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EDITED TRANSCRIPT

HM B.ST - Full Year 2018 H & M Hennes & Mauritz AB Earnings Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to today's Full Year Results for 2018 Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, Thursday, 31st of January 2019.

I would now like to hand the conference over to your speaker today, Mr. Karl-Johan Persson. Please go ahead, sir.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Hello, everyone. Thank you all for joining us today. I'm very pleased to welcome you all to this conference call about H&M group's fourth quarter and full year results for 2018.

With me today is: our CFO, Jyrki Tervonen; and our Head of Investor Relations, Nils Vinge.

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I will start with an overview of the fourth quarter, and Nils will take us through the financial details. Then I will give an update on our strategic focus areas before we answer your questions.

And you will find the slides to this presentation on hm.com/investorrelations.

The fashion industry is going through rapid changes, as we all know. And we are accelerating our transformation in 2018 to secure a positive, long-term development for the H&M group.

And 2018 was a challenging year for us and for the whole sector, but we ended the year with strong signals that we are on track. We built momentum through the year with the sales growth in local currencies of 3% overall and 6% in the fourth quarter. And in the second half of the year, we took market shares in most markets.

Importantly, performance in the fourth quarter was driven by more full-price sales and lower markdowns. And this is one of many signals confirming that customers appreciate our assortment with the improvements that we have made in terms of design, quality, price and sustainability.

If we look at the inventory levels, we're still up year-on-year. However, the sequential improvement in level and composition from the third to the fourth quarter show that we're moving in the right direction. And we expect this trend to continue as a result of a stronger customer offering and our ongoing improvements in our buying processes and logistics. Therefore, we also expect markdowns to be around 1 percentage point lower in the first quarter 2019 compared to the same quarter last year.

We did not reach the sales and profit targets we set up for the past year and obviously, we're not happy with that. But this should also be seen in the light of a very tough retail market and tougher than many anticipated.

And I think very important also when you look at the performance, it's good to see that the core business of the company is at the better levels at the end of the year compared to the same period last year, so we have seen a gradual improvement throughout the year. And also in the fourth quarter, the profits were negatively affected by large extraordinary costs related to our transformation program. And these were costs generated in connection with the replacement of the logistics systems in U.S. and Belgium last year, but also activities in preparation for the upcoming transitions, particularly the change of our online platform in Germany.

In Germany, we successfully migrated to our new platform last week. While these actions inevitably have a short-term impact on the margin, they will lead to a range of improvement for our customers over time.

So that was a short introduction. And with that, I hand over to you, Nils.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

Thank you, Karl-Johan. Starting with top line. Net sales increased 5% in the full year to SEK 210 billion. In the fourth quarter, net sales increased 12% to SEK 56.4 billion. In local currencies, the increase was 3% in the full year and 6% in the fourth quarter.

Looking at some individual markets in the fourth quarter. In the U.K., online sales grew by 38%, which compensated for a 1% decline in stores, leading to total growth of 8% in local currencies.

In several markets, both digital and physical channels are driving growth. In China, sales increased by 24%. In India, sales grew by 43%. While Russia had sales increase of 27%. However, in some markets, development was more challenging such as the markets that experienced logistics difficulties like the U.S. But sequentially, sales improved in the fourth quarter compared to the third quarter.

Gross profit in the quarter was SEK 30.6 billion, which corresponds to gross margin of 54.2%. Markdown costs as a share of sales decreased by approximately 60 basis points, and this was due to better full-price sales, driven by stronger collections.

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For the fourth quarter, the company decided to invest the positive dollar effect into a stronger customer offering. And apart from this, the gross margin was affected by a number of factors, continued costs of around SEK 250 million to resolve the issues that arose in connection with implementation of new logistics systems in the U.S., France, Italy and Belgium, of which SEK 125 million were the estimate. In addition, we have cost of approximately SEK 200 million to secure future transitions of platforms and logistics systems. We also had a negative year-end effect of approximately SEK 110 million.

Gross profit for the full year was SEK 111 billion, corresponding to margin of 52.7%. And looking at the first quarter of 2019, for the purchases made for the current quarter, the market situation regarding external factors is expected to be slightly negative. The main reason for this is the strengthening of the U.S. dollar.

SG&A increased by 14% to SEK 26.3 billion in the fourth quarter. In local currencies, the increase was 8%. The increase is mainly related to the expansion of stores and online, along with investments in H&M Club, our digital loyalty program. In addition, SG&A were affected by the costs to resolve the logistics issues we had in some markets earlier in 2018. For the full year, SG&A was up by 9% in SEK and 6% in local currencies.

Profit after financial items was SEK 4.35 billion in the fourth quarter. And for the full year, profit after financial items amounted to SEK 15.6 billion compared to SEK 20.8 billion last year.

And like Karl-Johan said, it's been a challenging year for the whole industry and thus also for the H&M group. We've made improvements gradually during the year. And strengthened by these positive signals, we decided to accelerate the transformation further with a particular focus on the replacement of logistics systems. Along with negative year-end effect, this resulted in costs of around SEK 560 million.

Net profit was SEK 3.54 billion in the fourth quarter, equaling earnings per share of SEK 2.14 compared to SEK 2.41 in the corresponding year-earlier period. And with a tax rate of 24% for 2018, net profit for the year was SEK 12.7 billion compared to SEK 16.2 billion in '17. Earnings per share thus amounted to SEK 7.64.

And looking at some key data. The inventory by the 30th of November amounted to SEK 37.7 billion, an increase of 12% in SEK and 10% in local currency. Although the inventory level was still too high, levels and composition improved sequentially from the third to the fourth quarter, showing that we're moving in the right direction. And with a stronger customer offering and the ongoing improvements in buying and logistics, we expect a gradual improvement in inventory levels going forward. Therefore, in the first quarter of '19, we expect markdown cost in relation to sales to decrease by around 100 bps compared to the same quarter last year.

