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JEWELRY

While down, US jeweler Tiffany's Q1 earnings show two promising growth signs: ecommerce, China

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The Tiffany T1 collection is showing positive signs of market acceptance. Image credit: Tiffany & Co.

By LUXURY DAILY NEWS SERVICE

U.S. jeweler Tiffany & Co. reported net sales for the first quarter beginning Feb. 1 dropped 45 percent to $556 million due to the retail stores closures worldwide over government-mandated COVID-19 lockdowns.

The net loss was $65 million for the first quarter of this year, versus a net income of $125 million for the year-ago period. A reading of its first-quarter earnings report conveys the sense that the New York-based company on track to be acquired by French conglomerate LVMH for $16.2 billion is OK cash-wise.

"The character and strength of Tiffany & Co. have been tested many times over the past 183 years and, because of its exceptionally talented and devoted employees, the company has always been able to persevere and succeed," said Tiffany CEO Alessandro Bogliolo in a statement.

"That is why we took balanced and appropriate steps, like much of the luxury industry, to protect our valued employees who are the heart and soul of the brand," he said.

"The entire Tiffany family has shown extraordinary agility and is fully committed to ensuring that the deep connection we have built with our customers is enhanced and strengthened during these difficult times.

"While the first quarter was very challenging with sales and earnings significantly impacted by COVID-19, the impact of which we expect to negatively affect our full-year sales and earnings relative to 2019, I am confident Tiffany's best days remain in front of us because there is evidence that the strategic decisions we took to focus on our mainland China domestic business, global ecommerce, and new product innovation are paying off even against the backdrop of a global pandemic.

"Let me expand, briefly, on each of these elements.

"First, while sales in key markets like the United States and Japan were down significantly during the first quarter, our business performance in mainland China, which was the first market impacted by the virus, is indicative that a robust

recovery is underway.

"Retail sales in mainland China were down approximately 85 percent and 15 percent during the first and second months of the quarter, but up approximately 30 percent during April, each as compared to the same period in the prior year.

"Moreover, that sequential strength has continued to accelerate with May retail sales in mainland China up approximately 90 percent despite global net sales being down approximately 40 percent in that month as compared to May 2019.

"This evidence not only leads us to believe that our global net sales will significantly improve over the balance of the fiscal year relative to our year-to-date performance, but also confirms that our decision to invest heavily in growing our domestic business in mainland China was particularly prudent and well-timed, given the recent sharp decline in Chinese tourism abroad and the increase in local consumption.

"We are confident that Tiffany is now well positioned to benefit in the years ahead in this important market.

"Second, while first-quarter sales were negatively impacted due to numerous store closures resulting from COVID-19, our global ecommerce business has performed well in the quarter due, in part, to last year's complete re-platforming of the front-end of our ecommerce sites and our decision to stand up a sales-enabled Web site in mainland China.

"First-quarter ecommerce sales were up 23percent globally with key markets such as the United States and the United Kingdom up 14 percent and 15 percent, respectively.

"Additionally, sales through our mainland China ecommerce portal have grown sequentially every quarter since the portal was launched last July.

"Our strong global online sales trend has continued through May, with global ecommerce sales more than doubling those of May 2019, reflecting significant increases across every region, and bringing our global ecommerce sales up to approximately 15 percent of our total net sales for the fiscal year-to-date May period versus the 6 percent that global ecommerce sales represented in each of the last three full fiscal years.

"Finally, Tiffany T1 our newly launched collection in rose gold and gold with diamonds is off to a tremendous start with cumulative sales through the end of May matching our original projections despite a significant number of our stores being closed around the world.

"Based on our experience with the Tiffany HardWear and Paper Flowers launches, we believe it is likely that year one sales of T1 will eclipse year one sales for these two launches combined and may well exceed the sales of Tiffany T-Color, which was successfully launched last October and since then has been often out-of-stock due to overwhelming demand.

"For these reasons, and as I stated earlier, I am confident that Tiffany's best days remain ahead of us and I am excited we will be taking that journey with LVMH by our side.

"On the topic of the merger, we are pleased that there has been additional progress with the antitrust/competition process in the last few weeks.

"Notably, we obtained clearance last week for the transaction from the Federal Antimonopoly Service of Russia and were notified in late May that the Mexican competition authority has declared our filing to be complete."

Financially sound

Mark Erceg, Tiffany's chief financial officer, pitched in with an update on the company's balance sheet.

"Tiffany has an investment grade balance sheet, has ample cash on hand and was in compliance with all debt covenants as of April 30, 2020," Mr. Erceg said in the earnings release.

"Nonetheless, we still took the decision, as have many other companies, to amend certain of our debt agreements in order to create additional financial covenant headroom given these unprecedented times," he said.

