

CHIEF CREATIVE AND CHIEF EXECUTIVE OFFICER'S LETTER

2016/17 was a foundational year for Burberry, in an environment that remained challenging for luxury – although with sector dynamics improving in the second half. Against this backdrop, we continued to elevate our luxury retail and digital business, and began implementing wide-ranging changes for the future.



Christopher Bailey
Chief Creative and Chief Executive Officer

With recent estimates suggesting a broadly flat performance in calendar 2016, the subdued result from the sector as a whole reflected fundamental shifts that have been shaping the industry over the past few years, including slowing Chinese consumption, reduced scope for space expansion and less pricing flexibility. The impact of these trends was exacerbated during the early part of the year by macro factors such as sluggish developed and developing economies, and consumer unease and travel disruption linked to geopolitical events.

However, we also began to see clear signs of recovery in the industry towards the end of the year, as the Chinese consumer rallied, Continental Europe improved and the UK continued to enjoy strong tourism with the sustained weakness of sterling following the Brexit vote. These contributed to an improved sector performance in calendar Q4, following nearly two years in flat or negative territory. Our own performance was consistent with these broader trends.

While these more encouraging signs have continued into the start of 2017, some challenges remain – not least for us given the uneven performance of the US and Hong Kong markets, both key for Burberry. As such, the outlook for the sector is mixed, with industry experts continuing to anticipate more tempered growth in the medium term, compared with the historic highs of the post-financial crisis years.

Alongside this more moderate growth outlook, we anticipate the industry will be shaped by different dynamics in the years ahead. Our customer is evolving rapidly, prioritising more distinctive experiences, more personal relationships with brands and greater product innovation. The influence of digital technology is extending still further across every aspect of what we do – from production techniques to the customer experience, in every channel. And demographic changes, from the maturing of millennials to the intensification of wealth in cities, mean we must keep developing and tailoring how we think and work to stay ahead.

Against this backdrop, we continued last year to take actions to elevate our luxury retail and digital business, strengthen our brand and reposition Burberry for growth, as we maintained our focus on maximising long-term shareholder value. In addition to our ongoing actions in wholesale and licensing, this included our announcement last May of a multi-year programme to accelerate our productivity and efficiency agenda, having identified significant opportunities across our existing channels, products and regions, and our ways of working. We touched on these in our last report, and have since distilled them into comprehensive plans covering five key areas: Product Focus; Productive Space; E-commerce Leadership; Operational Excellence and Inspired People, the detail of which I will turn to shortly.

To deliver on this ambitious programme we have also strengthened our executive leadership team with the extensive luxury experience of Marco Gobetti, who will take on the role of Chief Executive Officer in July 2017, and the transformation expertise of Julie Brown, our new Chief Operating and Financial Officer. And we have made further appointments over recent months to complement and enhance the existing skills of our senior team, including in key areas such as design, merchandising, technology and brand experience.

As such, the scope and scale of the changes we are making to our business are significant, and it will take time to realise their full benefits, particularly in respect of revenue growth. But our progress with laying the foundations for the future is encouraging.

Performance summary

Before turning to our renewed productivity and efficiency agenda, let me first summarise our performance for 2016/17.

Revenue was £2.8bn for the year, down 2% underlying, with retail outperforming at up 3% overall and up 1% on a comparable store sales basis. A notably strong performance in EMEA, driven by the UK, and an acceleration in mainland China were offset by continued challenging conditions in other markets including the US and Hong Kong, as well by the impact of our ongoing actions to build and reinforce our luxury brand positioning for the future. This included the loss of licensing income as we build our direct operations in Japan, the rationalisation of wholesale distribution globally, including in Beauty, and actions to protect the brand in a highly promotional environment in the US.

With adjusted profit before tax down 21% underlying to £462m, these factors weighed on the bottom line – although their impact was partially offset by the delivery of £20m of planned cost efficiencies in the year, and our plans are on track for at least £100m by 2018/19.

