STONE ISLAND

Sportswear Company S.p.A.

Annual Report
as at 31 October 2018

Index

Report on Operations

REPORT ON OPERATIONS

Letter to the Shareholders

Dear Shareholders,

The annual reporting period ended 31 October 2018 was better than expected, especially in terms of profitability which reached absolutely the highest levels in our industry, particularly considering the clothing segment. Revenue grew again this year with an increase of more than 30%. This put under pressure the entire production organisation but it coped well in terms of both product quality and delivery periods. This has been and remains our toughest challenge but the results achieved prove that the organisational structure and operating mechanisms developed over the years are up to the challenge.

In 2018, we further strengthened our relations with supplier Tintoria Emiliana by jointly investing in state of the art machinery. We have laid the foundations for centres of excellence in other product categories and have reinforced the prototypes division which has coped with the generational change that has seen it 80% involved in just two years. We identified people to train up in the quality control division while the finished goods warehouse has been expanded by 30% in terms of area with the new lay out helping increase productivity by more than 50% in just one year. All of this is geared towards maintaining the very highest level of knowhow, a key factor in the success of the brand in the last 37 years.

On the retail side, too, the Group achieved its objectives. Premises for a new store in Milan - much larger than the previous one and in an even more prestigious location – were found, while the Tokyo store was opened and is performing even better than expected.

In 2018, the restructuring the distribution process that has been ongoing in Italy and Europe for some time was substantially completed after important measures taken in Japan, too. Constant monitoring of retail activities in all of the countries where we operate remains fundamental in ensuring that Brand containers are in line with our product and image.

Together with traditional channels, the online retail channel also enjoyed very significant growth both for our own store which recorded a sales increase of more than 35% and for our on line customers and market places; the on line sales of our traditional customers also increased. It is significant that, in this channel too, Stone Island is an absolute leader in terms of full price sell out, clear evidence of the success of the strategy that has been adopted. It is worth stressing that our policy of producing to order only and not to push sales in the various discount channels has, for some time now, given the brand a consistent and reliable image.

Commercial success and the successful image do not distract us from the Brand's nature as an all-round brand with a strong identity but which cannot be pigeon-holed in the manner typical of fashion industry trends. We remain committed to investing in our product in order to satisfy the high expectations of our historical customers while giving new, young customers the chance to appreciate the core values of the brand and become its best possible testimonials.

In 2018, great attention was also paid to Corporate Social Responsibility (CSR). The Group has a code of ethics that it rigorously respects but it also places increasing importance on the need to use the support of international organisations both to test substance emissions during the manufacturing processes of our suppliers (Bureau Veritas) and to conduct ever more thorough and extensive audits of the protection of worker rights and safety.

The war on counterfeiting continues unabated. Work in this area with partners Certilogo and Mark Monitor is intensified every year and uses the latest techniques. There is also unceasing collaboration with government institutions and customs authorities in order to limit the problem as far as possible and to provide our customers with the certainty that they deserve.

We are confident that 2019 will be another year of positive results and will produce further stages in the growth of the business in terms of quantity, quality and culture.

Group structure

The Consolidated Financial Statements of the Sportswear Group as at 31 October 2018 include the following companies:

Sportswear Company SpA	Parent Company and owner of the Stone Island brand
Stone Island Retail Srl	Company which operates DOS in Italy
Stone Island Paris	Permanent Establishment/Branch which operates DOS in France
SPW Germany Gmbh	Company that acts as Agent for Germany and Austria and operates DOS in Germany
Stone Island Retail Germany Gmbh	Company which operates DOS in Germany
Stone Island Antwerp BVBA	Company which operates DOS in Belgium
Stone Island Amsterdam BV	Company which operates DOS in the Netherlands
Stone Island USA Inc	Sub Holding company involved in management of the US companies
Stone Island NYC LLC	Company which operates DOS in New York
Stone Island LA LLC	Company which operates DOS in Los Angeles

Foreword

As permitted by Article 40(2 bis) of Legislative Decree no 127 of 09/04/91, the Parent Company has prepared the Report on Operations in the form of a single document accompanying the separate financial statements and the consolidated financial statements. The consolidated financial statements of Sportswear Company S.p.A. and its subsidiaries (hereinafter, also "Group" or "Sportswear Group") as at 31 October 2018 and the separate financial statements of Sportswear Company S.p.A. as at the same reporting date have been prepared in accordance with International Financial Reporting Standards (hereinafter "IFRS").

