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Conference Call Transcript

BRBY.L - Burberry Group plc First Half Trading Update

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CORPORATE PARTICIPANTS

Stacey Cartwright

Burberry Group plc - CFO

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CONFERENCE CALL PARTICIPANTS

Antoine Colonna

Merrill Lynch - Analyst

Erwan Rambourg

HSBC - Analyst

John Guy

MF Global Securities - Analyst

Aurelie Husson

SG Securities - Analyst

Francoise Lauvin

Cheuvreux - Analyst

Yasuhiro Yamaguchi

UBS - Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Burberry Group plc first half trading update conference call. My name is Stephanie and I will be your coordinator for today's conference. For the duration of the call, your lines will be on listen-only. However, at the end of the call you will have the opportunity to ask questions. (Operator Instructions). I am now handing you over to Stacey Cartwright, Chief Financial Officer, to begin today's conference.

Stacey Cartwright - Burberry Group plc - CFO

Good morning, ladies and gentlemen. Welcome to our update call. With me this morning is Fay Dodds, our Investor Relations Director. We'll give you a brief overview of our performance in the half, before taking your questions.

First of all, sales for the half were up 13% on a constant currency basis and up 20% on a reported basis, as we had the translation benefit from the stronger euro and latterly the dollar. Importantly, we saw positive growth in all regions around the world, save Spain, in both the retail and wholesale channels and in all product categories. And if we exclude Spain, Burberry's sales were up 20% at constant currency, a better indication of the health of our brand globally.

Looking first of all by channel, retail sales increased by 14% on an underlying basis in the half, with growth in our comparable store sales of 3.4%, and that was on top, of course, of last year's 11% comparable store growth. Throughout the period, we saw continued weekly volatility in our sales, but overall we had positive comparable sales growth in Europe and Asia and double-digit comparable sales in the US. And we opened a further five mainline stores in the half, contributing to a 13% increase in average selling space, with 12% planned for the second half.

Turning now to wholesale, revenue for the first half as a whole was up 15% underlying, in line with our guidance of over 10%. And as we explained in July, improvements in our supply chain enabled us to deliver autumn/winter products on time for the first time ever. This has led to a re-phasing of deliveries within the half, benefiting the first quarter at the expense of the second quarter.

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Looking forward to the second half for wholesale, we are expecting the US to continue to gain market share among the big, luxury department stores, emerging markets to also remain a growth engine for us, albeit off a small base, but Spain to decline by over 20% as the weak economic environment puts pressure on the small independents who make up about half of our sales in this channel.

So, overall for wholesale, we are planning on revenue being broadly in line with last year at constant exchange rates. As ever, the final outcome will depend on the level of in-season or top-up orders that we receive from customers, where currently we have lower visibility than usual due to turbulent market conditions.

So, finally here on licensing, income was down 3% on an underlying basis in the first half. And we are now expecting a slight decline for the year as a whole, given some moderation in demand in Japan and lower royalties from our fragrance license in particular, where we're anniversarying the launch of The Beat for women last year.

As Angela said in her quote this morning, we're pleased with our performance in the first half of the year, with sales up 13% despite an increasingly challenging external environment.

Overall for the first half, we are expecting to meet market expectations for operating profit. As we flagged in July, we did sell less merchandise at full price, which has adversely impacted gross margin, but this has been offset by tight control over discretionary costs. And whilst stock is expected to be around GBP60m higher than in March, we remain focused on clearing this through our normal channels.

With the all important third quarter ahead of us, we are seeing volatility in trading and increased uncertainty for consumers around the world. Hence, the immediate outlook is less clear than it has been for a long time, but we will provide further guidance when we speak to you on January 20.

In the meantime, we remain focused on driving long-term growth through our key strategies. Under leveraging the franchise, we've concentrated for this season on our core icons and are seeing good growth in areas including outerwear, especially overcoats, check handbags, especially some of the new innovative lines such as the Beat Check, and we have a very strong soft accessories offer for Christmas as well.

Under intensifying non-apparel, this accounted for over 29% of sales in the first half, up from below 28% a year ago. And we are seeing good growth here in some of the newer areas, such as jewelry and men's accessories.

