# FINAL TRANSCRIPT

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## BRBY.L - Interim 2011 Burberry Group PLC Earnings Conference Call

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## PRESENTATION

**Angela Ahrendts** - *Burberry Group plc - CEO*

Good morning, welcome to Burberry's results presentation for the six months ended September 30, 2011. I hope that those of you who came early had the opportunity to enjoy the showroom tour. It's the new fall 2012 collection. And it's also great to have you at our global headquarters, Horseferry House here in London.

Today, I'll run through the financials, operational and strategic progress and then, as usual, Stacey and I will take your questions.

Burberry last month, as I hope you saw, was named by Interbrand as the fourth fastest growing brand in the world today, behind Apple, Google and Amazon.

So we also thought it was a great time to share with you further insights behind the cultural drivers of our momentum and our continued investment in innovative design, digital marketing and our Retail strategies.

But let me turn first to our first half achievements. Burberry delivered a record first half, with revenue of GBP830 million, up 30% underlying and that's at constant FX; adjusted PBT of GBP162 million, up 25% underlying; and a Retail/Wholesale profit margin of 14.9%.

We finished the half with GBP174 million of cash and an interim dividend up 40% to 7p per share.

This consistent performance across the business, with double-digit growth in both Retail and Wholesale and in every region and every product division reflects the strength and balance of our teams and portfolio today. And we're beginning to see the initial returns from five years of strategy infrastructure investments.

As we look forward to the second half, our focus remains on optimizing the solid foundation and our strong brand momentum, while continuing to execute our key strategies and investing to drive growth across the business.

As in the past, we remain very mindful and prepared to react to any local or global uncertainties, as we drive for long-term sustainable growth.

So the revenue for the half increased by 29% at reported FX or 30% at constant FX. The acquisition of our Chinese operations contributed 5% of this growth.

In Retail, comp store sales increased in the half by 16%; mainline stores outperformed during the period; and flagships markets, including London, New York, Paris, Hong Kong, Dubai demonstrated particular strength, due in part to the global traveling luxury consumer.

Some of the highlights for the first half including our innovative digital marketing and communications, which continued to increase our reach, awareness and drive traffic into the stores; our continued investment in sales and service programs, increasing our conversions and driving productivity; core outerwear and large leather goods, which drove half of our mainline growth; replenishment, which increased as a percentage of total sales in every major category, due to enhanced design and much better inventory management; and the strong customer response to Burberry Prorsum and London, which contributed to a further increase in our average retail selling prices.

So looking ahead to the second half, we plan to increase average selling space by about 15%; and to open eight to 10 net mainline stores, including in China and Latin America; and a beautiful new flagship store has just opened in Paris last week.

And while we face strong Retail comps for the current half, we are well prepared with our product design and marketing campaigns and service strategies which will positive impact this holiday season and long into the future.

Turning to space, space growth, as I mentioned at the preliminary results, we are this year accelerating our capital expenditure to GBP180 million to GBP200 million. This is focused on retail, particularly in key flagship markets, where we're ensuring that our physical presence is now keeping pace with the digital brand perception.

But why are we focusing on these flagship markets? About 60% of our mainline retail sales are done today in 25 flagship markets globally. These markets have high demographic local populations with the highest population density and strong per capita GDP.

They also have a strong influx of tourism. Experts estimate that today, up to 50% of luxury sales in Europe are done to tourism. Together, these characteristics partly cushion these flagship markets from global volatility.

Let me highlight a few flagship projects just to show you how we're clustering stores and optimizing these key growth cities. Let's take Hong Kong where today Burberry has seven mainline stores, five childrenswear stores, four Travel Retail doors and two Wholesale corners.

We needed a high profile street location, so we recently opened Canton Road; it's pictured here. You can see the external LED screens showcasing our digital assets, and all of this is controlled directly from London. This creates a dynamic brand statement and serves as great outdoor marketing in the large high-traffic market like Hong Kong. Today Hong Kong is estimated to be the 10th largest personal luxury goods market globally, with growth of 30% last year.

This is a computer rendering of our new Chicago store, a property we own. It will be a five-storey flagship in one of the largest, highest profile, and most eco-friendly Burberry stores in the world. It's planned to open next fall.

And we're also very excited about London where we're significantly increasing our retail footprint. Regent Street is the first to open next year and will more than triple our selling space here from about 8,000 square feet to over 25,000 square feet of selling space. It's a strategic high-traffic, corner location with outdoor branding to rival that of our Knightsbridge store, and it gives us the opportunity to showcase the world of Burberry, from a product standpoint, while closely linking to burberryworld.com from a digital and technology standpoint.

So this is just a snapshot of a few of our flagships. Many more are in the pipeline, and each one includes new innovative retail concepts.

Turning over to Wholesale, our performance in this channel was also strong, up 9% in total, with sales excluding China up 20% underlying, led by the Americas, emerging markets and Travel Retail, and strength in new merchandising initiatives, including shoes, childrenswear, men's accessories, and tailoring.

For the second half we're expecting a mid single-digit increase at constant FX, reflecting tougher two-year comparatives, continued strategic conversions to Retail, such as Saudi Arabia and our Spanish menswear, as well as the acceleration of the rationalization of the brand's distribution in Europe and the US. Excluding these actions, underlying Wholesale growth is planned at mid teens.

We're also pleased with our progress in the US department stores where our partners are now fully supporting our segmentation and digital marketing strategies. Our consistent performance, operational improvements and strong partnerships have all led to Burberry now receiving appropriately-sized and located shop-in-shops.

The image on the left shows the new Men's London shop in Bloomingdale's on 59th Street in New York City. We now have seven separate shops in the store, including Men's and Women's London and Brit, as well as childrenswear, together representing about a 40% increase on our original footprint in this store.