Cash flow from current operations was SEK 21.3 billion. And investments in terms of CapEx totaled SEK 12.8 billion, up from SEK 12.5 billion last year. In constant currency, CapEx was SEK 12.12 billion, slightly down from last year. And for the full year of '19, CapEx is expected to decrease approximately SEK 10.5 billion to SEK 11 billion in constant currency with a continued shift of the balance towards digital.

Liquid funds at the end of the year were SEK 11.6 billion. And the Board of Directors will propose to the AGM an unchanged dividend of SEK 9.75 per share to be paid out in 2 separate portions. Return on equity was 21.4% and the number of employees was around 123,000 translated into full-time positions.

And now back to you, Karl-Johan.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Thank you. So our transformation work continues, and we're driving change, as we have communicated before through 4 strategic focus areas, which are to: strengthen the customer offering for each of our brands; two, to ensure fast and flexible and efficient supply chain; to set a stable, scalable and innovative tech and IT foundation; and finally, to add growth by expanding with physical stores and our online stores.

The most important part when it comes to securing the best customer offering obviously is to improve our -- to continuously improve our assortment for all our brands. And we're now seeing clear signals that customers appreciate the improvements that we have made. We see this in more full-price

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sales, higher conversion rates, more recurring customers and the increased customer satisfaction. This clearly shows that we are moving in the right direction when it comes to the assortment. Part of this improvement comes from us investing in better prices and higher quality for our customers.

We're also working hard to further improve the shopping experience for the H&M in the physical stores as well as online. When it comes to the physical stores, we continue to do many tests around the world to develop a better shopping experience. And here too, we have received positive feedback in terms of increased customer satisfaction, but also when it comes to good receipts in sales and better results. So we are evaluating these steps, and at the same time, we are planning for a good, gradual rollout.

If we look at the shopping experience online, we're making improvements to the dot-com sites and our mobile app where we have made improvements in terms of stability and speed. We're also improving in terms of navigation, product presentation, improved delivery times and new payment options, just to mention a few examples.

And then we're also working hard when it comes to further integrating the online and the physical stores. We are improving and rolling out features like returns in store, Click and Collect, online purchases in store, our In-Store Mode app, just to mention a few examples.

And then finally, when it comes to the customer offering, we would also like to mention that we're continuing to develop and to roll out our loyalty club, rollout to new markets. Today, it's only present in 16 markets, and we're quite new with the club in many of those markets. But we have, by the end of 2018, we have reached 30 million club members, which is a good growth from 15 million, so doubling the growth from 15 million in the beginning of the year, and we're looking for a big increase in that number for 2019 as well. We will also rollout the club to a further 7 markets this year.

When it comes to improving the supply chain, we continue to invest a lot in the supply chain. One example of that is our investment in new fulfillment centers. We have opened 3 new fulfillment centers in the fourth quarter. These are located in Kamen in Germany and the street called Boleslawiec in Poland. Together, they add a total of 230,000 square meters of logistics area. We have also automated our logistics center in Poznan in Poland. And so good improvements, and this will release the capacity constraints that we have had before during -- especially during the second half of the year and also in the first quarter and also enable a range of other improvements for our customers, for example, faster deliveries in a number of European markets, including Germany.

Further ahead, towards the end of the year, we will also open 2 more fulfillment centers, one in Madrid and one in London.

When it comes to the product flow as well, AI is becoming an increasingly important tool for us. And thanks to our vertically integrated business model, we can build AI models with algorithms designed to address various parts of the product flow, from trend detection to quantification, allocation, pricing, to mention a few examples.

We're also working hard to further improve our internal processes when we -- in our buying process and to further differentiate our buying depending on what product type it is. So to become even more precise in our buying and to shorten the lead times. And these improved buying processes will lead to, all other things equal, to higher sales, lower markdowns and reduced working capital.

When it comes to our take in IT infrastructure, here we also invest a lot. And this has made it possible for us to complete the transition of online globally to our new online platform. Last week, we successfully transferred online in Germany, which is our largest market. And this means that now all H&M's 47 online markets are now on the new platform, which will enable further improvements of the shopping experience for our customers.

Furthermore, we have ramped up initiatives ahead of upcoming transitions of logistics systems. Applying the lessons learned from the difficulties we had with the transitions in some markets earlier in 2018, we have increased investments in the fourth quarter to secure transitions that are due this year. In parallel, we are investing to become even faster in developing customer-facing technologies and be innovative with tech wherever the customers are.

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When it comes to adding new growth, our expansion will continue with stores and online for all our brands. For 2019, we will add a net of 175 stores. In total, we plan to open 335 stores. In total, around 240 of these will be H&M stores that will open mainly in markets outside of Europe and the U.S. And meanwhile, we are intensifying the optimization of the store portfolio. And this includes renegotiations, relocations, closures, rebuilds and adjustments of store space. And during the year, we plan to close approximately 160 stores.

The shift in the market is also opening up for further improved lease terms, and we have the opportunity to renegotiate nearly 1,000 store leases in 2019.

We also continued the global rollout of online. In 2019, we will open the H&M online store in Mexico and buy a franchise in Egypt. And when it comes to our other brands, COS, Weekday, Monki and Other Stories, H&M Home, ARKET and Afound, I mean, we have a great portfolio in those brands, and these brands are only at the beginning of their journey and we will develop them further and see great growth potential for all of these brands. But as always, it's always important to make priorities for our investments and like we have communicated already, we will close down Cheap Monday in 2019. The business model of Cheap Monday is based on wholesale, a model which has faced major challenges due to the shift in the industry and the closure of Cheap Monday is part of our transformation where we prioritize and focus on our core business.

So this was a short update on our strategic focus areas and growth initiatives. As we said, the market is going through a big transformation. We are going through a transformation of our business as well. We set up some goals before the year. We haven't reached those goals and obviously, we're not happy with that. But we also have done a lot of good work during the year, which will benefit our business going forward.