Under accelerating retail-led growth, we talked about opening our net five mainline stores in the half. And this really stretched from established markets such as the west coast of the US, but also new markets such as Hungary.

Under investing in under-penetrated markets, revenue in Americas was up by over 20% in the first half and emerging markets up over 50%.

And finally, under operational excellence, as well as the delivery improvements I have already mentioned, we have made further progress on rolling out SAP to Hong Kong, opening a new regional distribution hub there. And we are also expecting to move to our new global showrooms and offices in London from late November.

So, with that, let me now hand you over to the operator for questions.

QUESTION AND ANSWER

Operator

Thank you. (Operator Instructions). The first question comes through from the line of Antoine Colonna from Merrill Lynch. Please go ahead.

Antoine Colonna - Merrill Lynch - Analyst

Yes, good morning.

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Stacey Cartwright - Burberry Group plc - CFO

Hi, Antoine.

Fay Dodds - Burberry Group plc - IR Director

Morning.

Antoine Colonna - Merrill Lynch - Analyst

Hi there. Two quickies. The first one is could you give us a breakdown or an approximate breakdown of licensing revenues by key countries or regions, please? Obviously, the termination of the menswear licensing is having an impact. To just try and model better, going forward, licensing revenues. That's my first question.

Second question. Could you come back on the inventories left at the end of the first half and tell us a little bit, in terms of color, what is these inventories? Is it a hotch-potch of everything or is there a dominance of a product category in there?

And last question. Could you confirm that the sourcing and supply chain savings you are going to obtain in the second half are going to be quite tangible? I think you referred at the beginning of the year to significant savings there. Thank you.

Stacey Cartwright - Burberry Group plc - CFO

Okay. So, first of all, licensing revenues by region. That's quite a hard one, Antoine, because obviously you have got Japan, which is Japan. When it comes to the ready-to-wear licenses, a large number of which we have been turning off, you've got small licenses in places like Germany, bigger licenses in places like the US. They are really spread across menswear in all the geographical regions.

Antoine Colonna - Merrill Lynch - Analyst

Is it fair to assume that it's broadly the same split as that at the end of March '08, in other words, the termination of the menswear licenses is not going to have a big impact on the regional split?

Stacey Cartwright - Burberry Group plc - CFO

Yes, I'd say they are not hugely material, Antoine.

Antoine Colonna - Merrill Lynch - Analyst

Okay.

Stacey Cartwright - Burberry Group plc - CFO

For modeling purposes.

Antoine Colonna - Merrill Lynch - Analyst

Okay.

Stacey Cartwright - Burberry Group plc - CFO

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I'd have said.

Antoine Colonna - Merrill Lynch - Analyst

Thank you.

Stacey Cartwright - Burberry Group plc - CFO

Okay. In terms of -- I think your second question was around inventory at the end of the first half and giving you some color around that. If I can try and give you a little bit of color around the GBP60m. Clearly, we've seen growth in inventory levels over the first half in line with the growth in the business. But what we've also had is an increase in inventories that, bluntly, we haven't sold through at the levels that we planned to in this first half.

If you go back and look at, say, autumn/winter '08, we placed orders for autumn/winter '08 back in November/December time last year and started to ship it in across May/June and then into July. And although we've tweaked the level of orders that were placed, we're still carrying more inventory for autumn/winter '08 than we would ideally like at this point.

Now, clearly, in the run-up to Christmas, the question will be how much of that we clear through at full price and how much of that ends up going into markdown after Christmas. So that's one of the areas of uncertainty that we're flagging.

And just to reiterate -- to give you a confirmation on the sourcing savings, Antoine, absolutely, we called out that for the second half we've managed to make quite significant savings on sourcing and with the supply chain, which are offsetting and exceeding the impact of the euro exchange rate, which was obviously going to make our sourcing that much more expensive.

Antoine Colonna - Merrill Lynch - Analyst

If the exchange rates were to be maintained going into the second half of the year, they would be exceeding or they would be just meeting?

Stacey Cartwright - Burberry Group plc - CFO

Well, will exceed because we've hedged.

Antoine Colonna - Merrill Lynch - Analyst

It would exceed, okay.