The image on the right is the new Saks Women's Brit corner, a 1,400 square foot shop, and we also have a new 1,700 square foot London space on the Women's Designer floor and a new Burberry Beauty shop on the main floor. And again, this is in addition to our existing men's and childrenswear shops.

The initial results of these new shop investments are very encouraging. And remember, we've already doubled the North American Wholesale business in the last four years, which now represents 8% of Group revenue.

Wholesale is now about 40% of America's sales, up from about 25% in 2007, and consistent with our key strategy of investing in under-penetrated markets we opened 16 shop-in-shops in the first half, with a further 60 or so planned in the coming 18 months.

And finally Licensing, where underlying revenue was up 4% as guided. Clearing up legacy issues cost us GBP4 million of revenue in the first half, due to the non-renewal of Japanese non-apparel and menswear licenses, and there was a step-up in royalties from the Japanese apparel license, as per our revised agreement.

And the global fragrance, eyewear and watch product licenses delivered good growth. September saw the launch of our new women's fragrance, Burberry Body, which I'll discuss shortly. These images show watch and sunglasses developed as a part of the broader September monthly capsule that was designed to complement and coincide with this fragrance launch.

These License categories continue to outperform as the products and marketing are more closely aligned with the global brand vision today.

As I mentioned earlier, the consistent implementation of our key strategies means we have seen momentum continuing across all businesses, with double-digit growth in every region and every product division.

Looking at the regional split, Asia Pacific was the fastest growing region with 52% growth, reflecting a strong performance from Hong Kong and the Chinese acquisition. With China now about 10% of Group revenue, Asia Pacific is expected to be our largest region this year, up from just over 20% of Group revenue five years ago.

Europe delivered 18% growth in the first half, with a strong performance from northern countries, particularly the UK, France and Germany. The rationalization of small specialty Wholesale accounts is ongoing, while the European team continue to elevate the brand's presence with the flagship cluster strategy in Retail, and upgrading Burberry's presence in key department store doors, be it concession or Wholesale.

In the Americas, we had growth of 27% with both the Retail and Wholesale channels performing equally strongly, and outperformance in high demographic markets. We also opened our first concession in Toronto, Canada, to complement our four mainline stores in the country, and we now have three mainline stores open across Brazil and Mexico.

We saw 35% growth in the Rest of the World, including the Middle East, now with 21 directly operated stores, following the transfer of the Saudi Arabian stores, two openings in India bringing the total to seven in this high growth country.

In the Wholesale channel we had 52 franchised stores at the end of September, the majority of which are in emerging markets. And the first half saw the opening of our seventh store in the young high growth Turkish market. We're planning to open about five further franchised stores in emerging markets in the second half.

We're a little tired, but I am pleased to say that Christopher Bailey, our Chief Creative Officer, and myself have visited all five regions in the last five weeks, including key flagship markets such as New York, LA, Hong Kong, and key emerging markets such as Delhi and Istanbul. We've been attending Burberry events, speaking to media and external conferences, and all of this ensures that we continue to further relationships in all regions, keeping Burberry front of mind with partners and consumers.

And finally we saw consistent double-digit growth across all product divisions. Core replenishment and outerwear drove strong balanced growth in both men's and women's apparel, while new initiatives like London Tailoring continue to gain traction.

At 39% of sales, non-apparel remains our largest product division, and men's accessories were a highlight, growing by nearly 50% in mainline Retail, albeit off a small base.

Large leather goods continue to represent about 50% of the total non-apparel division. The men's apparel division, which now represents 24% of our revenues, saw accelerated growth with the teams and strategy in their first full year of execution without any historical licenses.

Before I hand over to Stacey, let me show you a short video that highlights all of the key achievements the team did in the first half.

(Video playing)

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Good morning everyone. I'm going to start by giving you the financial highlights for the half year.

As you've heard, revenue was up 29% of reported FX. Our adjusted pre-tax profit at GBP162 million was up 26% year on year. And adjusted diluted earnings per share up 27%. Given the strong growth in the business and our desire to rebalance our dividend between halves, we've increased the interim dividend by 40% to 7p per share. Our overall dividend policy remains a full-year payout ratio of around 40%. We closed the half with GBP174 million of cash broadly unchanged from this time last year.

Operating profit increased by 25% to GBP162 million with only a marginal FX benefit. Retail and Wholesale profit grew by 32% to GBP116 million on revenue up 31%. While our Licensing business saw a small underlying increase in profit as expected.

So now focusing on our Retail and Wholesale business. As we've discussed before, the shift from Wholesale to Retail impacts the shape of our P&L account. It benefits the growth margin percentage but negatively impacts both the operating expenses ratio and the overall Retail/Wholesale operating margin percentage. Although obviously overall we make a much higher cash profit through this shift to Retail.

The impact of this shift from Wholesale to Retail is very marked in the first half of this year, driven partly by the China acquisition, so Retail was 64% of first half-year sales compared to 57% in the same period last year. And Retail accounted for 85% of the total revenue growth in the half.

Against this background, operating leverage from top line growth balanced the mixed shift in the first half, giving an operating margin of 14.9% broadly unchanged versus the prior year. This performance also reflects the changing weighting of revenue, investment and costs between the first and second halves.

And as we look ahead now into the second half we will continue to dynamically manage gross margin and operating expenses with the goal of delivering a further modest improvement in the Retail/Wholesale operating margin in the full year; balancing investment and strategic initiatives against what is delivered from the top line growth, our pay-as-you-go approach.

Gross margin was up 240 basis points in the half to 66.7%. Again, the majority of this increase came from the continued shift from Wholesale to Retail especially in China. But it was also helped by mainline Retail outperformance and an increased proportion of sales from replenishment styles, which more than offset the mixed shift to the smaller Prorsum and London businesses, which typically have lower gross margins than the more established casual Burberry Brit.

