28% to 25.2%. The management of inventory was very positive reducing from €154 million to €152.6 million with an incidence on sales dropping from 33.9% to 30.3% a level that we think might represent a healthy balance in our inventory management also considering the limited number of new direct boutiques to be opened.

The trade receivables went down from €45.2 million to…sorry from €47 million to €45 million, following the healthy and positive management of cash-ins and the fact the online boutique, the 4 boutiques in Moscow and the 5 shop-in-shops department stores were actually converted to direct to management stores.

Trade payables there is a slight increase there, €65.3 million against €63 million and the other assets and liabilities decreased from minus €9.4 million to minus €5.6 million which was mainly to do with the fair value…evaluation on the derivatives…the hedging derivatives.

Investments on Slide 15 amounted to €35.7 million in 2017, and as usual the aim is to safeguard the exclusivity and the prestige of the brand, both in the physical and online channel as well as investing in the IT platforms that we keep to maintain cutting hedge. In the following years, we will also maintain quite a high level of ordinary investments which should be around €120 million, €130 million in the three-year periods 2018-2020.

Debt reduction performed in an excellent manner, debt went down from €51 million to €15 million driven by the cash generation of operations and also the positive contribution of the trade working capital.

Cash generation therefore absorbed investments fully €35.7 million and the payment of €10.9 million of dividend for the…for 2016 that represented a payout ratio of 29.9%. In 2018, we will still pursue cash generation in order to absorb investment that we expect and also to absorb the increase of dividends and payout that went up from €29.9 million to €35.9 million with the net financial position which at 31st December, 2018 could amount to zero and to then improve the following year.

And then finally on Slide 17, shows how we were able to reduce debt by however maintaining over the years an important level of CAPEX and also progressively gradually increasing the payout.

And one last thing about the hedging…FOREX hedging and impact of foreign currency. So before given the floor to Brunello, I would like to devote sometime to the very careful FOREX risk hedging that we carryout. So that in 2018 we will preserve margins also despite the volatility in FOREX.

Hedging policy as, you know, in the currency has a target to neutralize the value…absolute value EBITDA from the impact of FOREX fluctuation. So when the price list of collections are defined estimated revenues are always hedged. And then a part of the revenues which amounts more or less to the cost in foreign fee, these are not…this part is not hedged and it is subject to a FOREX fluctuation. But if the currency and FOREX impact has mainly…is mainly linked to this chunk of the revenues.

We want to maintain the absolute value EBITDA unchanged, this is our aim because the impact of FOREX on revenues is offset by the opposite impact that the currencies have on cost. Our hedging policy although starting from January euro has appreciated vis-à-vis the dollar, and today it amounts to 1.24, this policy enables us to maintain EBITDA 2018 expectations unchanged.

As far as the expected revenues are concerned, given the further impact of FOREX that we have seen in the first months of the year, it is reasonable to expect slightly lower revenues at current exchange rates vis-à-vis what we thought in January. But with the subsequent increase in margins, if the EBITDA stays the same in absolute values, which is slightly higher than

10 basis points, 20 basis points improvement on an annual basis that we usually consider as ordinary.

This is the end of my contribution. Thank you very much, and I give the floor back to Brunello.

BRUNELLO CUCINELLI: Thank you. So I would like to talk about a pretty clear-cut visibility on 2018 as promised. So we have to say that things are going really, really well and hopefully god keeps helping us and this is always very useful to have that kind of help to.

Summer collection in stores are performing very, very well, the taste is being appreciated that's what really counts. A few days ago, we finished with the sales of winter collection. And I have to say that it all went perfectly well. The buyers provided an excellent feedback, both in Florence for the men's collection at mid January, and also in Milan last week during the women's fashion week.

So all the orders for the Fall/Winter collection have already been harvested. As you've done well, we really…we are really keen on the feedback from the press too because sometimes their feedback is does not match that of buyers. But really the press really makes you understand whether your collection is modern, contemporary, young, useful and exclusive. We feel that it is now a time that the brands…our brand is enjoying this kind of feedback, it is pure made in Italy product with a very high of craftsmanship especially in women there are some couture oriented touches. For men I would say, it is a very Italian taste, but at the same time it's very young also in, suits, contemporary, fresh, refined, of course, we should not be the ones to tell you, because it's not nice to boost about this, but this is what we believe. So we are very, very happy.

And another important point, there is always the search for exclusive well made items. When buyers come to our showroom this is the first thing they ask from us before looking at the price list, before looking at the quality, so the taste and then price last. Visual merchandizing plays a very important role and we have always been keen supporters of this.

We think there is also a lot of attention on the way in which you actually make your products. How your products are made? Where they are made? Whether you have harmed or hurt or damaged the wild life and the environment along the process? And this is very strongly perceived especially by young people.

