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Conference Call Transcript

BRBY.L - Burberry Group plc Second Half Trading Update Conference Call

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Erwan Rambourg

HSBC - Analyst

Gilles Lequeux

Cazenove - Analyst

Luca Cipiccia

Goldman Sachs - Analyst

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Redburn Partners - Analyst

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Burberry Plc second half trading update. (OPERATOR INSTRUCTIONS). I will now hand you over to Miss Stacey Cartwright, Chief Financial Officer, to begin today's call.

Stacey Cartwright - Burberry Group Plc - CFO

Good morning ladies and gentlemen. Welcome to Burberry's second half trading update call. With me this morning is Fay Dodds our IR Director. We're going to give you a brief overview of our performance in the quarter before taking your questions.

Our fourth quarter performance was very much in line with our expectations and as a result for the second half as a whole we've delivered 18% sales growth on an underlying basis with strong growth in both retail and wholesale channels. And this was achieved by increasing volatility in the markets in which we operate. This second half is the fourth consecutive six month period that Burberry's delivered double-digit growth.

So looking now by channel, retail sales increased 17% in the half with 6% comparable stores growth led by the US which continued to show double-digit comparable store growth, boosted by tourists and oil-related spend. Italy and Hong Kong were two of our strongest markets whilst Spain remained weak. During the half we've added 12% selling space including nine new mainline stores in locations including Aspen, Colorado and our first ever standalone childrenswear store located in Hong Kong. In the new financial year we expect to add around another 12% space growth with around 15 mainline store openings.

So turning now to wholesale, revenue here increased 25% in the half driven by our more balanced product offer, better deliveries, the more frequent flow of products to customers and better replenishment. We were delighted with the performance of North America in particular where our strategy of working more closely with our top customers continues to deliver. Looking forward, based on the early order book, wholesale revenue is expected to increase by around 10% in the first half of '08/'09. America and the emerging markets remains strong although Spain continues to be weak. And then finally licensing where revenue was unchanged year-on-year and this is a trend we expect to continue in the current financial year.

We continue to pursue our key strategies to drive growth. Under the first leveraging the franchise we're seeing great growth in products where there's been product innovation such as packaway trenches, where we've evolved the iconic check such as the crinkle mega-check scarf used in the Burberry The Beat campaign. Although we've concentrated our marketing messages behind certain categories such as dresses which feature very heavily in the current campaign.

Under the second theme, intensifying non-apparel, we've had further strong growth in this category. This category now accounts for 33% of retail and wholesale revenues, up from 28% in the second half of last year. Under accelerating retail-led growth, as well as the new store openings we've planned for the New Year we'll also renovate two of our major flagships in '08/'09, that's Beverly Hills and Knightsbridge which will better showcase the brand in these key luxury markets. Under investing in under-penetrated markets we continue to be delighted with the performance of the emerging markets and our local partners will add around another 20 stores in the coming year. Finally, under operational excellence, we're now preparing for the SAP implementation in Hong Kong very shortly with the US and other parts of Asia to follow as we move through the financial year.

So although the external environment is becoming more challenging, as Angela said in her quote this morning, we remain intensely focused on our core luxury retail and non-apparel strategies as well as on improving the operational efficiency of the company. So with that let me now hand you back to the operator for questions.

QUESTION AND ANSWER

Operator

Thank you. (OPERATOR INSTRUCTIONS). The first question we have is from the line of Thomas Chauvet of Citigroup, please go ahead with your question.

Thomas Chauvet - Citigroup - Analyst

Hello Stacey, hello Fay.

Stacey Cartwright - Burberry Group Plc - CFO

Hi Thomas.

Thomas Chauvet - Citigroup - Analyst

Congratulations on that statement. I just want clarification, when you indicate that retail like-for-like in the US were up double-digit in H2, can you confirm that this was also double-digit in Q4?

Stacey Cartwright - Burberry Group Plc - CFO

Yes it was, because it's very simple math this time round, because both the third quarter, and the fourth quarter, the 6% growth and double-digit across the US in both those quarters.

Thomas Chauvet - Citigroup - Analyst

Okay. And my second question, can you elaborate on this high net debt forecast, I understand it's largely working capital-related but if so can you tell us about inventory position and if Atlas had any impact on inventory at your end?

Stacey Cartwright - Burberry Group Plc - CFO

Yes it's less to do with that, plus it's very much as we articulated in the January statement, we were carrying more inventory as we came out of the third quarter and that continued through the fourth quarter. So that reflects the net debt position as at the end of March and obviously we'll give you the full details when we come back at the end of May.