Operating expenses as a percentage of sales came in at 51.8%, up from 49.5% last year, again reflecting the shift to Retail. Of the GBP109 million absolute increase in expenses, nearly half comes from decisions that we've made to continue to invest in the business including the five-month contribution of costs from China up to the anniversary of the acquisition date, which was September 1; investment in new markets, especially the Middle East and Latin America; the transitional costs for flagship projects that Angela talked about earlier; as well as further investment on annualization of spend in central functions including IT, corporate resources, logistics, planning, digital commerce and the corporate functions.

As Angela will discuss later, innovation is crucial for Burberry to maintain competitive advantage and we continue to invest throughout the business to sustain our leading positions. Share scheme costs were also higher year on year as expected.

So turning now to Licensing, sales and thus gross margin were up 4% on an underlying basis. We strengthened the in-house team to work closer with all partners, further leveraging brand momentum, luxury positioning and digital expertise across all licensed categories. As a result, operating expenses were slightly higher and operating profit was GBP46.4 million at a margin of 85.5%.

So returning to the income statement, our net interest charge was GBP0.5 million, largely reflecting facility fees, which offset the interest income on our cash balances. Note that this finance charge excludes the China put option liability charge of GBP2.9 million, which is reported in exceptionals. We're now expecting a marginally lower tax rate of 26.5% for the full year and this is the rate which has been applied to the half.

The GBP0.6 million from the discontinued operations in Spain is essentially a provision reversal due to more effective stock clearance; while the non-controlling interest relates to our partner share of income largely in the Middle East and China, offset by the losses from the Japanese non-apparel business.

Turning now to the cash flow, let me highlight a few items. Cash spend on restructuring the discontinued Spanish operations was GBP6.2 million, largely people costs on the final closure of the business. Depreciation increased to GBP40 million and is expected to rise to around GBP90 million for the full year, reflecting the increased investment in Retail and IT infrastructure.

There was a working capital outflow of GBP108 million, predominantly in inventory. However, as a result of the investment we've made in SAP and our planning teams, there is significant improvement in the quality and age of this inventory. For example, over 40% of the increase was in key global replenishment styles which are not marked down and the balance of the increase was to support overall growth in the business and to further support strategic initiatives such as shipping more of Spring/Summer '12 by sea rather than air freighting, thus lower our costs and our carbon footprint. And to reduce risk by ensuring we had appropriate levels of stock in China as we transition that business to SAP just after the half-year end. And that will unwind as we move back to our usual delivery cycle.

I'm delighted to say that the implementation of SAP that has just gone live in China has gone very smoothly and that's a tribute to both the global IT team and the local China management team. We ended the half with a cash inflow from operations of GBP104 million.

Moving down through the cash flow, capital expenditure was GBP63 million in the first half. With the acceleration of the spend on flagship projects in the second half including London, Chicago and Taipei, we continue to plan to invest between GBP180 million and GBP200 million for the full year, subject as ever to which side of the March 31 certain project spend is actually incurred.

And the only other line on this slide that I would highlight is the GBP11 million acquisition spend which is split GBP10 million on the Saudi Arabia subsidiary, in which Burberry has a 60% interest, and GBP1 million of deferred consideration for the China acquisition.

And finally, we've paid out GBP68 million in dividends and GBP42 million was contributed to the ESOP Trust for the purchases of shares to satisfy historic share scheme awards. A lower spend is anticipated in the second half with further share purchases being made through the Trust from time to time to meet future requirements.

All-in-all we ended the period with GBP174 million of cash, broadly unchanged from this time last year, and close to our seasonal low, ahead of the peak holiday season.

And this slide summarizes our guidance for the full year. We're pleased with our momentum and consistent performance in the first half as we start to benefit from the previous investments in planning, SAP and infrastructure. We're focused on executing our key strategies, investing for sustainable top line growth, while still modestly increasing the Retail/Wholesale EBIT margin percentage each year.

And now I'm going to hand you back to Angela.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

As Stacey mentioned, the continued momentum in the business is the result of a strong, focused team, consistently and dynamically executing our key strategies. Hopefully, you're fairly familiar with them after five years.

So this morning I wanted to take few minutes to touch on a theme that is very central to Burberry's past, present and future. We call it our creative thinking culture, and how this fosters innovation across every part of the business today. Creative thinking has deep roots in our history and in this fast-paced, digital world the extent to which we empower this, is what will give us competitive edge.

We are very proud of the recent recognition and acknowledging our innovative initiatives, from Fast Company's ranking Burberry as the 13th most innovative company in the world today, to September's Oracle Retailer of the Year award. These further reinforce how innovation has come to characterize the Burberry brand today.

Creative thinking shapes everything from our products to our processes to the way we communicate and do business. Consider the context. There are over 1 billion smartphones in the world today and by 2015, Cisco estimates there will be nearly one mobile-connected device for every person on the planet. A billion people are currently connected to social media, and the next generation of luxury customers are digital natives.

Altagamma today estimates that 60% of luxury purchases are researched online first. It's a new and often challenging environment, but it's one unparalleled opportunity for those companies prepared to respond rapidly.

So to maximize this opportunity, we are constantly adapting and evolving the Burberry culture and organization; hardwiring creative thinking into the business; creating new structures and roles, appropriate for this new context; and developing very innovative responses.

Christopher chairs what we call our Strategic Innovation Council. He harnesses the ideas and insights of our brightest young talent, while the Strategic Executive Council, which I chair, creatively executes this vision across all platforms globally.

Our IT, marketing, and creative media teams work seamlessly to ensure that the brand vision reaches our targeted audiences in the most efficient and compelling ways. And it's an honor that key partners, such as Twitter and Facebook, are now citing Burberry case studies when speaking publicly at global conferences. And we're flattered to be among the first few brands invited to launch a page on the new social media platform, Google Plus.