We have a long-term approach. We are investing a lot in the strategic focus areas I mentioned. We have a clear plan. We have a great colleague that are motivated and working hard, and we see results from that work and the positive signals that we are on the right track. So we are still optimistic that we have a bright future.

Thank you very much. And now, it's time for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question is coming from the line of Chiara Battistini, JPMorgan.

Chiara Battistini - *JP Morgan Chase & Co, Research Division - Co-Lead, European General Retail*

I have a couple, please. The first one would be on the price and product investments you'd be making in Q4. I was wondering if you could quantify the impact on the gross margin from those. And also if you're happy about the current offer now after these investments or you see further need to reinvest there? And tying in with the gross margin, maybe you could give us some color on how you foresee the gross margin evolution in 2019. And then the second question, just a clarification. Can you just please clarify what exactly the negative effects impacting the gross margin were in Q -- at the end of the year, please?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes. We -- it's correct. As I mentioned, we have made investments in the customer offering in terms of better prices, better quality also when it comes to sustainable materials, something we see that the customers are appreciating. That's one of the reasons for better full-price sales and increased customer satisfaction, which is not a comment on the exact investment that we are making. We believe we are at the good level now, very competitive and in terms of that. And we will always stick to the business [side and that] of course, it covers also to follow what the competition is doing. So we will constantly monitor what happens with the competition in all markets. If we look at the gross margin, we normally comment on these large external factors, the currency, the raw material prices, transport capacity and salaries and they were slightly positive for the fourth

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quarter. They will turn to slightly negative in the first quarter. We will continue to do investments also. We compared the first quarter this year compared to first quarter last year, and price reductions, we have commented on, which was -- which we expect to be 1 percentage unit lower first quarter this year. And then we have some extra costs that we have mentioned, the SEK 450 million approximately, where part of that is affecting the gross margin in the fourth quarter. It will also affect the gross margin in the first quarter, but not as much as in the fourth quarter this year. And on the year-end effect?

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

On the question on year-end effect, and that's, of course, is something that always happen. And it's a mixture of shrinkage, about inventory translation effect and so on. And this year, the negative effect amounted to just about SEK 110 million.

Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

Compared to last year.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

Yes.

Operator

Your next question is coming from Charlie Muir-Sands from Exane BNP Paribas.

Charlie Muir-Sands

The first question relates to your capital expenditure. You've indicated that in the current year, you would be spending a little bit less. But you also mentioned some promising signs of your pilots of new store formats. I wonder whether this would therefore be a transition year. And perhaps from FY '20, you might be thinking of spending some more on capital expenditure again to refurbish a lot more stores or not? And then secondly, on the opportunity to renegotiate rents, could you give us an indication of approximately how much you typically are saving on your rental when you are renegotiating at the moment? Is it 10% or more than that?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

It's -- when it comes to the first question, the CapEx, yes, we are doing a lot of tests with positive signs, and we are rolling out. That means the small improvements we see and the bigger improvements as well. So that is covered in the CapEx guidance that we have given. We opened less stores compared to before. So that means, in terms of the CapEx levels, that is part of the reason why it's coming down. And also, when it comes to the digital CapEx, the big part of the infrastructure is setting the foundation is some of it is taken. One of the examples that we have communicated today is that all the countries are now on the new online platform, so we can leave the old one, so to say. So I mean, everything is taken into account, including the rebuild program for the stores and the gradual improvements of the optimization of the portfolio when we guide for SEK 10.5 million to SEK 11 million in CapEx. And the second question was the renegotiations. Yes, we prefer not to quantify exactly what we think it will give. But it -- I mean, 1,000 contracts that we have the possibility to renegotiate, the market is going through a huge transformation. I think there's a good chance that we will see a good improvement coming from that. Sorry, we can't quantify.

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Charles Allen - *Bloomberg Intelligence - Senior Consumer Analyst*

But the CapEx, I just meant whether you think that this sort of SEK 10 million would be approximate level you would think about spending for the next few years? Or whether 2020, as you started really push with the store re-fits, it might tick up again.

Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

Yes. The guidance, as Karl-Johan just mentioned for 2019, is SEK 10.5 million and SEK 11 million, and it's shifting towards in a more digital investment. So when the guidance for 2020 or 2021, it's hard to say at the moment. But we feel that we have, in a way, peaked in our CapEx as we see it at the moment. So -- but to say exactly what it's going to be in 2020, it's too early. But as I said, we see it as we have had a peak year in 2018.

Operator

Your next question is coming from the line of Richard Chamberlain from RBC.

Richard B. Chamberlain - *RBC Capital Markets, LLC, Research Division - MD of Consumer Retail*

Actually, just a few more on margins, please. How should we think about the timing of the additional warehouse investments that you've mentioned in Spain, the U.K. and the U.S.? Should we expect those more in the second half of this year? That's my first one.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

No, I mean, part of the costs are taken we have now and then it will come gradually throughout the year. But I mean, these are planned, planned costs that we, I mean, have in the prognosis for the year to come and in the profit and loss prognosis that we do. So yes, we feel confident and that we have a good, I mean, it's in the plan.

Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

So that's the addition of the new logistic centers, but then as Karl-Johan said, we also have a lot of transitions in front of us where we -- similar transitions as we did in the U.S. and Belgium, hopefully more successful going forward.

Richard B. Chamberlain - *RBC Capital Markets, LLC, Research Division - MD of Consumer Retail*

Got it. Okay. And then speaking of OpEx, can you say how much OpEx was increased last year by free shipping for H&M Club? I see you're extending that to more markets this year. I think you mentioned 7. Has that materially increased OpEx?

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

No, it's affecting, but we choose not to quantify on that. I mean, when we decided to roll it out for the club members, obviously, it's something that we have tested. It will create value long term for the company, and it's good value for the customers as well. So that's why we decided to do it in short term. It's affecting the margins negatively. And here, it's also something where we have to see what happens in the market. Now we see more and more competitors actually introducing a cap and so on. So it's part of the total customer offering where we want to have the best customer offerings. We put it in relation to what the competitors offer as well.