Stacey Cartwright - Burberry Group plc - CFO

And remember, we hedged at EUR1.25 anyway. We're not that far off.

Antoine Colonna - Merrill Lynch - Analyst

Okay, okay. Thank you very much.

Operator

Thank you. The next question comes through from the line of Erwan Rambourg from HSBC. Please go ahead.

Erwan Rambourg - HSBC - Analyst

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Yes, hi. Good morning again. Three quick questions. First, in terms of price point, if you look at your pyramid of product today, what level of price points would you say has been the most resilient between the lower end and the higher end and how you see this evolving in the second half?

Secondly, can you give us a contrast between apparel, non-apparel in terms of performance and, again, how you see this evolving?

And then, finally, on Spain. Can you give us an idea of the number of independent retailers you have and what the comfort level would be for you? And how long do you think it's going to take to stabilize, not sales but at least the trend there?

Stacey Cartwright - Burberry Group plc - CFO

Okay. First question, I think, on price points. In terms of what's more -- well, first of all, to talk about how our average unit retail has moved generally over the course of the last year. Average unit retail in many of our territories is up close on 20%, so really demonstrating how we are filling out the pyramid at the middle and the top part of it, and migrating customers up through it.

That said, we have seen in recent months a return to core, by which I mean consumers wanting to not necessarily buy the new top of the range handbags, necessarily, but looking to buy the innovative versions of the check. And if you look at our advertising campaign for this season, you see the various versions in terms of Exploded Check, House Check and even the Haymarket Check, presented in different ways, including in some of the runway bags. There's definitely a bit of a return to core in terms of the branding, I think, that's going on.

Erwan Rambourg - HSBC - Analyst

But still above the access price, handbags?

Stacey Cartwright - Burberry Group plc - CFO

Yes.

Erwan Rambourg - HSBC - Analyst

Okay.

Stacey Cartwright - Burberry Group plc - CFO

And although, that said, we've also got a number of smaller handbags at the entry price point, below GBP500, which are also doing extremely well. So, it's right the way up through the pyramid.

Erwan Rambourg - HSBC - Analyst

Okay.

Stacey Cartwright - Burberry Group plc - CFO

In terms of apparel and non-apparel, we've called out the fact that non-apparel has put on market share again this half, versus apparel. But nonetheless, you've had womenswear performing extremely strongly and menswear up 10% as well, so it's not as though it's at the expense of the other product categories not growing.

Fay Dodds - Burberry Group plc - IR Director

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And again, very strong growth from childrenswear will be (inaudible).

Stacey Cartwright - Burberry Group plc - CFO

Yes. And then, in terms of Spain, we actually have over 1,000 small independents in Spain, a huge number. In terms of the number that we'd feel comfortable with, or where we might plateau out, to be honest, there isn't a target number there. We're very mindful that there are some of the very small end customers who, to be honest, it's better for us not to be dealing with. So, we've been almost taking them out of the equation before they've taken themselves out, so.

Erwan Rambourg - HSBC - Analyst

And how long can this take to feel comfortable with the number you're dealing with?

Stacey Cartwright - Burberry Group plc - CFO

Yes. Remember, you've got two things going on in Spain. You've got the economic environment, which is putting particular pressure on the independents, and then the whole make up of how we sell in Spain as well. And it will take -- to be honest, it will take a few years to roll through. Not necessarily the economic environment, but the natural erosion of the multi-brand accounts.

Erwan Rambourg - HSBC - Analyst

Okay. Thank you very much.

Stacey Cartwright - Burberry Group plc - CFO

Okay. Thanks, Erwan.

Operator

Thank you. The next question comes through from the line of John Guy from MF Global Securities. Please go ahead.

John Guy - MF Global Securities - Analyst

Yes. Good morning, Stacey. Just one, really, question on your gross margin. You flagged that gross margin would be slightly weaker on the back of higher markdown. I know that last year you were around about the 60.2% on gross margin for retail/wholesale. By what sort of expectation are you looking for gross margins to fall? And I do appreciate that you said that that would be more than offset by some of the discretionary spending savings that you have already made.