Finally, we're creating new departments to ensure that we continue to evolve our internal structures and processes to keep pace with as fast as the world and digital are moving. So we can further capitalize on these opportunities, and these range from mobile to consumer insight, where we've been laying the ground work by investing in people, data capture and systems.

Crucially for the development of a creative thinking culture, these teams, old and new, are working together forming unconventional relationships. This cross-functional, collaborative working style and the structures that underpin them keep our teams connected, aware and inspired.

And as such, this is self-reinforcing. We're creating the conditions for innovative thinking, and it's these conditions that are attracting and retaining some of the best talent in the business today.

So where do you see the results? It begins with product design and extends right through marketing retail and our use of technology.

So product, product innovation is key to everything we do. The business begins and ends with great product. And there's no better place to see this in action than on the landing page of burberry.com, our most powerful and dynamic brand statement.

The landing page will always reinforce our core iconic products, while showcasing the innovation that keeps them relevant. For example, here you can see Prorsum runway collection, the highest expression of the brand, which is always front and center; the trench coat, constantly re-imagined, season after season, which has driven our outerwear sales consistently higher in both fashion, as well as replenishment. And fresh takes on our heritage iconic check, with new accessories in smaller shapes, accented by this season's best of colors.

Next, marketing; we've talked to you before about how our teams work collaboratively, to generate creative digital marketing strategies that showcase the brand content, increase global reach and awareness and drive true customer engagement.

We have to keep innovating to maintain our digital leadership. Take our Spring/Summer 2012 runway show, for which our young, digitally-native team pioneered the Tweetwalk. This was a collaboration with Twitter that enabled Burberry followers to see the new collection, even before it appeared down the runway. This led to Burberry being the second highest trending organic topic on Twitter globally the day of the show, further demonstrating the incredible brand reach that these kinds of initiatives can deliver.

And we also replicated Tweetwalk on Chinese social media website, Sina Weibo, where we're also the leading luxury brand. And this ensured that Chinese customers were also able to share in this unique and innovative experience.

The advent of social media in China provides Burberry with a tremendous opportunity to further leverage our digital assets and engage and grow our audience in this dynamic, high growth environment. In September, the renowned L2 think tank also named Burberry the global brand with the second highest Chinese digital IQ, coming from 41st a year ago, to now ranked between Audi and BMW at the top of this year's index.

And next in Retail; we're constantly testing and trialing new retail formats and concepts, to ensure that customers see and feel the newest monthly themes wherever they shop. The digitally-enhanced retail experience and highly trained sales and client services must exceed consumers' expectations in their brand perception.

From innovative flagship stores, such as Sparkle Roll in Beijing and Canton Road in Hong Kong, with their large external LED screens, to trial formats like Burberry Brit, upgraded smaller footprint Travel Retail stores in Asia, right through to dedicated Wholesale shop-in-shops in the US, which I showed you earlier.

We also include burberry.com under Retail because, as we say internally, this is our million square foot store. These landing pages connect not only customers, but stores, divisions, associates, enabling them to see, hear and feel the brand, assuring global alignment; the one pure brand expression across all mediums. Visitors to burberry.com spend over seven minutes today on the site, truly engaging and exploring all facets of the Company.

Finally, I hope you recall what John Douglas, our Chief Technology Officer, showed you when he spoke to you last summer. Innovative technology is at the heart of everything we do, and our great partnerships are imperative today.

From internal collaborations to working with best in class external partners; from the solid SAP foundation that's now in place in all major markets; to the Verizon network that is dynamically connecting our stores and offices; to the powerful ATG platform that enables all e-commerce activities in 45 countries in six languages, and is capable of supporting our rich creative video content that brings it all to life.

The scale and reach of these major international partners support and enable the evolution of Burberry's vision, allowing us to stay highly relevant in a rapidly changing consumer environment. And it's not a coincidence that we always launch our most innovative initiatives with our most iconic item, the trench coat.

It's always front and center of the runway shows. It was the inspiration for Art of the Trench, the social media platform that has engaged the younger generation with our core icon, and almost 2.5 million visits from over 200 countries to date.

And then came burberry.com, which showcases the trench new seasonal interpretations, as well as its heritage, its craftsmanship and the way in which it inspires our collections today. And most recently, the launch of Burberry Bespoke, the new digital platform that enables customization and personalization of your trench coat for the first time, with over 12 million design options, and the ability to share your design with friends on Facebook and Twitter.

Burberry Bespoke is positioned as our most exclusive luxury offering. Most of these one-of-a-kind trench coats are made in England, in our factory in Castleford, Yorkshire. And once a bespoke coat is purchased, superior customer service is given throughout the entire process, with the finished product elegantly packaged and delivered to you in four to eight weeks.

Finally, changes to the way we communicate internally and externally ensure we are embedding the new, more social ways of working. We're just starting to build a global social enterprise platform within Burberry in partnership with salesforce.com. This new platform will link traditional CRM to social media to internal infrastructure, dynamically connecting our customers, employees and partners. And the result will be Burberry fully digital end-to-end and able to capitalize further on the upside of a faster more connected world.

This new environment demands new ways of working, connectivity and innovative approaches across structure, process and product and will unlock significant opportunities. Just take the recent launch of Burberry Body. A few years ago this would have just been a fragrance launch; for us the launch of Body was the single biggest opportunity we had to connect and expand the global audience with the Burberry brand by leveraging one category in the most innovative ways.

And the only way to achieve this vision was to work in the most united way, more than ever before, not only internally but externally with our partner, distributors, agencies and media outlets. Combining an accessible entry price point to the brand with authentic luxury positioning, Burberry Body enabled us to extend our reach and engage global audiences with a coherent pure brand story across multiple channels, iconic outdoor, TV, print, digital and in-store all simultaneously.