We ended the year with a strong net cash position, up £149m to £809m, and we increased the full year dividend to 38.9p, up 5%. In April we completed £100m of a £150m announced share buyback. A further share buyback of £300m is to be completed in 2017/18, in addition to the £50m already announced. This reflects the Board's confidence in the growth prospects for the business and its ongoing commitment to maintaining a strong balance sheet with solid investment grade metrics.

While we actively managed the business through near-term market dynamics during the year, we also continued to take actions to position it more strongly for the long term. As noted above, this included starting to implement a wide-ranging productivity and efficiency programme to enhance future growth. While we are still early in this process, progress across its five areas of focus underpinned a number of improvements through the year – from the outperformance of fashion and strong growth in leather goods, to improved mainline retail conversion and customer retention, to the delivery of enhanced efficiencies. These initial results give us real confidence for the future.

Product Focus

The first pillar in this programme is to move from product breadth to product focus. This will allow the customer to connect more readily with the creativity, craft and storytelling that define and differentiate our offer. With significant scope to simplify our assortments, amplify the excitement in our products across price points and tailor our offer more effectively to the needs of the customer in different locations, we began to make changes in the year to unlock this opportunity.

Building a more strategic approach to drive outperformance in our core categories has been a central focus, with comprehensive plans now developed for the product areas we have identified as having the greatest growth potential for the coming years. The first area in which we have begun to implement this new approach is bags, with full price sales up 16% in the year. In line with our evolved strategy for the category, this was driven both by new launches such as the Bridle and Buckle bags, as well as increasing novelty in our more established styles. While we are still at the early stages of our plans for bags, this strong initial uplift is illustrative of the benefits we expect to build across other areas over time, with a pipeline of categories to follow.

The second key area of progress is how we are evolving our merchandising approach, with particular emphasis on cultivating the local customer – a key opportunity for us. Our move to one Burberry label globally, together with reducing our assortments by 15 to 20% over the year, have been fundamental steps in creating the conditions to realise this opportunity. Then, within this significantly simplified assortment, we have implemented new tools and ways of working that mean we are more effectively tailoring our assortments to the individual needs of stores in different locations – from climate, to customer profile. Finally, this more streamlined approach is also allowing us to give far greater visibility to the fashion and newness that is so critical to building loyalty and repeat custom. This was reflected in the outperformance of fashion during the year, including the growth of our runway collections and the successful introduction of our new, lightweight tropical gabardine.

All this is being enabled by changes to how we work across our product functions, to improve collaboration and focus from design to delivery. Part of this has been structural, with the evolution of our organisational model towards an end-to-end category management approach, meaning we are building cross-functional teams specific to the potential of each category, with shared accountability and KPIs. And we are reinforcing these structural changes by redesigning our processes as needed, for example getting local input earlier in the cycle. This is a significant evolution for us and although the changes will take time to embed, we are already seeing early benefits across our business.

The final area I would highlight in respect of product is the announcement we made just after the year end of a new partnership with Coty, to accelerate the growth of Beauty. Consistent with our drive for greater focus across our product offer, this follows the successful repositioning and elevation of the business over four years of direct operation. Looking ahead, we will continue to lead all creative aspects of Beauty, while benefiting from Coty's first-class industry expertise and distribution. We will transition to this new model in October 2017 and expect the deal to be earnings accretive from 2018/19.

Productive Space

Our second pillar is to move from new space to productive space. Following a decade of geographic expansion, our focus in this next phase is shifting to how we make all our space more productive – retail and wholesale, online and offline, and with an emphasis on our full-price channels. We have significant opportunity here.

The foundation of our activity over the past year has been our Retail Excellence programme, covering all aspects of our retail operations, including how we serve our customers, approach customer cultivation and manage our stores. Results this year show good early traction.

Within service, we increased our investment in training and introduced a new service model ('CLIENT'), and we are currently embedding a new global customer feedback programme based on net promoter scores. These actions helped drive improvements in conversion and retention globally – with room for continued growth. Within cultivation, we accelerated the expansion of our Customer Value Management programme and Private Client teams to bring more customers closer to our

brand and products through appointments, events and experiences. This richer, more personalised approach drove a significant uplift in repeat business in the year. Finally, within operations, investments in areas including point of sale systems and new staff scheduling tools drove improvements as we seek to standardise and simplify our processes globally. A standout area of progress here was our omni-channel programme, which has significantly increased the amount of product available to our online customers by enabling us to fulfil e-commerce orders from store stock.