Operating performance of the Sportswear Group

The Consolidated Financial Statements for the year ended 31 October 2018 faithfully reflect operational and market events and show EBITDA for the Group of Euro 56.8 million, equal to 29.8% of Revenue.

EBITDA is not specifically defined for accounting purposes by IFRS so the figure calculated might not be comparable with those calculated by other companies. However, this indicator is commonly used by both Management and investors to evaluate the operating performance of businesses. The Group's EBITDA is calculated by taking EBIT (Operating Profit) and adding back depreciation, amortisation and any allocations to provisions for risks. It may be extrapolated directly from information contained in the IFRS consolidated financial statements.

The Group reports a net profit of Euro 38.2 million.

Statement of Profit or Loss highlights are provided in the following reclassified schedule:

Consolidated Statement of Profit or Loss (Euro '000)	**2018**	**% of revenue**	**2017**	**% of revenue**
Revenue	190,758	100%	146,109	100%
% growth	31%		35%	
Sundry income	1,494	0.8%	1,395	1.0%
Cost of goods sold	(79,882)	41.9%	(63,259)	43.3%
Gross Margin	**112,370**	**58.9%**	**84,245**	**57.7%**
Selling expenses	(14,829)	7.8%	(10,839)	7.4%
Communications costs	(5,513)	2.9%	(5,702)	3.9%
Personnel costs	(15,196)	8.0%	(13,498)	9.2%
General & administrative expenses	(20,014)	10.5%	(16,651)	11.4%
EBITDA	**56,818**	**29.8%**	**37,555**	**25.7%**
% growth	51%		93%	
Depreciation & Amortisation	(3,753)	2.0%	(3,151)	2.2%
Non-recurring allocations to provisions	(45)	0.0%	0	0.0%
EBIT	**53,020**	**27.8%**	**34,404**	**23.5%**
% growth	54%		103%	
Financial income (expenses)	-103	0.1%	-523	0.4%
Earnings before taxation	**52,917**	**27.7%**	**33,881**	**23.2%**
Taxes on income	(14,712)	7.7%	(10,537)	7.2%
Tax incidence	28%		31%	
Net profit of Group	**38,205**	**20.0%**	**23,344**	**16.0%**

% growth	64%		121%	

Selling expenses include operating commission for stores managed with sale or return contracts whose sell out revenues are included in Revenue from sales.

The key profit indicators are set out below, as calculated based on the above Statement of Profit or Loss figures and the Statement of Financial Position information provided further on:

Profit indicators		31/10/18	31/10/17
ROE	Net Profit / Net Capital	53.61%	44.92%
ROS	EBIT/Revenue	27.79%	23.55%
ROI	EBIT/Net Invested Capital	74.35%	55.61%

Operating performance of the Parent Company

The Separate Financial Statements for the year ended 31 October 2018 faithfully reflect operational and market events and show EBITDA for the Parent Company of Euro 52.3 million, equal to 29.7% of Revenue.

EBITDA is not specifically defined for accounting purposes by IFRS so the figure calculated might not be comparable with those calculated by other companies. However, this indicator is commonly used by both Management and investors to evaluate the operating performance of businesses. The Company's EBITDA is calculated by taking EBIT (Operating Profit) and adding back depreciation, amortisation and any allocations to provisions for risks. It may be extrapolated directly from information contained in the IFRS separate financial statements.

The Parent Company reports a net profit of Euro 36 million.