Central to this story was a multi-million pound global marketing campaign created in-house yet funded by our partner, roughly doubling our overall media spend for the year. Before I touch on the details of the campaign let me share with you one part of it, the television commercial, which we air globally in the run-up to Christmas.

(Video playing)

So by launching Burberry Body simultaneously across all of these platforms, we were able to connect the brand to its widest global audience ever.

The innovative use of social media played a central part of this strategy, offering samples exclusively to Burberry Facebook fans in the two weeks before the launch. It created excitement and engagement with almost 0.5 million new Facebook fans joining on our online community. Today the total stands at almost 9.5 million fans from just 3 million a year ago and we will reach 10 million by Christmas.

Meanwhile we premiered the TV advertisement you just saw on YouTube, taking over their home page in 13 countries with 70 million impressions. And as you'd expect, the highly emotive content and imagery was synchronized across every channel, from the hologram of Rosie Huntington-Whiteley, the first Burberry Body at the September runway show, our biggest brand moment, which was live streamed to audiences of millions on burberry.com, social media and through hundreds of global media partnerships, to the windows of our own retail stores around the world and those of key wholesale partners; to the burberry.com landing page; to Burberry Acoustic where the soundtrack Rose, by British band The Feeling was recorded at Abbey Road Studios and also made available on iTunes; to PR events in key markets like New York and Los Angeles.

High profile outdoor advertising at about 15 of our flagship markets allowed us to further extend the reach of the brand in these iconic locations such as Paris, London, again New York, Los Angeles etc. And finally, the Nude collection was conceived with 60 options across apparel and non-apparel, all timed to launch with the fragrance in September.

So to finish on Burberry Body, we are pleased, very pleased with the early fragrance results, which will make a positive contribution to our Licensing business. But more importantly, we're thrilled that we were able to touch nearly one billion people worldwide with compelling Burberry content and product in innovative ways. Burberry Body is also important because it shows what a great team can accomplish when focused on a big brand project and are empowered to think creatively.

So in conclusion both our brand and business have great momentum with a consistent balanced performance across channels, regions and product divisions and we're only beginning to see the early benefits of the past five years of strategic investment in IT and human infrastructure.

The management team is fully prepared to act responsibly as we have done before should any luxury demand slow. But our focus today remains firmly on executing our five key strategies, investing for growth, educating, inspiring and retaining our talented global teams and using the innovation that flows from our creative thinking culture to sustain competitive advantage and remain highly relevant in this rapidly growing luxury sector. All of which will ensure that Burberry continues to thrive, not only as a great brand but as a great company.

Thank you very much and Stacey and I will now take your questions.

## QUESTIONS AND ANSWERS

**Fraser Ramzan** - *Nomura - Analyst*

Fraser Ramzan at Nomura. Three small questions for you, first of all the Brit trial, how's that progressing, any news for us in terms of how you might think about rollout, I guess space productivity is pretty good so any options there?

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**Angela Ahrendts** - *Burberry Group plc - CEO*

Yes, let's take one at a time instead of all three because we have nothing to write on. The Brit trial concepts are going great, we've not yet had a full-year anniversary on a number of them but we've got a handful in the US, we opened one in Milan, we've got Covent Garden, which I hope you've all seen, about 8,000 square feet. So we said upfront that we wanted time to set up different formats in different markets and the merchandizing teams are playing with the assortment, the visual teams are playing with the fixturing etc.; but so far so good.

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**Fraser Ramzan** - *Nomura - Analyst*

Okay. And then moving on to US department stores, great successes there in the first half and you talked about a net 40% space increase. How might we think about that in terms of productivity or the trade-off between a category department and a shop-in-shop?

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**Angela Ahrendts** - *Burberry Group plc - CEO*

I think the 40%, that was specifically on the Bloomingdale store, so don't take that out of context, but we did say we've got about 60 more planned in the next 18 months. And honestly we typically say when you go from just trading wholesale to opening a shop-in-shop, depending on the location again, flagship markets will drive a disproportionate amount of the growth. But there's typically 20% to 30% uplift because that's typically also what you're gaining in real estate.

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**Fraser Ramzan** - *Nomura - Analyst*

And better margins presumably too?

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Well, they're not -- just to clarify, they're not concessions, we talk about shop-in-shops but they're still under a Wholesale model. In the US.

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**Fraser Ramzan** - *Nomura - Analyst*

And then finally Japan on apparel, still loss making but good progress. Anything to report there in terms of your early learnings?

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Yes, I think it's off a small base but within the Japanese market over the last few months where you've seen Japanese department stores still under pressure, you've seen our license business still perform in line with what you see by way of the Japanese department store statistics, and non-apparel JV is picking up very nicely. Off a small base but we're very pleased with the progress.

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**Fraser Ramzan** - *Nomura - Analyst*

Thanks.

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**Thomas Chauvet** - *Citigroup - Analyst*

Thomas Chauvet, Citigroup. Three questions, the first one on your gross margin and OpEx dynamics, the gross margin was obviously much better than expected. It looks like there will be similar channel mix effects in the second half, so perhaps an upside to full-year gross margin. Can you perhaps on the cost side elaborate on what you're expecting as OpEx to sales for the second half and also what is the amount of non-recurring costs related to the strategic investments compared to GBP50 million or so, I guess, in the first half? That's my first question.

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Okay, so the first question and I know there is a real desire to zoom in on the OpEx but bear in mind what we -- we keep trying to lift you one step above that and remind you that we are dynamically managing the improvements we see out of gross margin with the ability to then reinvest back into the business.