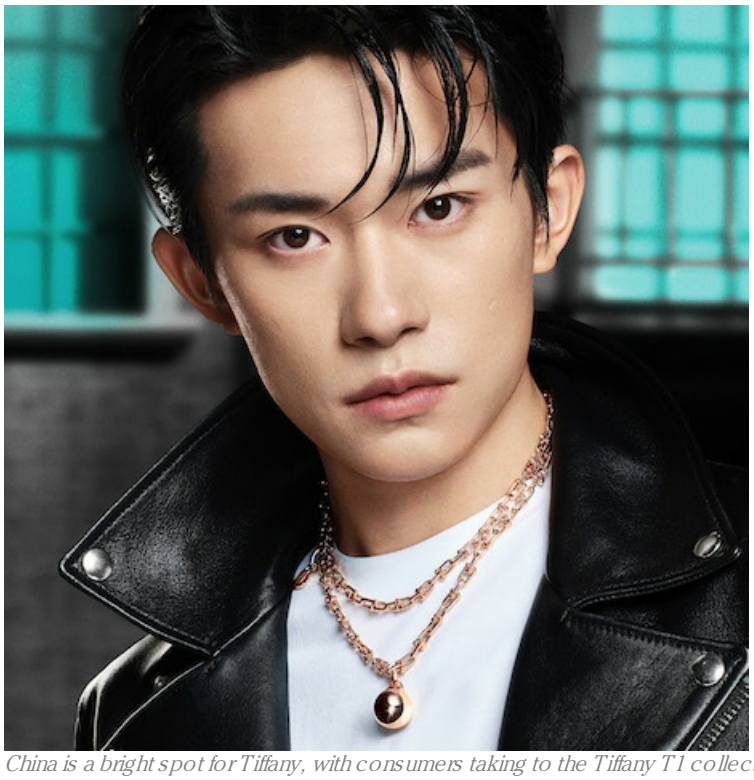
"These amendments were executed on June 8, 2020 and effect changes to certain provisions and covenants from the second quarter of fiscal 2020 through and including the first quarter of fiscal 2021, including, among other things: (a) an increase in the maximum leverage ratio under the Credit Facility, Shanghai Guaranty and our private notes, to 4.50 to 1.00; and (b) a reduction of the fixed charge coverage ratio test for debt incurrence in our private

notes to 0.75 to 1.00.

"Based on our current forecast, we believe that these amendments give us ample headroom during the effective amendment period to remain in compliance with our leverage ratio financial maintenance covenant, and to meet the fixed charge ratio test for debt incurrence.

"The amendments are also permitted under the Merger Agreement.

"Finally, we have thoughtfully revised our plans to significantly reduce costs and dramatically lower our CAPEX spending by postponing selected projects for the year, versus our going-in plans, to help protect earnings and preserve cash."



China is a bright spot for Tiffany, with consumers taking to the Tiffany T1 collection fronted by Tiffany T ambassador Jackson Yee. Image credit: Tiffany & Co.

Per Tiffany:

Net sales by region in the first quarter were as follows:

- In the Americas, total net sales declined 45 percent to $225 million, which included a comparable sales decline of 45 percent. On a constant-exchange-rate basis, both total net sales and comparable sales declined 44 percent. Management attributed the declines to COVID-19 and the resulting closures of substantially all of our stores in the region that began in mid-March and persisted through the end of the first quarter.
- In Asia-Pacific, total net sales declined 46 percent to $174 million and comparable sales declined 45 percent. On a constant-exchange-rate basis, total sales decreased 44 percent and comparable sales declined 42 percent as compared to the prior year. Management attributed the declines to the impact of COVID-19 that caused store closures in mainland China beginning in February and spread to the rest of the Asia-Pacific markets in March and April. Stores began to re-open in mainland China at the end of February. As of April 30, 2020, approximately 85 percent of the Company's retail stores in this region were fully or partially open.
- In Japan, total net sales declined 40 percent to $86 million and comparable sales declined 41 percent. On a constant-exchange-rate basis, total sales and comparable sales decreased by 41 percent and 42 percent, respectively, as compared to the prior year. Management attributed the decreases to the effects of COVID-19, including the resulting closures of substantially all of the company's stores across the region, which primarily began in early April 2020, and the decline in tourist traffic that persisted throughout the quarter. As of April 30, 2020, approximately 5 percent of the company's retail stores in this region were fully or partially open.
- In Europe, total net sales declined 40 percent to $61 million, and comparable sales declined 42 percent. On a constant-exchange-rate basis, total sales and comparable sales decreased 38 percent and 40 percent, respectively. The decline in total net sales reflected the impact of COVID-19 and the resulting store closures

that primarily began in mid-March and persisted through the second half of April, when various markets slowly began re-opening. As of April 30, 2020, approximately 15 percent of the company's retail stores in this region were fully or partially open.