Statement of Profit or Loss highlights are provided in the following reclassified schedule:

Parent Company Statement of Profit or Loss (Euro '000)	**2018**	**% of revenue**	**2017**	**% of revenue**
Revenue	176,061	100%	134,564	100%
% growth	31%		33%	
Sundry income	1,807	1.0%	1,904	1.4%
Cost of goods sold	(80,138)	-45.5%	(63,557)	-47.2%
Gross Margin	**97,730**	**55.5%**	**72,911**	**54.2%**
Selling expenses	(14,708)	-8.4%	(12,137)	-9.0%
Communications costs	(5,409)	-3.1%	(5,477)	-4.1%
Personnel costs	(11,497)	-6.5%	(9,993)	-7.4%
General & admin. expenses	(13,822)	-7.9%	(11,427)	-8.5%
EBITDA	**52,294**	**29.7%**	**33,877**	**25.2%**
% growth	54%		71%	
Depreciation & Amortisation	(2,193)	-1.2%	(1,761)	-1.3%

Non-recurring allocations to provisions	(45)	0.0%	0	0.0%
EBIT	**50,056**	**28.4%**	**32,116**	**23.9%**
% growth	56%		74%	
Financial income (expenses)	-39	0.0%	-345	-0.3%
Earnings before taxation	**50,017**	**28.4%**	**31,771**	**23.6%**
Taxes on income	(13,981)	-7.9%	(9,964)	-7.4%
Tax incidence	28%		31%	
Net profit of the Parent Company	**36,036**	**20.5%**	**21,807**	**16.2%**
% growth	65%		79%	

Selling expenses include operating commission for stores managed with sale or return contracts whose sell out revenues are included in Revenue from sales.

The key profit indicators are set out below:

Profit indicators		31/10/18	31/10/17
ROE	Net Profit / Net Capital	50.18%	40.10%
ROS	EBIT/Revenue	28.43%	23.87%
ROI	EBIT/Net Invested Capital	75.49%	57.06%

Statement of Financial Position of the Sportswear Group

The Group's balance sheet structure is reflected in the following table, as reclassified to show Sources and Applications of Funds:

Reclassified consolidated statement of financial position (euro 000)	31/10/2018	31/10/2017
Intangible assets and investments	7,988	6,782
Tangible assets	19,283	18,047
Other non-current assets/(liabilities), net	3,200	2,875
Total non-current assets/(liabilities), net	**30,471**	**27,704**
Net working capital	55,936	44,085
Other current assets/(liabilities), net	(7,707)	(7,858)
Total current assets/(liabilities), net	**48,229**	**36,227**
Net invested capital (applications)	**78,700**	**63,931**
Net financial position	(6,780)	1,557
Employee severance indemnity/TFR provision and other non-current provisions	2,801	2,512
Shareholders' equity	82,679	59,862
Total sources	**78,700**	**63,931**

Shareholders' equity has increased thanks to the net profit for the year of Euro 38.2 million and decreased due to the dividends of Euro 15.2 million paid during the reporting period. At the reporting date, shareholders' equity stood at Euro 82.7 million while the net financial position was positive by Euro 6.8 million.

At 31 October 2018, consolidated net working capital was equal to 29.3% of revenue, as detailed below:

Net working capital (Euro 000)	31/10/2018	31/10/2017
Trade receivables	46,907	36,742
Inventory	28,360	22,169
Trade payables	(19,331)	(14,826)
Net working capital	**55,936**	**44,085**
	29.3%	30.2%

At 31 October 2018, the consolidated net financial position showed net cash and cash equivalents of Euro 6.8 million against net financial indebtedness of Euro 1.6 million at 31 October 2017, as detailed below:

Net financial position (Euro 000)	31/10/2018	31/10/2017
Cash and cash equivalents	30,711	12,765
Long-term net financial payables	(16,423)	(9,191)
Short-term net financial payables	(7,508)	(5,131)
Net financial position	**6,780**	**(1,557)**