Stacey Cartwright - Burberry Group plc - CFO

Yes. I think various of the analysts have estimated anywhere between 40 and over 200 basis points as the likely impact in the first half. We would be at the top end of that range, if not a little bit beyond it. And as you say, very tight cost control internally, which means that overall we are happy that we will be coming in with EBIT in line with analyst expectations.

John Guy - MF Global Securities - Analyst

Okay. And really, just following on from that, with regard to the level of OpEx as a percentage of sales for the full year, do you think that that is likely to remain around the 45%, 46% level or do you think that that could go as high as 50%?

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Stacey Cartwright - Burberry Group plc - CFO

Well, we're obviously making sure internally that everybody is battening down the hatches and looking at costs very, very closely. What we have said about the second half generally is that we are not going to give too much guidance at this point because, at the end of the day, your OpEx as a percentage of revenue depends on what your revenues are.

John Guy - MF Global Securities - Analyst

Sure.

Stacey Cartwright - Burberry Group plc - CFO

And with the volatility that we are seeing week by week and uncertainties of consumers generally around the world right now, we do have limited visibility. And I am sure you are hearing that from a number of other companies.

John Guy - MF Global Securities - Analyst

Yes, indeed. Great. Thank you very much indeed.

Operator

Thank you. The next question comes through from the line of Aurelie Husson from SG SS. Please go ahead.

Aurelie Husson - SG Securities - Analyst

Good morning. I have three questions. The first one would be on the Spain market, if you could give us the performance in H1 on wholesale and retail channels.

The second one would be on the UK market. You had a lot of market share gains recently. I wanted to know if -- what is the trend that you are currently observing in this market.

And finally, on the US, do you still have an order book which is above 20%?

Stacey Cartwright - Burberry Group plc - CFO

Okay. Spain market, the wholesale and retail is minus 20% in the half.

Fay Dodds - Burberry Group plc - IR Director

And wholesale was just over 20% down.

Stacey Cartwright - Burberry Group plc - CFO

Yes.

Fay Dodds - Burberry Group plc - IR Director

Retail slightly below.

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Stacey Cartwright - Burberry Group plc - CFO

Yes. So that's the mix there, but a very consistent message across both those channels to market.

In terms of the UK market, nicely up in both Q1 and Q2 at similar levels, so positive.

And in terms of the US order book, still positive but not up at the 20% levels. And I should just explain what the order book comprises. You have committed forward orders for your wholesale partners, but you also have a number of re-orders. And we're being quite conservative at the moment about the level of re-orders that we're expecting to get from the US wholesalers, particularly in the context of their results announcements last week. You saw their like-for-like sales down anywhere between 8% and 12%. And in that context, even if we are outperforming, as we know we have been doing, and taking market share, if their like-for-like sales are down to that degree we can't assume that we won't be impacted.

Aurelie Husson - SG Securities - Analyst

Okay. Thank you.

Stacey Cartwright - Burberry Group plc - CFO

Okay.

Operator

Thank you. (Operator Instructions). We've got a follow-up question from the line of Antoine Colonna from Merrill Lynch. Please go ahead.

Antoine Colonna - Merrill Lynch - Analyst

Yes. I just wanted to ask you, the 8% to 12% you just referred to a second ago, for which period was that for, please?

Stacey Cartwright - Burberry Group plc - CFO

That was the month of September that the US department stores came out with last week.

Antoine Colonna - Merrill Lynch - Analyst

Okay, okay.

Stacey Cartwright - Burberry Group plc - CFO

So that's Saks and Nordstrom and Neiman.

Antoine Colonna - Merrill Lynch - Analyst

Yes, but you weren't referring to Burberry, yes?

Stacey Cartwright - Burberry Group plc - CFO

Oh, no, no, no. Sorry if it came across that way.

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Antoine Colonna - Merrill Lynch - Analyst

No.

Stacey Cartwright - Burberry Group plc - CFO

No, I was just explaining that's why we may not get the re-orders that we were anticipating, if the top stores are suffering at that level.

Antoine Colonna - Merrill Lynch - Analyst

Could you make a comment also? Sorry. Could you just make a quick comment also on October so far, as to whether it's been overall showing any differences with the past quarter, please?