There is no doubt, I am always very firmly convinced that our team must be young, and this true for all industry and sectors and politics included, I don't want to hide the elections in Italy over the last couple of days. Clearly show that there is a need to…there is a need for…a contemporary team in politics too.

In company, the average age is lower than 37 years, 43 for the management, but without me there would be a very sharp drop. So what we would like to say seriously is that we can project for 2018 a healthy double-digit growth, both in terms of revenues and EBITDA and EBITDA should be slightly more than proportional.

In 2018, we will invest more or less €45 million and as usual, if some special opportunity arises we will try and seize it. So, if we happen bump into a store in a special location, we will be seizing this opportunity.

At the end of the year, net financial position should amount, should be close to zero and we are particularly pleased with this but as usual, we keep saying that the problem you see with this, I would say, any company is not debt, the level of debt, but to be able to design a modern product. In the future around 40%...dividend should amount to 40% of our profits. We should have equity, net equity slightly more than half revenues. So, we are confidential for that.

As for FOREX hedging, as Moreno was saying, we have done this from the very beginning. Our Company started its business in Germany, and we were basically cashing in Deutsche marks. So, the advantage was that of getting money, getting…being financed in Deutsche mark with the Italian rate of 22, 23, but despite that we were fixing our exchange rates, because we have always wanted to have an industrial pure profit because this is our business. For the 2019, 2020 two year period, we envisage a healthy growth in line with the past years with EBITDA slightly higher than the growth of revenues.

We would like to invest around €80, €90 million, 120, 130 over the three year period, and the net financial position should be positive and gradually improving. So, to some up, before moving onto the fascinating topic of the web, I would like to say the true investments lie in seeking contemporary products on a daily basis. You see we exchange ideas on taste changes, we try and we strive to be fascinating both in the way we behave, the way we communicate and how we also behave in stores. We mentioned this at length in November call.

We try also to embrace change without any fear accepting the fact that each and every one of us wants to feel special and I believe in this very much. And we know that everyday there will always be somebody posting a picture of you or even a selfie. So you can't possibly look the same today and tomorrow, but let's now talk about this fascinating theme of the web, the online world. We are very, very satisfied and pleased with how things are going and also we are happy with the way in which we have actually tackled and faced this challenge.

On the one hand, communication is paramount and when you actually log into our website, you see the institutional part with our philosophy, product is also very important and the way you presented visual merchandizing is essentially, it's important for sales. And we are sure that online sales will improve, we don't know to what extent, but what we did want to do is to setup facilities that could possibly cater for large growth. So, the real estate is there, the facilities are there. This has always been a sort of obsession of mine. We tried to update our technology to use ultra sophisticated technologies. The investment is important, but I think that this world is changing so fast that we needed to be up to date. And I like this very much.

However, we keep implementing our grand policy of brand safeguards and we discussed this topic and with our partners and stakeholders, because we are always fully convinced that the web, the online world might massify ones imagine and this is…this applies to everybody. As usual, I devote 70% of my time to products and it has always been the case from the very beginning. Of course, at the beginning we were focusing on raising the capital and new banks have been great with us, but if now you see 70%...I devote 70% of my time to products. And the half of the remaining 30% is devoted to how the web is changing and how we can be recognizable, special and unique.

You see this, online world is complicated and to me it is also fascinating and it is evolving very rapidly. A few days ago, we celebrated, we turned 40 and today, I would like to…our Company and please listen carefully because this is the dream of our my life that I am about to communicate to you, what I would like to envisage for the future is for this Company to stay headquartered in Solomeo for a few centuries through my daughters, granddaughters, grand grandchildren maintaining the ownership which does not mean that they needed to manage and rule the Company because I have always maintained that you do not inherit the way and the ability to manage a company. You inherit the ownership of a company. So, the works to restore the parks are drawing to a close, we are also completing the works of the peripheries. I have always loved this art of preserving and I have spent so much money, I have spent a fortune and my father says, you must be crazy and I am so lucky to have my father still with me and he is 90, so I think it's always a pleasure to speak to him.

Today, I think that we…because we want to respect all those invest in our Company, and we think it is not fair that the listed Company pays for this restoration. It is the private foundation that should pay for it, because I was an investor from San Francisco or somewhere else, I would say, why doesn't your business help me support something or restore something in San Francisco, why should I spend my money in Solemeo, whereas all this restoration work is entrusted to the family foundation hopefully for a few centuries. And joke-fully but not so much, I'd say but be careful because after I am dead, I am going to come back and take a look at how you are looking after all these assets and if you don't do things properly, I will be hunting your night. But you see we need to envisage life in over the next 100, 200 years.

So coming to a close before questions, Q&A, we are happy with the business. We are full of gratitude towards mankind and towards you, who have shared and agreed with our corporate culture. You have paid tributes to us, and maybe you have also paid tribute to my wonderful country, which is Italy. So endless thanks for everything, if you need us just give us a call, do not hesitate and come and visit. And now, let's open the floor for questions. Thank you, very much.