The following table shows the consolidated statement of cash flows for 2018 and 2017. It has been reclassified compared to that included in the consolidated financial statements in order to show cash flows in terms of the change in the overall consolidated net financial position:

Consolidated statement of cash flows (Euro 000)	31/10/2018	31/10/2017
EBITDA	**56,818**	**37,555**
Change in net working capital	(11,851)	(6,751)
Change in other receivables/(payables) – current and non-current	(476)	2,758
Net capex	(6,195)	(3,281)
Financial income (expenses)	(103)	(523)
Taxes on income	(14,712)	(10,537)
Free Cash Flow	**23,481**	**19,221**
Dividends paid	(15,294)	(7,744)
Change in shareholders' equity and other changes	150	134
Net Cash Flow	**8,337**	**11,611**
Net Financial Position at start of period	1,557	13,168
Net Financial Position at end of period	(6,780)	1,557
Change in Net Financial Position	**8,337**	**11,611**

Free Cash Flow for the 2018 reporting period totalled Euro 23.4 million compared to Euro 19.2 million for the 2017 reporting period.

Statement of financial position of the Parent Company

The Parent Company's balance sheet structure is reflected in the following table, as reclassified to show Sources and Applications of Funds:

Parent Company statement of financial position (Euro 000)	31/10/2018	31/10/2017
Intangible assets and investments	4,474	4,287
Tangible assets	11,932	10,881
Other non-current assets/(liabilities), net	2,473	2,434
Total non-current assets/(liabilities), net	**18,879**	**17,602**
Net working capital	61,076	48,562
Other current assets/(liabilities), net	(6,377)	(7,127)
Total current assets/(liabilities), net	**54,699**	**41,435**
Net invested capital (applications)	**73,578**	**59,037**
Net financial position	(12,180)	(5,839)
Employee severance indemnity/TFR provision and other non-current provisions	3,586	3,424
Shareholders' equity	82,172	61,452
Total sources	**73,578**	**59,037**

Shareholders' equity has increased thanks to the net profit for the year of Euro 36 million and decreased due to the dividends of Euro 15.2 million paid during the reporting period. At the reporting date, shareholders' equity stood at Euro 82.2 million.

At 31 October 2018, net working capital was equal to 34.7% of revenue, as detailed below:

Net working capital (Euro 000)	31/10/2018	31/10/2017
Trade receivables	54,178	42,901
Inventory	25,983	20,099
Trade payables	(19,085)	(14,437)
Net working capital	**61,076**	**48,563**
	34.7%	36.1%

The Parent Company's net financial position at 31 October 2018 shows net cash and cash equivalents of Euro 12.1 million compared to Euro 5.8 million at 31 October 2017; it is detailed in the following table. We note that the net financial position also includes financial receivables from subsidiaries totalling Euro 12.1 million at 31 October 2018 and Euro 12 million at 31 October 2017, as the Parent Company provides financial support to help with the subsidiaries' operating activities.

Net financial position (Euro 000)	31/10/2018	31/10/2017
Cash and cash equivalents	23,959	8,171
Long-term net financial payables	(6,249)	1,434
Short-term net financial payables	(5,530)	(3,766)
Net financial position	**12,180**	**5,839**

The following table shows the Parent Company's statement of cash flows for 2018 and 2017. It has been reclassified compared to that included in the separate financial statements in order to show cash flows in terms of the change in the overall net financial position:

Parent Company statement of cash flows (Euro 000)	31/10/2018	31/10/2017
EBITDA	**52,294**	**33,877**
Change in net working capital	(12,514)	(7,948)
Change in other receivables/(payables) – current and non-current	(789)	2,378
Net capex	(3,431)	(1,696)
Financial income (expenses)	(39)	(345)
Taxes on income	(13,981)	(9,964)
Free Cash Flow	**21,540**	**16,302**
Dividends paid	(15,294)	(7,744)
Change in shareholders' equity and other changes	95	(22)
Net Cash Flow	**6,341**	**8,536**
Net Financial Position at start of period	(5,839)	2,697
Net Financial Position at end of period	(12,180)	(5,839)
Change in Net Financial Position	**6,341**	**8,536**