Stacey Cartwright - Burberry Group plc - CFO

Yes. It just continues volatile, Antoine, is what I would say. That increased volatility we saw during the second quarter continues into October.

Antoine Colonna - Merrill Lynch - Analyst

Okay. But no marking elements so far?

Stacey Cartwright - Burberry Group plc - CFO

No.

Antoine Colonna - Merrill Lynch - Analyst

Okay. Thank you.

Stacey Cartwright - Burberry Group plc - CFO

Thanks, Antoine.

Operator

Thank you. (Operator Instructions). We've got a question coming through from the line of Francoise Lauvin from Cheuvreux. Please go ahead.

Francoise Lauvin - Cheuvreux - Analyst

Yes. Good morning to everyone.

Stacey Cartwright - Burberry Group plc - CFO

Hi there.

Francoise Lauvin - Cheuvreux - Analyst

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I was just wondering, I'm a bit confused about the licensing revenues, because I don't really estimate the amount that comes from the end of the licensing of the menswear.

And I wanted to ask you about your future hedging on the yen. What are the levels and what will be the impact for the end of the year and next year?

Stacey Cartwright - Burberry Group plc - CFO

Okay. So, in terms of understanding the licensing numbers, you know, Françoise, that we've got a bit chunk of it that's made up from the Japanese license, then the global licenses and then this smaller piece which is eroding, which is the ready-to-wear licenses. And as we go, we're reaching the end of the terminations fairly shortly. We'll be out of the licenses, the residual menswear licenses, by the end of 2009.

Françoise Lauvin - Cheuvreux - Analyst

Okay.

Stacey Cartwright - Burberry Group plc - CFO

That's the first point. Do you want to pick up the yen or --?

Fay Dodds - Burberry Group plc - IR Director

Yes. In terms of the hedge on the yen, we hedge about 12 months forward of our anticipated yen revenue. I think at the moment we are hedging at about -- hedged at about JPY210.

Stacey Cartwright - Burberry Group plc - CFO

About JPY210.

Fay Dodds - Burberry Group plc - IR Director

So I can confirm that for you later.

Françoise Lauvin - Cheuvreux - Analyst

And do you have the level you're hedged at?

Stacey Cartwright - Burberry Group plc - CFO

About JPY210.

Françoise Lauvin - Cheuvreux - Analyst

But the currency level?

Fay Dodds - Burberry Group plc - IR Director

That is at JPY210 to the pound.

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Francoise Lauvin - Cheuvreux - Analyst

Okay. Thank you.

Operator

Thank you. The next question comes through from the line of Yasuhiro Yamaguchi from UBS. Please go ahead.

Yasuhiro Yamaguchi - UBS - Analyst

Hello.

Stacey Cartwright - Burberry Group plc - CFO

Hi there.

Yasuhiro Yamaguchi - UBS - Analyst

One question is your debt projections. You indicated that you are prepared to go up to about GBP100m debt by the year end.

Stacey Cartwright - Burberry Group plc - CFO

Yes.

Yasuhiro Yamaguchi - UBS - Analyst

And how you see the debt levels going forward and also if there are any implications to potential share buybacks?

Stacey Cartwright - Burberry Group plc - CFO

Yes. We've -- we haven't changed from where we were at the year end, which is that we think it's appropriate to carry up to around GBP100m of net debt on the balance sheet. So when we get to March 31, don't expect us to land it on the nail. That's the sort of range of what we think is appropriate.

In terms of share buybacks, in this current climate it doesn't feel like the right thing to be doing right now. So, obviously, we'll come back and talk to you again when we talk in January. But right now, there's nothing planned on the horizon.

Yasuhiro Yamaguchi - UBS - Analyst

Thank you.

Stacey Cartwright - Burberry Group plc - CFO

Thank you.

Operator

Thank you, ladies and gentlemen. We've got no further questions in queue, so I hand back to the host to conclude today's conference.

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Stacey Cartwright - Burberry Group plc - CFO

Well, thank you very much, everybody, for your attention today. We look forward to speaking to you on November 18, which is when we will be announcing our interim results. Thank you very much.

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