Thomas Chauvet - Citigroup - Analyst

Okay, thank you.

Stacey Cartwright - Burberry Group Plc - CFO

Thanks Thomas.

Operator

Thank you. The next question we have is from the line of Erwan Rambourg of HSBC, please go ahead.

Erwan Rambourg - HSBC - Analyst

Yes hi, Erwan Rambourg from HSBC in London. Good morning again.

Stacey Cartwright - Burberry Group Plc - CFO

Hi Erwan.

Erwan Rambourg - HSBC - Analyst

Just three questions if I can. First on Spain, you've converted a while back the womenswear recently baby, can you give us an update on the feasibility of conversion of the menswear at some stage?

And in this market which is still tough, when do you see an inflection point in trends and is this more macro-led or can you do anything about it? Just -- I'll go on with the other two.

In terms of the comp sales, I know you don't give a guidance specifically on comps, however I was just wondering if you can give us a feel for how you believe comps can be sustained at this quite high level of 6% you've put out in Q4 for the first part of the year?

And then thirdly on license revenues, can you give us a split in terms of sales between Japanese licenses on one side and fragrance, eyewear and other, in terms of split of sales but also in terms of growth rates please?

Stacey Cartwright - Burberry Group Plc - CFO

Okay, alright, well I'll take you back, right back then to ECI. I think your first question, Erwan, was having converted womenswear and childrenswear etc. successfully, can we do menswear? Just to flag that menswear is more challenging to do from the point of view of just how material it is to El Corte Ingles. In Spain, menswear is a much bigger business than womenswear, it's how the brand was built over time, when it was built under license. Therefore we are having conversations with El Corte Ingles about a more innovative way of getting the best of both worlds whereby they don't lose the benefit of the retail sales but equally we can have more influence over the buy and help to drive some of the benefits out for the greater good of both us and El Corte Ingles, and those conversations are ongoing.

Erwan Rambourg - HSBC - Analyst

Great.

Stacey Cartwright - Burberry Group Plc - CFO

Then the second point I think was around, when is it going to get better in Spain? I would say that again, in our understanding from talking to our partners in the marketplace is that this is macro-related. I think Spain is suffering somewhat more than some of the other markets right now and we seem to be right in the thick of it. We don't believe we're performing any worse, we're not performing any better than the peers, and the issue for us in Spain is that we don't have -- a) Spain does not have a huge luxury market anyway and our brand positioning in Spain is more of a better brand than a luxury brand, again through history, through the license and therefore we don't have that protection that we seem to have secured for ourselves or some form of insulation from that luxury positioning.

In terms of how we sustain comp sales, well I think it's more about the product innovation continuing to look to drive productivity in our own stores, to bring the right levels of innovation, to drive the right customer behavior into our stores through the marketing campaign. It's continuing to execute on the strategies as we have done.

Erwan Rambourg - HSBC - Analyst

So do you think comps can be positive still in H1 of this year?

Stacey Cartwright - Burberry Group Plc - CFO

You know we're not going to call out anybody's crystal ball right now, yes we did call out in this statement but we do see a more volatile environment. And by that we mean that literally on a daily basis across all of our stores, whether it's Europe or the US we can see significant swings up and significant swings down. So very difficult to predict trends right now.

Erwan Rambourg - HSBC - Analyst

Okay.

Fay Dodds - Burberry Group Plc - IR Director

And on Japan, we said that Japan is broadly two thirds of our licensing revenue, and at constant currency if you look at the year as a whole, that's been broadly flat. We've seen good growth from our global product licenses, the fragrance, the eyewear and the timepieces but that's been masked because we've been terminating or not renewing certain licenses mainly in menswear as we take greater control of the brand around the world. And so that is what drives the broadly flat constant currency performance.

Erwan Rambourg - HSBC - Analyst

So it's still about two thirds, one third?

Fay Dodds - Burberry Group Plc - IR Director

Yes.

Erwan Rambourg - HSBC - Analyst

Okay, thank you very much, very clear, thanks.

Stacey Cartwright - Burberry Group Plc - CFO

Thanks Erwan.

Operator

Thank you. We have a question coming through from the line of Gilles Lequeux of Cazenove, please go ahead with your question.

Gilles Lequeux - Cazenove - Analyst

Hi, this is Gilles Lequeux from Cazenove, good morning again.

Stacey Cartwright - Burberry Group Plc - CFO

Hi Gilles.