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Richard B. Chamberlain - *RBC Capital Markets, LLC, Research Division - MD of Consumer Retail*

Okay. Great. And just finally, I guess, it's interesting you are choosing to hold the dividend, but cut CapEx for this year. I wondered if you can say how much you'll be spending on digital CapEx this year. And why you've chosen to hold the dividend instead of maybe accelerating CapEx on digital to catch up with some of the other players in the industry?

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

I mean, we're spending a lot, and we feel confident we're investing a lot. We're satisfied with that. We're really forward leaning and then doing a lot of good things there. So our focus is to develop the business in as good as way as possible, short term and long term and that we are doing. And when -- I mean, it's more for the Board to comment on. But they obviously look at the plans for the business, the financial statements, cash flow prognosis and a lot of different things and also the financial strength of the company, and so on, and also the underlying trend of the business which where we're showing positive signals. So I mean, it's their recommendation to the AGM, and we think it's good. We're happy with that.

Richard B. Chamberlain - *RBC Capital Markets, LLC, Research Division - MD of Consumer Retail*

Okay. So on the CapEx split, I would've thought you're still spending the majority on new stores. Is that correct? That you've increased your digital spend?

Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

Yes, it's slightly above 50% of our net investment in CapEx is already in digital.

Richard B. Chamberlain - *RBC Capital Markets, LLC, Research Division - MD of Consumer Retail*

Slightly above 50%?

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

And it's increasing.

Operator

Your next question is coming from the line of Adam Cochrane from Citi.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

A couple of questions for me. In terms of -- there's a few bits on the balance sheet regarding a significant increase in accrued expenses and capitalized expenses, would you be able to confirm what they relate to and how that may impact the profit and loss going forward, whether it is depreciation or going through some cash payments later? And then secondly, in terms of the net financial income, can you sort of explain the moving parts within that and it is sort of going into a net debt position. You still have the financial income coming through. Is that something that you'd expect to carry on? And then finally, the one-off costs that you had in 3Q and 4Q, should we assume that they completely reverse out next year or across this year, and let's assume that they don't occur at all next year, albeit you might get some others coming in from other areas, but those particular ones are done and dusted.

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Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

Well then, to start with capitalized expenditures. So that's our investments in IT systems and digital investments that is capitalized in the balance sheet. And during the years, we have invested, I think accumulated somewhere slightly above SEK 10 billion and also depreciated accumulated slightly above SEK 1 billion. The depreciations during 2018 was slightly over SEK 500 million connected to the capitalized expenditures. So it's net depreciated in the balance sheet is now more or less SEK 9 billion. And of course, when we are taking these in use in more and more countries, the depreciation will increase. Probably, the depreciation just for the capital expenditure would increase during '19 from SEK 500 million to maybe SEK 800 million.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

Can you give us the guidance on what the overall depreciation charge would be because of presumably lower store count, there's a few benefits in there as well.

Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

I think the increase will be in line with the increase from '18 to '17.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

When it comes to what's the final question there, what the extra cost that we have now in the third and fourth quarter, in the fourth quarter, we said it was SEK 450 million and then also adding the year-end effects, if that will happen in the third and fourth quarter in 2019. Did I get your...

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

That's right. Yes.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

Yes, exactly. Now the things, it's extra one-off costs. So connected to one part in the fourth quarter, then it's connected to the ramp-up in securing good transitions of the logistics system, and one part is securing a good transition of the online transition in Germany. So it has affected quarter 1 as well. But it will not -- those 2 will not affect the third and fourth quarter next year.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

And how have you spent the money in advance to sort of secure? There's going to be less issues with logistics and IT in the following quarter before you implement it? What exactly or just generically, what do you mean by you spent this money to secure the transition?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Well, at securing -- one, when it comes to logistics systems, one is the spillover effect on the backlog from the transitions that we had in U.S. and Belgium. So it's setting that right in the fourth quarter. That we have done. The second part is making sure that we improve the system so that the following transitions in the year to come, in 2019, is in at a much better level because we have a lot of problems, that what's happened in the U.S. and Belgium. So a lot of investments have been made to secure that we improve the logistics system so we can roll it out. And in the fourth and first quarter, we have prepared for Germany, the transition from the old platform to the new platform in the first quarter. So those were costs that we took in the fourth quarter and now in the first quarter. But that will not happen, obviously, in the second quarter, third quarter and fourth quarter during 2019.

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Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

And also to your question, Adam, it's about change management to invest in training the staff, et cetera, better than we did in the U.S. and Belgium, so they are prepared for the coming transition.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

And finally, on the accrued expenses, increased by about SEK 4 billion. Can you just tell us what the -- what's in that balance? And then why did it increase by so much, please?

Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

Yes. I don't have the balance specification next to me. But normally, one big part of the SEK 23 billion is the landlord contributions. There are also always vacation pay accruals, social charges accruals, salary accruals and duty and freight accruals. So it's a mixed pot. But the biggest pot is connected to landlord contributions.

Operator

Your next question is coming from the line of Magnus Råman from Handelsbanken.

Magnus Råman - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

I have a question on the Click and Collect rollout that you talked about. When you consider a country rolled out, so how many stores typically do you offer in a good country with only, say, 5% or 10% of total stores having Click and Collect be called a Click and Collect rolled out country?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes, it varies from country to country. So we look -- obviously, we look at introducing something that we believe is good for customers. And we also have to take a financial -- what makes financial sense for us into account. So we set the target for a country how many stores we want to roll it out -- how many stores in each country we want to roll out. And then when we have completed that or nearly complete it, then we see it as a rollout.

Magnus Råman - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

And I mean, if you look out in time at bit in a more mature phase of that rollout, how many stores typically in a country would you say roughly would be included?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

How many stores in a country?

Magnus Råman - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

Yes. What share of stores would be having Click and Collect?

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes. We have -- it depends from market to market and city to city. I mean, in some cities, we have a lot of stores. And then it makes sense to maybe don't have a huge share. And if we only have one store in the city, then it will be 100%. So it varies a lot. And we are present in more than 70 markets, so there's a big difference depending on market density and how many stores we have.