Capital expenditure of the Sportswear Group

During the reporting period, the Group incurred significant levels of capital expenditure. At the Parent Company headquarters in Ravarino, new ERP system modules were implemented with a total investment of Euro 1.2 million, machinery totalling Euro 0.5 million was purchased and system improvements totalling Euro 0.2 million were made. Refurbishment works and furnishings for the new Showroom in Munich involved a total investment of Euro 0.3 million while significant capex was incurred to open the new store in Venice (Euro 0.7 million), to complete the store in Los Angeles (Euro 0.2 million), to take over the premises for the new store in Milan which is scheduled to open early in 2019 (Euro 1.3 million) and for a contribution towards furnishings and fittings and other works at the new store in Tokyo (Euro 1 million).

Relations with subsidiaries, associated companies and parent companies

Relations with subsidiaries have been maintained on an arm's length basis, as described in detail in the Notes to the Separate Financial Statements. There have been no significant transactions with associated companies and other related companies.

Treasury shares and shares/quota of parent companies

The Parent Company does not have any treasury shares.

Research & Development

Research and development includes all activities necessary to renew and update the collections every season. It has always been extremely important to the Group and determines how products are received by the market from one year to the next. Such expenses include the cost of developing new products, prototypes and samples. Such costs are expensed in the period in which they are incurred.

We are confident that the success of these activities will generate good results in terms of sales with a favourable impact on the business as a whole.

Risks and uncertainty

General information on risks and uncertainty

The specific risks that could give rise to obligations for the Group companies are assessed when determining any provisions necessary and are disclosed in the notes to the financial statements, together with any significant contingent liabilities. This section refers to risks and uncertainties essentially regarding the economic, regulatory and market environment that could impact the performance of the Group companies.

The Group's income statement, balance sheet and financial situation is primarily affected by factors relating to the macroeconomic environment (and including include increases or decreases in gross domestic product, the level of consumer and business confidence, interest rates, raw materials/commodities prices, the rate of unemployment and exchange rates) – in the countries where it operates and where it sells its products. Given the fact that it is hard to predict the extent and duration of the various economic cycles, each macroeconomic event – whether a significant slump on major sales markets, volatility on financial and exchange rate markets and the resulting weakening of capital markets, an increase in energy prices, commodity/raw material price fluctuations, other adverse changes in interest rates, exchange rates and government policy (including environmental regulation) or infrastructure spending, which could have a negative impact on the sector in which the Group companies operate – could negatively impact to a significant degree the prospects and the activities of the Group companies, as well as their operating results and financial situation. The profitability of the Group business is also subject to risks regarding the rate of inflation and the solvency of customers.

In terms of market risks, as already stated, significant attention must be paid to uncertainty over exchange rate trends, especially with regard to the US Dollar and the GB Pound. In addition to the aforementioned impact on costs, exchange rates have no little impact on tourist flows and on products flows, also outside the brand's official distribution channels as exchange rate fluctuations can be quickly exploited above all thanks to online sales. This is a complex area and it is still hard to forecast clearly how it will develop.

Employees of the Group companies are safeguarded by legislation and collective labour agreements which, through local and national representation, guarantee them the right to be consulted in relation to specific matters such as the downsizing or closure of departments and workforce reductions. The laws and/or collective labour agreements applicable to the Company could affect its flexibility in reviewing and/or strategically repositioning the business. The Group's ability to make any reductions in personnel or other measures to end – or suspend – employment relationships is subject to the agreement of the trades unions. Industrial action by the employees could have a negative effect on the business.