So when you talk about what might be the one-off in the first half. You've just seen Angela's whole second half -- second part of her presentation on the innovation that we continue drive. And really it's about driving that top line, driving gross margin improvement that allows us to keep investing in that innovation.

And what we are then focused on is making sure that the net of all of that continues to deliver nice modest operating margin improvement consistently year after year. So I know there's a tendency to try and dig into a particular OpEx number but that's really not reflecting the fact that we are dynamically managing how much investment we're putting in, according to the affordability of what we're driving out of the top line and the improvements that we put in on gross margin.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

And I would also add that I made it a point in my presentation, I think two different times, to remind you that we continue to clean up the specialty store base as well. So pretty consistently hundreds of specialty stores around the world we've been closing as we've been opening up our own retail stores. So we've still got a lot of legacy issues, we tell the teams it's a pay-as-you-go approach. So to Stacey's point, we're just dynamically managing that, there's not necessarily a number that we're shooting for.

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

And specifically then on the second half, clearly we've talked about for the full year as a whole we're going to put on that nice modest Retail/Wholesale EBIT margin percentage improvement. The first half was essentially flat, therefore it's all second half weighted.

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**Thomas Chauvet** - *Citigroup - Analyst*

Okay, thank you. Secondly, with regards to retail opportunities with China and Saudi, we've seen clearly the impact on gross margin and revenue can be huge from shifting a business from Wholesale to Retail. Can you indicate what other marketing -- which are the markets you see such opportunities over the next couple of years, how many stores does that represent or was China and Saudi the biggest opportunities?

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

I think as you saw in Angela's presentation, we said we ended the half at 52 franchise stores and we always talk about franchise stores as being on a journey, if you like. The first way we enter into the market is through a franchise arrangement and when they reach a certain stage of maturity or local market conditions permit, then we move to maybe a joint venture or direct ownership.

So, if you like, the pool to play with is the 52, but it's all about timing and I don't think we're going to get drawn on the timing as to when each of those markets might be right for bringing in-house, but ultimately that would be the goal.

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**Thomas Chauvet** - *Citigroup - Analyst*

Okay thank you. And finally, could you update us on the first impacts of SAP integration in China and the CRM projects? Thank you.

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

In terms of SAP in China, it is literally the last couple of weeks that that has gone live progressively across all of the functional areas. It's been a monumental exercise, huge callout to the local team and to the IT team. They trained 1,000 people on the ground in China, including all of the retail staff personnel.

In terms of the visibility etc., it is only just a couple of weeks in but I will tell you it has to be better than adding up 2,500 lines of till rolls. So that's really telling you what we've come from and therefore what we're going to.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

And CRM, again I'm calling it out, we don't have it today. So we're just now investing in it. We've been consolidating 22 databases into a single customer view around the world. Hopefully you saw an announcement, we've just hired a new Senior Vice President to the Executive Team and he joins us from many years of insight in analytics. So he is building the team, he's partnering with our technology team and deciding exactly what platforms and what partners we're going -- sales forces, the umbrella and then there's multiple little partners around the world to get all this data etc. So we've put up these results without CRM.

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**Thomas Chauvet** - *Citigroup - Analyst*

Thank you.

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**John Guy** - *RBS - Analyst*

John Guy from RBS, just a few questions please. Just going on to the specialty store clean-up, could you give us an indication as to when you think you'll start to wind that down and what contribution to the OpEx as a percentage of sales the clean-up had in the first half of the year?

In terms of the stock levels, given the incremental stock that's gone into the Chinese stores as you roll out SAP, can you just talk about how comfortable you are around stock levels today and the absolute number in terms of stock that you've had to put in to the Chinese retail stores? Just so I can get a feel for what the underlying stock level should be post SAP implementation.

And on the replenishment --

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

We've already forgotten question one by the way. I can still remember question two, which is around Chinese inventory. Think of it as about GBP10 million worth of extra inventory that's gone into that market to make sure that we didn't miss a beat during the SAP implementation.

And your first question, John, you are going to have to go back.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

But also realize it's not just Chinese inventory. We put a third of the inventory on the sea where historically we would air that. So that impacts the timing of the inventory reported as well.

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**John Guy** - *RBS - Analyst*

Okay, the first question was around the specialty store clean-up and you were talking about the OpEx.

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Think of the specialty store clean-up as being a few million pounds worth of revenue and essentially with no OpEx associated with it; and you can work it through.

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**John Guy** - *RBS - Analyst*

Okay, thanks. And the final one just on replenishment, you've obviously done a great job in driving up the replenishment in the apparels side. Where do you think that you can take that over the course of the next few years?

**Angela Ahrendts** - *Burberry Group plc - CEO*

Honestly, it's at the levels it needs to be at now; it's about 60% of the non-apparel business. It's about half of our apparel business today is in replenishment. I think the difference is we're still running it manually. So as we start to roll out the replenishment modules and get it up on a technology system, that will lead to make it more dynamic. But I think the levels are pretty much where we want them today.

**John Guy** - *RBS - Analyst*

Thanks very much.

**Aurelie Husson-Dumoutier** - *Societe Generale - Analyst*

Aurelie Husson-Dumoutier, Societe Generale, I have actually one question. Have you seen greater performance with the increasing control of the brand? Is it possible that in the medium run we see the perfume business being done in-house and what about the Japanese license, would you buy it back some day?

**Angela Ahrendts** - *Burberry Group plc - CEO*

I think that's one question with three parts. I forget the first one again but let me go on to the fragrance one. We've got a great relationship with our partner, Inter Parfum, and I think that's why I wanted to share with you the new way that we're working with them.

We've taken a number of other licenses in-house but that's a real big one. So we're in constant dialog on doing what's best for the brand long term and what's best for the Company.

What was the first one? Japan.