Magnus Råman - *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

And alluding to country-by-country, perhaps, you can't provide a number. Anyhow, I have a second question on logistic centers. The 3 ones that you've mentioned that you just opened and then the 2 coming logistic centers, are they for online deliveries only? Or is it also store fulfillment here? Or can you elaborate a little bit about that?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Online and one is a combination. London is an omni-warehouse, so to say.

Operator

Your next question is coming from the line of Anne Critchlow from Societe Generale.

Anne Critchlow - *Societe Generale Cross Asset Research - Equity Analyst*

I've got 2 questions. The first one is about the percentage of sales from the newer brands, if you can give an update on that because you gave us a figure last year of 10% of total sales. And then the second question is more about customer behavior. So in the countries where you have H&M Club with free shipping and returns, and you also have collection and return to store, what's your feeling about what customers actually prefer? And what's driving the sales in those types of countries?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Sorry, can you repeat the last question there?

Anne Critchlow - *Societe Generale Cross Asset Research - Equity Analyst*

Yes. So I'm sort of interested in whether it's H&M Club free shipping and returns or the ability to collect in-store and online order and return to store that is driving sales in countries where you have both offers for customers. What do you think customers prefer in terms of free shipping to home or collection in-store?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes, okay. If we look at the new business part, we had a target of more than 25% for the year. We didn't reach that. We still had good growth. We increased by 21% in Swedish crowns and 20% in local currencies. The brands were -- I mean, it's been a tough market that affects all the brand. We pulled down a little bit of expansion for some of the brands. So good growth, but not really satisfied as we had higher ambitions. When it comes to the question about what customers appreciate, when I -- most of what's driving most sales was that, I think, that was your question in terms of the free returns and...

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Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

Click and Collect.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Click and Collect. I mean, it's a combination of different things. It's part of the total customer offering. Customers are appreciating it. And the whole integration of online and physical stores, we believe, is a great strength. So it's hard to say exactly what's -- what each feature, what each services is driving in itself. It's the total package.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

And this is the message we've had for a long time. There isn't one specific feature that will drive everything. It's a combination of everything having aggregated, that -- that shopping experience becomes more seamless and more convenient.

Operator

Your next question is coming from the line of Rebecca McClellan from Santander.

Rebecca Anne McClellan - *Grupo Santander, Research Division - Equity Analyst*

Just a couple of questions, please. Firstly, in terms of your inventory across online and the stores, how integrated is it? And -- because my impression is that it's not particularly integrated. And therefore, as this as the business upgrades, et cetera, progress, what's the spike going to be on the inventory -- overall inventory through inventory integration?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Part of it is integrated, but it's getting more and more integrated. I mean, we have several initiatives on how to improve the selling, how to reduce markdowns and how to improve the inventory levels. That is one thing. I mean, setting a better logistic infrastructure connected to the more complex world that we are in today. We're in more markets. We have several channels. We have several brands. So we map up a good logistic infrastructure in terms of number of logistic centers, the size of them, how many for online, how many for stores, how many should be omni. So that we have done, and we are building towards that. So examples of that are the 3 new centers that we opened up in the fourth quarter, and 2 more to come during the year in London and Madrid. All AI -- or not all, but part of the AI initiatives that I mentioned earlier will help us as well when it comes to being more precise in how we buy, how we quantify and allocate the product. And then also, again, to segment the products, we buy depending on what product type we are buying in a better way than we have done in the past will shorten lead times and we will tie up less capital in that as well. So just -- and then, obviously, the most important part is to continuously improve the assortment, so we sell more, sell better. So all of those are initiatives that, we believe, will lead to better sales, lower inventory levels in relation to sales.

Rebecca Anne McClellan - *Grupo Santander, Research Division - Equity Analyst*

Is there an element of being a bit of a dual inventory position? Because you need to have a certain amount of inventory for online and a certain amount of inventory for the stores and because it's not much cross-tunnel inventory integration, you can perhaps sort of over inventory because of that.

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Well, if we come from 2 different channels, but we're getting more and more integrated in everything we do. So I mean, we're -- obviously, when we plan the assortment, we don't -- we look at the total and we plan what we believe is good for the stores. We plan what we believe is good for online. But then we have some infrastructure constraints and we have some technical constraints. And that's one of the reasons why we are investing in a better logistic infrastructure and IT and tech infrastructure, so we don't have those cost pains. And we can become even more integrated between markets, between channels.

Rebecca Anne McClellan - *Grupo Santander, Research Division - Equity Analyst*

Okay, okay. My second question just in terms to determine warehousing upgrades sort of the equivalent of what you did in the U.S. and Belgium, that's still due for spring, is it?

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

We haven't set any time yet. But it's still -- it's in front of us, yes.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

More markets, yes.

Operator

Your next question is coming from the line of Michael Benedict from Berenberg.

Michael Benedict - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

You mentioned that Germany was re-platformed in January. Could you give us a sense of the impact it had on sales and costs?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes, but we mentioned the extra ramp-up cost, not the full cost, but the extra ramp-up costs that we decided to take in order to ensure a good transition of Germany. That's roughly SEK 200 million. And then we have had some capacity constraints for quite some time actually in Germany. So that's one of the reasons why we're building the new logistic centers to be able to sell more. So that has been going on for quite some time, affecting sales negatively in Germany in quarter 3 and quarter 4, and mostly actually in quarter 1 because there we have the capacity constraints and at the same time we're doing the transition. So hopefully, we -- or not hopefully, but we obviously believe, with more capacity and also improved delivery times, we have a good chance of selling more, but affecting sales negatively quarter 3, quarter 4, quarter 1. And there has been quite a lot of costs connected to that transition as well.

Michael Benedict - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Okay. That's really helpful. And secondly, you've mentioned you've doubled your H&M Club members. Do you have a target in mind for your club membership? And what's the suspected impact of that will be on profit?