Credit risk

During the reporting period, trade receivables increased in line with the sales revenue growth while the level of doubtful debts remained stable. The Group is not particularly affected by the credit risk thanks to existing controls in terms of credit limits, constant monitoring of receivables, the use of credit assurance and commercial policy on export markets. Moreover, the Group also adopts a fairly cautious approach when providing for doubtful debts and, at 31 October 2018, the financial statements did not include any significant receivables, subject to genuine uncertainty over collection, for which no provision had been made.

The consolidated financial statements do not include other types of receivables subject to particular risks of a fluctuation in value.

Liquidity risk, cash flow risk and interest rate risk

As at 31 October 2018, the Group had net cash and cash equivalents of around Euro 6.8 million.

The cash flows, funding requirements and liquidity of the Group companies are managed with the aim of ensuring the effective and efficient management of financial resources. As shown in the statement of cash flows, during the reporting period, the Group's operating activities generated cash. At 31 October 2018, the Parent Company had approved but unutilised borrowing facilities amounting to Euro 29.2 million (entirely comprising of advances on notes receivable, short-term credit facilities and current account overdrafts). Meanwhile, almost none of the existing loans are subject to compliance with covenants. Moreover, the Directors do not expect any significant difference between the maturity dates of financial payables and the dates agreed by contract.

Borrowing includes loans subject to variable rates of interest in relation to which the need for derivative hedging is considered on a case by case basis and fixed rate loans.

The Group companies do not have any financial assets of a speculative nature. Generally speaking, they do not have any financial assets linked to interest rate trends. Any interest rate increases could have a negative impact on the future profitability of the Group companies.

Exchange rate risk

The Group's receivables are not subject to any significant extent to the risk of exchange rate fluctuation. This is because the Group operates in an international environment in which transactions take place almost exclusively in Euro. The Statement of Financial Position amounts subject to the exchange rate risk at 31 October 2018 were for immaterial amounts.

In more detail, foreign currency receivables and the Group's next exposure to the exchange rate risk at 31 October 2018 were as follows:

Foreign currency receivables	**Total in foreign currency**	**Equivalent in Euro**
US Dollars	3,422,314	3,023,780
Canadian Dollars	747,770	503,346

The Group's balance sheet structure shows the following (in addition to the comments made on trade receivables):

• The Group's assets include goodwill solely relating to the consolidation differences of several subsidiaries and to "Rental agreement takeover rights (Key Money)" for the stores in Paris, Cannes, Munich, Florence, Forte dei Marmi, Rome, Antwerp, Amsterdam and Hamburg, as recorded under Goodwill. Moreover, the amounts paid to acquire the rental rights to the stores are partially independent of the performance of the stores to which they relate. In fact, it is normal practice in the sector to invest amounts of key money and, therefore, given the prestigious locations of the stores, it could have an inherent value, irrespective of how profitable the stores are;

- in addition to the above, non-current assets consist almost entirely of the net carrying amount of buildings.

- inventory relating to prior seasons is subject to a strict obsolescence policy. No significant risks are expected in relation to selling it off, also considering the fact that, for 2019, the Group can count on a sales force also based on the usual sales channels for this type of inventory;

- the Company’s assets do not include any speculative investments.

Significant events after the reporting date and outlook for the business

Revenue forecasts for 2019 are optimistic: the Spring Summer 2019 season has ended with 28.9% growth. In addition to the opening of the new store in Milan, as previously mentioned, we also highlight the fact that a rental contract was recently signed for a store in Frankfurt which is scheduled to open in late autumn.
In December 2018, we acquired a majority investment in our main knitwear supplier.
On 26 November 2018, shareholder Carlo Rivetti contributed shares representing 50.1% of the share capital of Sportswear Company S.p.A. to Rivetex S.r.l., a company 100% owned by him.

Compliance with Personal Data Protection Requirements

Pursuant to Appendix B) to Legislative Decree 196/2003 (“the Italian Data Protection Code”), the Directors note that the Group companies have adopted the minimum security measures required by said legislation.

Personnel

At the reporting date, the Group companies had a headcount of 233 employees against 214 at 31 October 2017.

For the Board of Directors

The Chairman

Carlo Rivetti