**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Shall I pick up Japan, I think your question was would we buy the license back in? Remember that that license now expires naturally in 2015 and what we're working with our teams on the ground in Japan to do is to make sure that we are preparing ourselves for when that license falls away and therefore that is when you would essentially be putting global product into that market place instead.

We have got a small test going on starting next year, which is where we essentially have agreed with our local license partner there that the childrenswear business, the local licensed childrenswear business falls away and it will be global childrenswear business that starts to flow into that marketplace. So, if you like, that's the first of what will be essentially Burberry global product in Japan from 2015 onwards.

It's all part of the learning and development and certainly childrenswear will move. If there's opportunities to do anything else then we'll have a conversation at the time.

**Angela Ahrendts** - *Burberry Group plc - CEO*

Yes, and I was going to say, remember that non-apparel is already been inputted by the JV, now you'll have childrenswear; so there's only men's and women's from a global basis that's left. It's really tricky how much focus you want to put on there when you have a guaranteed income stream versus where you want to shift resources to optimize other larger opportunities that are out there worldwide.

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**William Hutchings** - *Goldman Sachs & Co. - Analyst*

William Hutchings at Goldman Sachs & Co., I just have -- well, it's two questions on your online strategy. One on the top line, as you've bedded in some of these investments you've made, what have you learnt in terms of how far you can push the online? Where do you think it's going to get in terms of percentage of revenues or as a sensible level over the next couple of years?

And also on the cost side, in terms of the digital marketing strategy, are you starting to see any way that you can actually reduce your A&P, your costs relative to revenues because the cost of doing digital marketing strategies is lower?

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**Angela Ahrendts** - *Burberry Group plc - CEO*

You might be -- I'll take the first one first, you might be able at some point. As we're rapidly investing to drive growth etc., we're actually taking our percentage up slightly because we've historically invested on a marketing front half of what our peers have. So now that we've got momentum, you are right, we always say for every GBP1 spent in the digital space you get 10 times the reach that you get in the traditional space.

But it is just that, it's marketing, we do mid-single digits in e-commerce. And it's funny because all the reports that come out, I tried again to mention that in the presentation, that the luxury customer, 60% of the luxury customers do look online, do browse online.

But I don't know, I don't think anyone knows how much of the luxury business will ever truly be done online because a luxury -- luxury shopping is almost sport. So they browse online, they come into store, that's where they shop and that's, we do believe, a big part of what has just driven a 16% comp and a Retail business up 45%.

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**Andy Wade** - *Numis Securities - Analyst*

Andy Wade, Numis Securities. Just a question on operating costs again, I'm afraid. Looking at it there's obviously two parts to it, the part which is to do with space, so China, the flagships, new markets, where the OpEx investment is effectively rolled up in your CapEx IRR calculation and you've got very clear criteria on how you invest your CapEx.

But the other part of it, the discretionary stuff where your OpEx investment is, is in the innovation side of things, and you're looking to drive long-term growth from that. It's obviously not CapEx, but it feels like OpEx investment for long-term growth, and I was just wondering how you choose to invest that. Is there specific criteria for projects which they have to meet? Do you expect a long-term return on it, or is it just pay-to-play, effectively, to stay ahead of the game?

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**Angela Ahrendts** - *Burberry Group plc - CEO*

A combination of all of the above. But mostly it's -- mostly we look at the world, and whether it's an event, whether it's a PR focus, whether it's marketing focus, we run the country, we run the world, by region. So if you actually stood back and looked at our marketing strategies, you'll see that they are very strategically placed by region. They typically link into a flagship event, but we don't do anything -- we do the event locally, but now it's always streamed globally.

So it's really a combination, and most of it at this stage has to do with reach, with awareness. We have a very small database. We are looking, like I said, to put CRM in place. We are rapidly -- we believe that building this database and putting CRM in place will be a further differentiator as we go out. So investing in marketing, engaging consumers, getting this information on them, that's really the key measurement today.

Even in our stores, if you go in, if you come out and they've not asked you for your e-mail or your phone number, that's how they're incentivized today. They're not incentivized by what you buy.

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**Andy Wade** - *Numis Securities - Analyst*

Do you have a clear idea of what the returns on this stuff that you're getting is? Or is it just that you know it's the right thing to do?

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

I think the point there is, if you ask any company how they know that they get returns out of a particular placement of an advert in Vogue, or a particular hoarding, it's a difficult one to have, cause and effect. But you know, from 16% comp, that something's happening in terms of the halo over the brand as a result of how we're directing the spend.

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**Andy Wade** - *Numis Securities - Analyst*

Thank you.

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**Louise Singlehurst** - *Morgan Stanley - Analyst*

Louise Singlehurst, Morgan Stanley. Three questions from me, please. Firstly you talk about the benefits of the infrastructure spend, and the SAP coming through, and how we're going to benefit from that, going forward. Can you just talk about the discussions that you're having with the US wholesalers; how quickly you're delivering; the ability for in-season re-orders? And in the event that they become a bit more cautious in terms of their forward orders, do you think that puts you in better stead versus the competitors?

And then secondly --

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**Angela Ahrendts** - *Burberry Group plc - CEO*

Let's take them one at a time, if you don't mind.

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**Louise Singlehurst** - *Morgan Stanley - Analyst*

Of course.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

So I will tell you right now, we're not having those conversations with US wholesalers. Right now, it is all focused on growth, and that was the message in the presentation. We are out-performing the store, we are out-performing almost every department. And that's why, I will tell you, finally, finally, after five years we're getting the real estate the brand deserves.

So we're not having those conversations. The US does keep replenishment inventory, so they are well-positioned to optimize the re-orders; but we're not -- this marriage isn't looking at divorce right now.