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes, we have targets. We choose not to give the exact target for the year. What we have said is that we have, I mean, as I mentioned earlier, gone from 15 million to 30 million club members by the end of 2018. And we plan for a good -- very good increase as well for 2019. We're improving the club. And it's being rolled out to 7 new markets during the year. So hopefully, we will have many more club members by the end of 2019.

Michael Benedict - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Great. And just last one for me. You've said your inventory position is expected to improve in Q1. Could you quantify the impact of that on your gross in Q1, specifically?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Sorry, what -- I'm not sure what you mean. Can you say that again? How...

Rebecca Anne McClellan - *Grupo Santander, Research Division - Equity Analyst*

You mentioned your inventory position will improve in Q1. Would you able to quantify the impact of that on your gross margin?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

What we have said is that we -- the -- what our best guess now is that reductions will be 1 percentage unit lower in quarter 1. And by the end of quarter 1, we will see further improvements in the inventory levels and composition. So going out of quarter 1, the inventory level will be better in terms of level and the composition. And we will also see 1 percentage unit lower reductions in quarter 1.

Operator

Your next question is coming from the line of Geoffrey Ruddell, Morgan Stanley.

Geoffrey Frith Ruddell - *Morgan Stanley, Research Division - MD*

I just wanted to take you back to the guidance you gave us at the Capital Markets Day. I mean, you've been very open that you've missed and fallen short of the 2018 guidance. But I'm wondering if you're still happy with the guidance you gave for the '18 -- sorry, the '19, '20, '21 years? And in particular, are you expecting profits to grow this year and next year and the year after?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes, we -- exactly, we missed the goals we gave. Obviously, not happy with that. And I think it's very difficult, given the transformation that we're going through and the whole market is going through and with all that uncertainty to be very precise on figures and timing. So what we're saying now is that we believe we will see improvements during 2019 compared to '18, improvements in selling, profits, inventory levels, satisfied customers, so that's what we are saying.

Geoffrey Frith Ruddell - *Morgan Stanley, Research Division - MD*

But you say -- just to be clear. So you are saying you expect EBIT to be higher this year than in the year that you're just reporting today.

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes.

Geoffrey Frith Ruddell - *Morgan Stanley, Research Division - MD*

Great. And do you expect the stock-in-trade to be back between -- in the 12% to 14% range by the end of the new financial year?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Same there, actually. We are -- I mean, we believe we'll see improvements, but we prefer not to give exact timing and the -- an exact figure.

Operator

Your next question is coming from the line of Jorg Nowicki from TextilWirtschaft.

Jorg Nowicki

My first question, actually, partly was already answered. It was about the new brand. But there's one point left, which I would like to point again, which is Afound. Can you give us -- since this is such a huge market, the up price market and so on, I was wondering really how Afound actually started and when or if you're going international with it?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

It started well. But as always, when we launch a brand, it's been the same for H&M. That was long ago in 1947, but costs and stores and so on. We -- you learn a lot, tweak it, and then improve. And then when we feel ready, we will expand. And the same with Afound, we have a lot of good receipts. We are fine-tuning maybe is not the right word, but improving it and preparing for expansion. And so we will definitely expand with Afound. And Germany is one of the markets that we're looking at.

Jorg Nowicki

Can you give a year on that? Is that going to be the case this year?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Sorry, we don't want to. We haven't -- no, we don't want to communicate on exact timing yet on when we will go abroad with Afound.

Jorg Nowicki

Okay, okay. All right. The second one would be a big part of the business in fashion retail today takes place in marketplaces -- on marketplaces and platforms. And kind of, I think, your business in China, your growth in China shows the impact of Tmall. When can we expect going -- H&M going on marketplaces such as Amazon and Zalando and other big marketplaces?

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

We have evaluated all the marketplaces that are out there in all markets, just to see if there's good fit between the brands we have and the marketplaces and if it makes sense for us long term to be on any of those marketplaces. Short term -- financial short term, it makes a good sense to go on a lot of the marketplaces because it will boost the selling and profits. But we always do what's best for the company in the long term. So we have certain criteria that we look at for the different brands if we are to go on a marketplace. And right now, for the H&M brand, the only one that we are on is Tmall because it fits those criteria. And -- but we are evaluating, we are looking. Vague answer, but that's all I can give now.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

And for the smaller brands, we are already on some other platforms, as you know.

Operator

Your next question is coming from the line of Karl Reschreiter from UniCredit Bank.

Karl Reschreiter

I have 2 questions regarding the segment reporting of your group. The first one is, what about the profitability of the online segment? And the second one is, what would be the like-for-like development of sales will be in the store segment?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

When it comes to the online segment profitability, we choose not to go down in detail on that. And it becomes -- I mean, as we mentioned earlier, the channels are getting more and more integrated. It's very difficult to say exactly what's online and what's in stores. But what we can say is that profitability, as for the whole group, has gone down in both channels. We see, in the fourth quarter, the underlying business is improving. But we have a lot of costs connected to the ramp-up of the logistics systems and the online transition, which is affecting profitability in both channels. And then we have the free shipping, free returns on the online as well affecting the online a little bit more in the short term as well. And when it comes to like-for-like development, we -- I mean, as we said earlier, we -- it's not something we comment on. But we have seen a gradual improvement throughout the year.

Karl Reschreiter

One question. What's the amount of balance liabilities at the end of the last year, the balance sheet date?

Jyrki Tervonen - *H & M Hennes & Mauritz AB (publ) - CFO*

We don't have that yet here, but that will be disclosed in the Annual Report. So we haven't finished the Annual Report at the moment. So I don't have the figure for the off-balance-sheet.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

But there will be -- this will no material differences from last year.

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Operator

Your next question is coming from the line of Antti Lehmusvirta from Kauppalehti Business.