Alongside this initial emphasis on our retail business we are sharpening our focus on how we inspire customers more consistently across channels, not least working closely with our wholesale partners to create a stronger, more carefully curated Burberry offer globally. With scope to accelerate this activity to drive still-greater coherence and support brand perception, this is important work for the future.

E-commerce Leadership

Through early investment and focus, we have established a leading position in digital in our industry, with more than 48 million followers on social media worldwide and a 'Genius' ranking from the influential think-tank L2. We aim to consolidate this leadership position over the coming years, while deploying it more assertively to drive online sales on our own website, and through third parties. From enabling seamless customer journeys across digital platforms, to using technology to service our customers in stores, and – critically – linking these online and offline worlds, we are well-placed to extend our leadership in this area.

The evolution of Burberry.com was a key focus during the year. The relaunch of the global site on mobile and desktop offered customers a richer brand experience at the same time as better functionality, improving conversion on both platforms and driving mobile to nearly 60% of our online traffic. Meanwhile, the redesign of our China site to tailor it more effectively to local preferences and behaviours drove increases of around 70% in direct-to-consumer sales, while giving valuable insights for our overall site development for the future. Finally, we soft-launched our new customer app towards the end of the year, ahead of a global rollout early in 2017/18. This will offer a more personalised shopping experience for our customers, both online and by linking them more effectively to our stores and sales associates globally.

This emphasis on facilitating experiences across the physical and digital worlds has long been a focus for Burberry, because it reflects how our customers live today. And we have never been more excited about the opportunities that technology offers in this space, nor more convinced it must be central to how we evolve our offer. Whether partnering with leaders in social media to bring our physical moments to life for online audiences, or enabling purchases straight from the runway for next day delivery globally, we see great future potential here.

Finally, we saw particularly strong growth in sales through third parties over the year, as we enhanced our focus on developing our relationships in this space. For example, we collaborated with established offline partners including Harrods in London, Shinsegae in Korea and Barneys in the US to develop unique products and experiences for their websites; we deepened our relationships with pure play online retailers such as My Theresa and Moda Operandi through elevated digital experiences for our runway shows and collections; and we continued to innovate in the area of social commerce, including making exclusive products available for purchase via WeChat. These kinds of partnerships will form an important part of realising our future e-commerce ambitions and we have exciting plans ahead.

Operational Excellence

Our fourth pillar, Operational Excellence, is focused on driving efficiency and investing appropriately to support our wider growth plans. We have real headroom in this area, with particular scope to simplify our processes, procure more effectively, optimise our inventory management and improve information and technology.

Turning first to processes, following a detailed review of opportunities to standardise activities across our shared services we moved towards a simpler, single global way of working during the year, which drove good initial results. We intend to accelerate these in 2017/18 with the planned establishment of Burberry Business Services in Leeds, a new centre of excellence in which we intend to bring together our UK and EMEA shared services teams from Commercial Procurement, Finance and HR, as well as some customer service and IT roles.

In procurement, we have begun to make changes that will enable us to realise significant financial benefits over time, including through the implementation of a new technology solution to streamline how we manage our non-stock purchases and using customer insight data to target our marketing spend more effectively.

We also made further improvements to our inventory management process as we seek to provide our customers with a great experience, wherever and however they are shopping with us. Actions during the year included the expansion of our single pool of inventory programme, which allows us to fulfil customer orders from stock in both hubs and stores; quicker delivery times and enhanced delivery information for online purchases; and a new, facilitated returns process.

Finally, the further development of our technology infrastructure is underpinning many of these early advances and will be central to delivering on our broader commitments across all of our strategic priorities over time. With work well progressed for new digital tools that will improve how we operate in areas from planning, to supply chain, to enhancing customer service in stores, we have an ambitious plan in place to initiate further changes to our systems over the coming year. This will prioritise business continuity, security and the rollout of a common, standardised technology platform globally, to facilitate efficiency business-wide.