Gilles Lequeux - Cazenove - Analyst

Just a quick question on share buyback. Is it fair to say that given the increase of inventories and its impact on your net debt position that you're not likely to proceed to any real important share buyback in 2008? Because as you're always mentioning share buyback is coming after everything else, and you want to keep a neutral debt position on the long term.

Stacey Cartwright - Burberry Group Plc - CFO

Yes Gilles it's exactly that, that share buyback is, if you like, the balancing number. We've stated our balance sheet strategy or policy to maintain a broadly cash neutral position. We will be carrying around GBP70 million of debt at the end of the year, so obviously that will limit the opportunity for much in the way of buyback in '08/'09.

Gilles Lequeux - Cazenove - Analyst

But at the same time, I understand that but at the same time, you've got a strong balance sheet and clearly the share price it's from an historical point of view, is pretty low. So don't you think it would be a good opportunity to have a little bit of extra debt?

Stacey Cartwright - Burberry Group Plc - CFO

It's obviously something that -- it's something that the entire Board considers on a regular basis Gilles, so it's something to be kept under regular review.

Gilles Lequeux - Cazenove - Analyst

And my final question, I'm just trying my chance there, would it be possible to have an idea of your level of inventories in absolute terms for the year ending March '08.

Stacey Cartwright - Burberry Group Plc - CFO

Yes obviously you had some indication of pick-up in inventories as at the end of September; we've talked about carrying more inventory than we were expecting over the period up to Christmas and we'll come back with more details when we talk to you at the end of March. Really you're looking at two or three things going on there, one is the shift in the business model, so we've moved to actually holding replenishment stock now that we never held before, we've moved to situations like our September market which delivers across March and April. So we're holding stock there that we never held before. Fay mentioned earlier the fact that we were terminating certain menswear licenses. That means we're now

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holding stock for those categories that we never did before. And then we've undershot on our sales projections in this second half, so we're holding excess from that respect. Really what we're looking through to is how we then clear down that excess as we move into '08/09 and you know we have a very effective clearance route through our outlets, so we'll give you more details on that when we come back at the end of May.

Gilles Lequeux - Cazenove - Analyst

Alright thank you very much.

Stacey Cartwright - Burberry Group Plc - CFO

Thanks, Gilles.

Operator

Thank you. The next question we have is from the line of Luca Cipiccia of Goldman Sachs. Please go ahead.

Luca Cipiccia - Goldman Sachs - Analyst

Hi, good morning, Luca Cipiccia from Goldman Sachs.

Stacey Cartwright - Burberry Group Plc - CFO

Hi Luca.

Luca Cipiccia - Goldman Sachs - Analyst

Hi. Just two questions if I may; the first is on price increases, if you can give us an idea of whether there's been any since the beginning of the year and how should we think about that variable in -- as we progress into the year.

And secondly, more generally, on your comment about the more volatile environment that you're facing now, just curious to hear what are the things that you're doing or where are the areas where you think you could have an advantage compared to competition given the environment and where do you see the opportunity in such greater volatilities? Your product positionings, your price positioning, is there anything where you feel that actually you could find some opportunities there?

Stacey Cartwright - Burberry Group Plc - CFO

Okay. The first one in terms of price increases, only the price increases that we will have implemented at the start of the season relative to how our sourcing costs and everything has moved. So there's nothing that we've specifically done mid-season, which I think is probably where you were going Luca?

Luca Cipiccia - Goldman Sachs - Analyst

Yes.

Stacey Cartwright - Burberry Group Plc - CFO

In terms of the volatile environment and our position versus our peers, the thing we think we've got going in our favor is very strong tail wind behind us in terms of the momentum of the brand. Everything we've been doing over the past couple of years seems to be standing us in good

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stead whilst we're very cognizant of the headwinds of the economic environment. So I think it's really about continuing to execute on our strategies, continuing to innovate from a product point of view, continuing to drive the right marketing messages.

Fay Dodds - Burberry Group Plc - IR Director

We've talked about being underpenetrated in certain markets like the US and the emerging markets, we've got a very small childrenswear business which we think -- and there's a lot of opportunity going forward. The menswear, we're pulling some of the licenses back in-house so that's giving us an opportunity to have a much more consistent global offer. Shoes, jewelry, there's a lot of product initiatives, underwear as well, where we're really playing catch up with some of our peers.

Luca Cipiccia - Goldman Sachs - Analyst

Do you see the pricing as well as a variable where maybe you could find some extra room for growth now, in terms of?