Antti Lehmusvirta

I was wondering how are you prepared for Brexit.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

We are prepared for Brexit, almost said breakfast. But Brexit, breakfast, we're looking at different scenarios. Obviously, there's a lot of uncertainty, so we'll see how it goes. But we have contingency plans in place. We believe if it happens, the main things will be -- would affect the product flows, import duties and also maybe some delays in the product flows as well. So we're looking at all the different things that will be affected, and we have plans in place.

Operator

Your next question is coming from the line of Andrew Hughes from UBS.

Andrew Hughes - *UBS Investment Bank, Research Division - MD and Head of the Pan-European Non-Food Research*

Yes, can we just go back to -- yes, can you hear me?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes.

Andrew Hughes - *UBS Investment Bank, Research Division - MD and Head of the Pan-European Non-Food Research*

Yes. Can we just go back to the fourth quarter gross margin. And if we take out the markdown movement and the special factors you mentioned, your underlying gross margin was down about 100 basis points, and that was with a benefit from external factors. Should we expect that underlying gross margin should actually deteriorate as we go into next year as the external factors move against you? That's the first question.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

As always, Andy, there are a lot of different moving parts in the gross margin. And you're right. We go from an environment at a time when we had some help from -- especially currency, and now it's turning against us. So all things equal, of course, it puts more pressure. But for us, the most important is always the customer experience, and that's number one. And then, of course, we need to mitigate what we can and to improve. And then we have the reductions, as we mentioned, that hopefully will offset some of the other negative parts.

Andrew Hughes - *UBS Investment Bank, Research Division - MD and Head of the Pan-European Non-Food Research*

All right. Okay, okay. And in terms of your comments on the composition of inventory being better, I mean, it looks like you've got about 4.5 months of inventory. I mean, how can you say the composition is better because you're having to make a guess about what will be selling well in 4, 5 months' time? Is that right? Will you be able to do that?

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

We're not that levels, what -- we want to see further improvements. But the sequential development from the third quarter to the fourth quarter to what we believe will be the case and by the end of the first quarter this year, I mean, we are improving. And the composition is improving. And there are different parts in the composition, of course. It's new -- I mean, current seasonal garments. We have garments season-less, so to say, and then we have older garments. So it's mainly the older garments with lower value that has come down. And we are improving in -- so it's a better competition -- composition in terms of the stock freshness. And also reductions are coming down as well in the fourth quarter and the first quarter, so -- which is a sign in itself.

Andrew Hughes - *UBS Investment Bank, Research Division - MD and Head of the Pan-European Non-Food Research*

Yes, yes. Okay. And just finally on -- to clear up on depreciation. I think you said it would be at the same rate in FY '19, so it was up 14% last year. So we assume another 14% increase.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes, that's our best estimate for now. And as I mentioned, the capital expenditure depreciations will increase in 2019. As I said, they were around SEK 500 million during '18. And our best estimation is then to -- that they will end up being SEK 800-something million on a yearly basis. But there shouldn't be any major other increases. So we will still look into any write-downs of the inventories. So at the moment, we don't see any major impact compared to 2018 in those items [also].

Andrew Hughes - *UBS Investment Bank, Research Division - MD and Head of the Pan-European Non-Food Research*

Right. Okay, okay. And one last thing while I'm on in terms of -- last year, you certainly thought about a scrip dividend, and it didn't happen. Did you think about it again? Or do you -- or you're sort of comfortable with your level of debt and you don't think you need to go down that route?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

We can't comment on that. I mean, this is a recommendation from the Board, and we are happy with that. We think it's good. We are in a good situation. We can do necessary investments. Underlying core of the business is going in the right direction, so we're confident.

Operator

Your next question is coming from the line of Szilvia Bor, Crédit Suisse.

Szilvia Bor - *Crédit Suisse AG, Research Division - Research Analyst*

Two questions from me, please. Firstly, on credit sales. How much of sales is now driven by credit sales? And how do you expect this to change in the medium term? If you could comment on that, that would be useful. And secondly, online delivery terms. You mentioned that term -- your overall customer -- online customer fulfillment is improving with shorter delivery times. And then you also mentioned that some of your competitors are now introducing tighter delivery terms, i.e., more expensive online services to protect margins. My question is relating to how far do you think you will have to go competing on online service levels and when do you think that you might need to start reversing some of the rather generous delivery terms to protect margins?

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Regarding the credit sales, I don't know -- I don't have the figure.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

No, it's not something we comment on, but it is something that customers appreciate. And we are -- we have invested in Klarna and we're developing an app, so they will be able -- customers will be able to use credit in stores and online in a safe way. So this is something we are developing.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

And when it comes to delivery terms, it's -- when it comes to delivery terms, it's obviously something very important. It's something that we want to continue to improve. So we are improving quicker standard deliveries, and that will be further helped by the new centers we're building. We are introducing more countries with next-day deliveries. We're trying out same-day deliveries in some markets. Time-slot deliveries, we have a number of markets rolling out in more as well. So that will be a very important part of the total customer offering. The free shipping, free return is part of that as well. But as we've said before, when it comes to the products, and this is part of the customer offering, we want to make sure that we have the best customer offering of all competitors. And we will also monitors -- monitor what the competitors are doing. So it depends a lot on that as well.

Operator

Your next question is coming from the line of Chiara Battistini, JPMorgan.

Chiara Battistini - *JP Morgan Chase & Co, Research Division - Co-Lead, European General Retail*

Sorry, just one follow-up question on your supply chain. Could you please expand on the initiatives you're putting in place there? And also you mentioned that the lead times are going down, so could you please remind us on what the length of the lead times now are today versus a year ago, please?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

The improvements to the supply chain, we have quite a lot of initiatives connected to that. Again, we're building new logistic centers around the world for the online, for stores, omni-warehouses, automation of warehouses, improving the supply chain as well. The AI initiatives to be even more precise in our location and quantification is part of that as well. Using 3D in technique is helping the lead times, differentiating the buying processes depending on what product it is will make us even more precise in lead times as well. So -- and all in all, lead times are coming down. I don't think the most important part is not the average lead time. The most important part is that we can be super quick when we want to be quick. And when we want to buy more in advance due to -- for better in prices, for example, we can do that. So it's constantly a balance.