Inspired People

These changes to our systems and processes will be complemented by an evolution of our overall ways of working, which form a critical part of our final pillar, Inspired People. Our focus here is to ensure we have the right skills and capabilities to meet our strategic objectives, that we build an organisation that is the right shape and size for the future, and that our teams are motivated and inspired. We consider this work fundamental to the successful delivery of our overall productivity and efficiency ambitions, and are putting commensurate energy and care into its execution as we manage our organisation through a period of significant change.

An important early step has been detailed work to consider how we might evolve our operating model. This has focused on how our structure could better support our aims of driving greater global consistency while better meeting the needs of our local customers, as well as simplifying our broader ways of working. We are currently concluding this work as we design our organisation for the future, and changes are already underway.

In tandem with changes to how we are structured and how we work, we have also renewed our focus on culture through a more vibrant engagement programme, designed to reignite our values of 'Protect, Explore and Inspire' and our distinctive pioneering spirit. From initiatives designed to immerse every employee in the creativity and craft behind our products, to new forums that bring together our global teams around shared priorities, we continue to explore new ways to inspire and connect our people. This has been further reinforced by an increased emphasis on fostering talent at all levels in the Company, with highlights in the year including the graduation of our first cohort of Burberry Apprentices and enhanced training and development opportunities.

The final area I would highlight under Inspired People is our wider commitment to the places and communities where we live and work. This is a fundamental part of our culture as an organisation, and our focus on this area in recent years has seen us make a real impact, from the reductions in the environmental impact of our operations that saw us named last year as a Textiles, Apparel and Luxury Goods industry leader in the Dow Jones Sustainability Index for the first time, to the real difference we have made to the lives of thousands of disadvantaged young people around the world through the work of the Burberry Foundation.

Encouraged by this progress and with the appetite to do much more, we finalised plans during the year to bring together our sustainability work, philanthropic giving and volunteering under a new and more ambitious Burberry Responsibility strategy. This is designed to address the most material social and environmental challenges in and around our operational footprint and will focus on three areas: positively impacting the communities that sustain our industry; creating positive change through all our products; and achieving carbon neutrality and revaluing waste. Each of these will have a set of challenging, public-facing goals and a flagship programme to be delivered hand-in-hand with expert partners. We look forward to announcing the detail of this programme soon.

Clear objectives, timelines and success measures are now in place for each of these five strategies, and their delivery is being overseen by a newly established Transformation Management Office, reporting to our Chief Operating and Financial Officer.

Looking ahead

And so, to close, a final few words about the future.

This will be my last letter to you as Chief Creative and Chief Executive Officer of Burberry, with Marco assuming the role of Chief Executive Officer in July. In many ways, I see one of the highlights of my term as Chief Executive Officer as the recruitment of Marco to be a partner for me, and a great leader for this Company. As I transition into the new role of President and Chief Creative Officer, this evolved structure will allow me to redouble my focus on design for this next phase, and on making products and telling stories that inspire our customers. This is the essence of who we are, and what we do – and my passion for making Burberry the most compelling brand, selling the most beautiful and finely crafted products, in the most innovative ways has never been stronger.

Over the past three years I have worked with our leadership team to put Burberry on what we believe is the right track for the coming years, through a period of real challenge and change for our business and the industry as a whole. And, with a clear plan now in place, I will remain fully engaged with the implementation of this plan in my new role as I partner with Marco and our evolved senior leadership team to drive the Company's future strategic direction.

So it is with huge optimism that I look forward to the next chapter for this brand of which I am so proud.

Over the past 161 years, Burberry has never stood still. In the past 15 years alone, this is a Company that has transformed from a predominantly licensed business, to a wholesale business, to our focus today on creating a leading luxury retail and digital business for this next phase. Which means we have shown our ability to change and adapt in the past – and we are now positioned to do so again for the future.

With so much opportunity identified across our business and a detailed programme in place to unlock it, we know this will be challenging work – and it will take time. But we are also confident of its rewards. With the right team and ways of working in place, we are ready.