**Louise Singlehurst** - *Morgan Stanley - Analyst*

Thank you. And a question for Stacey. In terms of, just going back to the margins, can you just update us where we are in terms of thinking about the differential between the Wholesale and the Retail margin?

**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Yes, we've always said, Retail margin, Wholesale margin, in terms of net operating margin in percentage terms. In terms of value, it's that way round. In terms of the pounds millions; which is one of the reasons why, apart from just the better control over the brand, you are chasing retail-led growth. It's more pounds millions at the end of the day.

In terms of the differential between the two, there is so much that is done on a combined basis, in terms of the back end of the business, the way that we optimize inventory across the channels; the way in which we centralize all of the logistics distribution, not to mention the design and the sourcing. We don't break it out for that reason, but you will always on an incremental marginal basis say that Wholesale on a percentage basis would deliver a better percentage; and find that will close as you start to drive better productivity through your own retail stores, but you'll never get it to close completely.

**Louise Singlehurst** - *Morgan Stanley - Analyst*

Great, thank you. My final question, for Angela. You highlight, I think it was the Bain statistic, where 50% of revenues in European luxury are from tourism. I know you haven't got your CRM system in place, but is that something that would resonate for the Burberry brand? Thank you.

**Angela Ahrendts** - *Burberry Group plc - CEO*

Yes, absolutely. And again I tried to call out that we estimate today, we do about 60% of our business in 25 key markets, and that's why the increased capital that we are spending, we are clustering, we are opening flagships in those top 25 markets. It is where we did the iconic outdoor for Body in 15 of those 25 markets; so we believe the Bain statistic, we feel it, and that's where the investment's going.

**Robert Miller** - *Redburn Partners - Analyst*

Robert Miller, Redburn Partners. In the context of the fact that your first-half stock level seems to be pretty much identical to what we'd expect for second-half cost of goods, how do you think the business would react differently to the moment in 2008, '09, when the world ended and you dropped 900 basis points of gross margin, if we did see a severe turndown in demand, particularly in Europe?

**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

I think the main thing to point out is that we are very differently positioned to where we were three years ago. In terms of us talking right upfront about the investment we've been making in the business over the last five years, in people, in technology in terms of SAP, in terms of planning resource, inventory management, it does mean that we now have visibility over the business that we didn't have, bluntly, three years ago. And we're able to optimize and move inventory as a result.

The other thing to point is that half of our business is done in replenishment today, and again, that means that that is far less risky from an inventory management point of view. That is not inventory that ever gets marked down. And you've seen the shift





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over the course of the last three years, five years even, to selling more inventory at full price through the mainline stores, and we've been progressively closing and curtailing the inventory that goes to outlets.

So in the event of a slowdown, you have the ability to turn up what you've been doing in the outlets, to be less pure about that legacy clean-up, if you like. But equally you've also got the ability to turn off what would otherwise be coming down the replenishment pipe, by working with your vendors to delay future receipts of product which is more perennial.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

The other thing I would add on the inventory piece, which I think is really important; we keep reminding you how much of the business, half of the business today is large leather and non-apparel. Half of the business in apparel is outerwear. Those are the two highest-selling price points that we have. So also on the inventory, about 80% of the delta does have to do with a higher average unit cost, not necessarily more units on hand.

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**Robert Miller** - *Redburn Partners - Analyst*

So how does it split between replenishment and non-replenishment, that GBP340 million of inventory?

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

In terms of replenishment, replenishment makes up about one-third of that -- sorry, half of that overall inventory level. The other half is made up of current inventory, pretty much -- it's in -- I would say, inventory is in the best shape it's been in since the day that I arrived at Burberry, seven years ago. It is the most current, and the most fresh inventory that we've had.

It's also helped by the fact that we have what we call monthly flow of product into the stores now. So that means that there is this dynamic, fresh flow of product, which keeps that inventory, even in the context of having replenishment product there, it keeps it looking fresh and innovative to the consumer who keeps coming in.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

And I also think the important thing, we just told you that Asia will be the largest region in the world by the end of the year. We also told you it was up 52%. We have to be able to optimize that as well.

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

And the China business, which has only just gone SAP, just imagine what we can now do to that, from a replenishment point of view, having it on-system, and having the visibility.

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**Robert Miller** - *Redburn Partners - Analyst*

So give us some help, then, with the long-term working capital opportunity. Because on these numbers you look to be turning your stock about two times, which is not great by retail standards. What do you think the goals are of the business, in the long term? What's the opportunity?

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

We've only just got everybody on to SAP, so I think that's a little premature. The first thing has been getting our arms around all of the inventory. In the luxury sector you are not going to be driving traditional high-street retail turns, that's the second point there.

Do we think there's opportunities for improvement? Absolutely. But we will continue to chip away at those, rather than set ourselves a target at this stage.

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**Julian Easthope** - *Barclays Capital - Analyst*

Julian Easthope, Barclays Capital. I've got a question in terms of your retail partners in the Wholesale division. I think there have been some reports that some of these may be coming under pressure, particularly in Europe. It's not obvious from your receivables, but have you seen any material increase in bad debts?

And in addition to that, with your cleansing of those -- of your partners, of some of the smaller partners, do you think you're now more protected than you were two or three years ago?

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

I think your second point is absolutely spot on, that we keep raising the bar on the Wholesale accounts that we do business with across Europe, those smaller specialty retail accounts. So that does mean that we are de-risking the business, from a bad debt perspective there. That said, we've got very stringent credit procedures in place internally, in terms of how we manage all of those Wholesale receivables, particularly across Europe. I would say that we haven't seen anything in those half-year numbers to give added cause for concern.

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**Angela Ahrendts** - *Burberry Group plc - CEO*

Great. Thank you very much.

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**Stacey Cartwright** - *Burberry Group plc - EVP & CFO*

Thank you.

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