Chiara Battistini - *JP Morgan Chase & Co, Research Division - Co-Lead, European General Retail*

And maybe when you say when we want to be quick, we can be quick. How quick can that be? Can it be -- or are we talking a couple of weeks, a few weeks, a month?

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes, it's a couple of weeks. It depends on what market, what type of product we're talking about and what quantities we're talking about as well. So I mean, if we want to test something in small quantities and scale up when we see it's selling, that's one type of way that we want to buy. And I mean, we are constantly improving in this as well in that we are differentiating different parts of the assortment.

Operator

Your next question is coming from the line of Dana Telsey, Telsey Advisory Group.

Dana Lauren Telsey - *Telsey Advisory Group LLC - CEO & Chief Research Officer*

As you think about the performance in the fourth quarter so far in your real estate portfolio, how are you thinking about the U.S. real estate, whether by store -- the potential for store closures, lease adjustments or even taking a look at the other ancillary concepts and keeping them, not keeping them? How do you think about it?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Sorry, I'm not sure I follow. What was the last part of that question, if we think about the other concepts?

Dana Lauren Telsey - *Telsey Advisory Group LLC - CEO & Chief Research Officer*

Yes. Do you close those stores? Do you keep them open? What would be the appropriate number of stores in the U.S.?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

I mean, U.S., it's a huge market. We still see growth opportunities in the U.S. for all brands. We're still opening stores in the U.S. But it's also a market -- probably the market that is going through the biggest change at the moment with too many shopping centers around, maybe too -- and yes, too many physical stores. So a lot of things are happening in the U.S. markets, where I think we will see a lot of closures. So we really need -- as well as opening stores, we really need to be active with optimizing the portfolio that we have. That's one of the markets where we will be most active when it comes to optimizing the portfolio in that we will rebuild a lot of stores. We will also renegotiate a lot of leases. We will close stores in the U.S. and move some stores. So it's a market that's going through a big transformation. And when it comes to the new brands, yes, we will continue to see U.S. as an important market for those brands as well. But it's a big step going into the U.S. market. And if you take ARKET, Afound, Monki, Weekday, they are not present there. And so we really need to be well prepared when we enter the U.S. market.

Operator

Your next question is coming from the line of Adam Cochrane from Citi.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

So just a quick follow-up. If you pick the [val] space, when you look at the price investments that you made over the course of last year, I know you don't want to quantify them, but would you be able to identify when they started and how will they annualize in Q1, Q2, Q3? So as we've got the pressure from FX instead of being a tailwind moving into a headwind, when do you think the current price investments that you've made would annualize, please?

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Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

We have made a gradual investment throughout the year, so more towards the second half of the year. When we make investments, if we make investments, we, of course, look at what, I mean, the gross margin forecast, looking at external factors, looking at estimates for reductions, looking at all the factors influencing the gross margin as well. So we don't want to quantify what the exact effect is on the gross margin from that -- from those particular investments for 2019. But looking at the year behind us, more investments towards the second half.

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

And you have to look at market by market.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

That's right. And one other bit is in terms of your total logistical changes that you've done in the business, how fast through that process do you think you are as it stands today?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

For the logistical changes.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

For your new distribution centers, for the global distribution platform as you see it, how far along the journey do you think you are?

Nils Vinge - *H & M Hennes & Mauritz AB (publ) - Head of IR/Franchise*

Okay. When it comes to online and new platform, we're done now with Germany, so that's great. And when it comes to the rest, we're mainly hitting the stores. We're more or less halfway through from the turnover base.

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Yes. And then as we continue to grow, I mean, and integrate the channels, enter new markets and so on, expand with new brands, we will continue to build new logistic centers. So we haven't, I mean, really an end goal in mind. The business will continue to evolve, but -- yes.

Operator

Your next question is coming from the line of Andreas Inderst from Macquarie.

Andreas Inderst - *Macquarie Research - Senior Equity Analyst*

I have a few questions. The first one on the slowdown in December and January versus Q4 '18, what were the reasons behind that? I mean, you mentioned one reason, Germany, but maybe you can elaborate a bit more. And maybe related to that, you have an ambition to reach 10% to 15% growth again in the longer term. What is the timeline for that? That's maybe my first question. Then the second one, related to your comment that you expect 2019 profit growth, EBIT growth. Is it on an adjusted EBIT basis, given you had over SEK 500 million one-off costs? Or is that on a reported

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basis? And then my final question is just a clarification on your comment on 1 percentage unit reduction in markdowns. Are you guiding a 100 basis points improvement in the gross margin from markdowns? Or what exactly do you mean with 1% unit reduction in markdowns?

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Okay. If we look at the start to the year, December and January, it's 4% in local currencies. And then we have to look at -- on the positive side, we have the Chinese New Year affecting sales positively in several markets in January. On the negative side, we have the transition of the -- of Germany, the online store, which has affected the sales negatively by quite a bit for the online part in Germany. And then we also have more full-price sales, less markdowns. We have bought more cautiously, so we have a higher stock turn on the new products, new seasons that we are buying. So we're not at the 10% to 15% growth target. It's a long-term ambition. What we have said for the year is that we want to see improvement. And we believe we will see improvements compared to 2018. That goes for EBIT as well. So on a reported basis, we believe we will see improvement compared to 2019. When it comes to the 1 percentage unit, how that will affect the gross margin, we don't want to go into those details. But it's more -- it's that reductions as an isolated part will be -- we estimate will be 100 basis points below last year as a share of sales, yes.

Operator

There are no further questions at this time. (Operator Instructions)

Karl-Johan Persson - *H & M Hennes & Mauritz AB (publ) - CEO, President & MD*

Okay. Thank you all very much for participating in this conference call, and we wish you all a good day. Thank you.

Operator

That does conclude our conference for today. Thank you for participating. You may all disconnect.

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