- Other net sales of $9 million were 65 percent below the prior year due to the impact of COVID-19 and lower wholesale sales of diamonds.
- Tiffany closed two company-operated stores in the first quarter and relocated two stores. At April 30, 2020, the company operated 324 stores 123 in the Americas, 90 in Asia-Pacific, 58 in Japan, 48 in Europe, and five in the UAE versus 321 stores a year ago (124 in the Americas, 89 in Asia-Pacific, 56 in Japan, 47 in Europe, and five in the UAE). As of April 30, 2020, approximately 70 percent of the company's retail stores remained closed worldwide. The company has continued to gradually reopen a number of retail stores across its markets in accordance with applicable guidelines established by local governments.
- Sales results by jewelry category in the first quarter were as follows: Jewelry collections declined 44 percent, engagement jewelry declined 49 percent and designer jewelry declined 39 percent, which management attributed to the effects of COVID-19 and the resulting store closures across the markets.

Other highlights in the first quarter:

- Gross margin (gross profit as a percentage of net sales) of 55.6 percent was below the prior year's 61.7 percent. The lower margin was largely due to (i) sales deleverage on fixed costs resulting from the effects of COVID-19 on net sales, (ii) certain overhead costs not capitalized in the period resulting from certain manufacturing locations being closed or operating at reduced capacity during the first quarter due to COVID-19 and (iii) an increase in inventory reserves. Additionally, the first quarter of 2020 included the impact of a $12.3 million charge that was recorded to fully reserve the asset related to an expected insurance recovery in respect of the bankruptcy filing of a metal refiner to which the Company entrusted precious scrap metal.
- Selling, general and administrative ("SG&A") expenses, which included $16.3 million of costs related to the pending merger [with LVMH] and a $12 million charitable contribution to The Tiffany & Co. Foundation (see "Non-GAAP Measures" for further details), decreased 10 percent from the prior year. These costs were more than offset by decreased store occupancy expenses and a decrease in labor and incentive compensation costs. Excluding the pending merger related costs and the charitable contribution noted above, SG&A expenses decreased $72.2 million, or 16 percent, compared to the prior year (see "Non-GAAP Measures"). SG&A expenses as a percentage of net sales increased significantly due to sales deleverage on operating expenses resulting from the effects of COVID-19 on net sales. Changes in foreign currency exchange rates did not have a meaningful effect on SG&A expenses in the first quarter as compared with the prior year.
- The effective income tax rate for the three months ended April 30, 2020 was 28 percent versus 17.3 percent in the prior year. The increase in the effective income tax rate for the three months ended April 30, 2020 was primarily due to the jurisdictional mix of earnings, which are taxed at the statutory tax rates applicable to each jurisdiction, as well as an estimated increase in the Global Intangible Low-Taxed Income ("GILTI") tax, each of which reflects the impact of COVID-19 on the Company's results of operations.
- The company did not repurchase any shares of its common stock in the first quarter pursuant to certain restrictions set forth in the Merger Agreement.
- Net inventories at April 30, 2020 were 2 percent above the prior year.
- At April 30, 2020, cash and cash equivalents and short-term investments totaled $1.1 billion. Total debt short-term borrowings and long-term debt of $1.5 billion represented 48 percent of stockholders' equity, versus 32 percent a year ago. This increase was primarily the result of a $500 million drawdown on the company's revolving credit facility during the quarter. This drawdown, which was permitted under the merger agreement, was a precautionary measure in order to increase the company's cash position and maintain financial flexibility in light of uncertainty in the global markets resulting from COVID-19. The drawdown proceeds can be repaid at any time. Management believes that cash on hand, internally generated cash flows and the funds available under the company's revolving credit facilities are sufficient to support the company's liquidity and capital requirements for the foreseeable future.
- As mentioned in the previous earnings release for the fourth quarter and full year of fiscal 2019, the company will not be communicating an outlook for the remainder of the year.

The company continues to operate in a dynamic environment, which will continue to evolve. The full extent of the impact of the COVID-19 pandemic on the company's operational and financial performance will depend on many factors outside the company's control.

Next scheduled announcement
The company expects to report its financial results for the second quarter ending July 31, 2020 by issuing a news release.

> Power play. #Adut, #Vittoria and #FrejaBehaErichsen exude the individual courage, strength and optimism that the new #TiffanyT1 collection is all about. Tell us what Tiffany T1 means to you in the comments below and discover the collection: https://t.co/DTcWUgIQNL #TiffanyT pic.twitter.com/CzR9pqpwzQ
>
> Tiffany & Co. (@TiffanyAndCo) May 29, 2020