Stacey Cartwright - Burberry Group Plc - CFO

We're not expecting pricing to add significantly to the bottom line, we're very cognizant of the fact that there has been some increases into some of the markets over the course of the last couple of seasons. We've just got to be very sensitive to that.

Luca Cipiccia - Goldman Sachs - Analyst

Okay thank you.

Stacey Cartwright - Burberry Group Plc - CFO

Thanks Luca.

Operator

Thank you. The next question we have is from the line of Lisa Rachal of Redburn Partners. Please go ahead.

Lisa Rachal - Redburn Partners - Analyst

Hi, good morning, can you hear me?

Stacey Cartwright - Burberry Group Plc - CFO

Hi, Lisa, yes we can.

Lisa Rachal - Redburn Partners - Analyst

Okay great. Just a couple of quick questions. The first is on retail like-for-like in the fourth quarter. Is it fair to say that promotional activity did not play a materially bigger role in the performance of the fourth quarter than it did in fourth quarter '07?

Stacey Cartwright - Burberry Group Plc - CFO

Yes that's absolutely right.

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Lisa Rachal - Redburn Partners - Analyst

Okay, great, and then the second question is on US wholesale; would it be fair to -- I guess, what is your sense of sell -- Burberry sell-through rates in the US department stores? Would it be fair to guess that it's somewhere between retail like-for-like and the increase that you're indicating for first half '09 and underlying growth?

Stacey Cartwright - Burberry Group Plc - CFO

Let me just think. We're performing -

Lisa Rachal - Redburn Partners - Analyst

Somewhere between double-digit and 20% with -- is that your sense for what you're (inaudible)

Stacey Cartwright - Burberry Group Plc - CFO

Sell-through is measured in a slightly different way but -- and we're performing very strongly with all of our partners in the US.

Lisa Rachal - Redburn Partners - Analyst

Okay.

Stacey Cartwright - Burberry Group Plc - CFO

Even more strongly with some than others. So someone like a Nordstrom we know we're doing particularly well with and we know that they're very pleased with our performance which is why we're looking at an order book for autumn into '08 of 20% plus up. So --

Lisa Rachal - Redburn Partners - Analyst

Okay, so your sense is you continue to continuously outperform?

Stacey Cartwright - Burberry Group Plc - CFO

We continue to outperform. Yes.

Lisa Rachal - Redburn Partners - Analyst

Okay, great thank you.

Stacey Cartwright - Burberry Group Plc - CFO

Thanks Lisa.

Operator

Thank you. Our next question is from the line of Françoise Lauvin of Cheuvreux. Please go ahead.

Françoise Lauvin - Cheuvreux - Analyst

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Good morning. I have two questions actually. In the retail stores and particularly in the US could you explain a bit how the split is among footprint and maybe the average ticket, did it go up or down in the course of the second half? That's the first question.

And the second question is it appears that the sterling is very weak now versus major currencies, could you take us through the dynamics there that you -- or the impact that you may have both in terms of top line but also in terms of cost base? Thank you.

Stacey Cartwright - Burberry Group Plc - CFO

Okay. First of all your point about the US and are we seeing a pickup in the average ticket value, the average unit retail as we call it, and the answer is yes a very nice pickup there. That's as much to do with as we've been filling out our product pyramid and having more offerings at the middle and the top of the pyramid so we've been moving the average price point that way.

In terms of sterling being weak, it's more the case actually the strength of the euro, the sterling versus dollar is pretty consistent from where it was a year ago. And obviously in terms of the euro benefit, or rather the euro move, we get both the benefit from reported earnings in that we don't hedge translation effect, so in this set of numbers you'll have seen that there's a benefit from an exchange rate point of view and as we move into '08/'09 we'll get a benefit from the translation point of view on the euro as well. What we'll obviously be looking at is where we have transactions in euros, what we've got that's hedged, what isn't hedged, what are the actions that we can be taking to mitigate the impact of that both in -- largely in EBIT terms. And that's really second half related, we've typically got euros covered for the first half of the year.

Francoise Lauvin - Cheuvreux - Analyst

Okay, thank you.

Stacey Cartwright - Burberry Group Plc - CFO

Thanks Francoise.

Operator

Okay thank you. There are currently no further questions in queue so I'll hand you back to your host to wrap up today's call.

Stacey Cartwright - Burberry Group Plc - CFO

Well thank you very much everybody for your attention. We look forward to speaking to you on May 28 when we'll be back with our full year results. Thanks very much.

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