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Conference Call Transcript

BRBY.L - Burberry Group plc Trading Update Presentation

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PRESENTATION

Operator

Welcome to Burberry Group's first half trading update conference call. My name is Faye, and I'll be your coordinator for today's conference. For the duration of the call, you'll be on listen-only. However, at the end of the call, you will have the opportunity to ask questions. (Operator Instructions).

I'm now handing you over to Stacey Cartwright to begin today's conference. Thank you.

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Good morning ladies and gentlemen, and welcome to Burberry's first half trading update call. With me this morning is Fay Dodds, our Investor Relations Director. We're going to give you a brief overview of our performance before then taking your questions.

So total revenue in the half was up 6% on a reported basis, or down 5% at constant exchange rates. Within this, Retail sales increased 14% on an underlying basis, with 2% comparable store sales growth in the half and of this 5% came in the second quarter as consumers responded favorably to our Autumn/Winter collections.

This is obviously a pleasing trend as Retail is always a leading indicator and demonstrates more closely the health of the brand. Although of course it's really too early to tell if this trend will continue into the all-important holiday selling period.

By region, Europe and Asia were again up double digit with stand-out performances from Korea and the UK. When looking forward, do remember that the UK has been strong since around December of last year. Spain and the United States were down double digit again in the half, although both did trend better in the second quarter.

In Wholesale, revenue was down 23% in line with the guidance we gave back in April. Remember that 10% of this decline was a result of our own actions as we closed underperforming brands such as Thomas Burberry, and closed some small accounts across Europe.

In Licensing, underlying revenue was down 6%, perhaps a little better than expected, as it included the first half impact of the recent amendment to the Japanese apparel license. And just to remind you that not only does this amendment increase our profitability from Japan but the license now expires in 2015 instead of 2020, so we alone are able to decide whether or not to renew at that point or pursue other options available to us in this all-important market.

Although this is only a sales update, and we're going to give you full details on the P&L account, cash and balance sheet at our interims next month, we are pleased with the progress that we've made in significantly reducing inventory levels still further. This has been achieved by lower procurement as we bought Autumn/Winter '09 cautiously, as we said we would, and Retail sales have been better, particularly in the second quarter, and particularly at full price.

So as a result the gross margin for the half is better than we'd planned, although operating expenses as a percentage of sales will also be up, given the mix shift in revenue towards Retail, and the cost increases that we're facing as discussed in previous updates.

And finally, net cash at September '09 is higher than at March '09, which is a much stronger position than our usual seasonal first half net cash outflow.

We've also made further operational progress under our five strategic initiatives. So under Leverage the Franchise, Burberry's return to London Fashion Week reinforced the brand's momentum around the world.

And for Non-Apparel Development, this category showed the strongest growth in the half driven by handbags and small leather goods. And for the first time we have sales in non-apparel matching those of womenswear in our own retail stores.

Under Retail-led Growth, we opened nine more stores with some exciting developments in Asia in particular, especially Singapore, Tokyo, and Australia.

In Under-Penetrated Markets, we're delighted with our progress in China where our franchisees opened seven stores in the half, bringing our total in that market to 44.

And under Operational Excellence, we completed the implementation of the global cost efficiency program, which will contribute GBP50 million of P&L benefits this year.

And we've also today given you guidance on our normal metrics. So under Retail, average selling space for the full year is now expected to be between 8% and 10%, which is a little below previous guidance because we've now included for the first time the impact of closing a handful of under-performing stores in the first half as part of the global cost efficiency program. Following 12% space growth in the first half, this works out to around 6% in the second half.

Under Wholesale we're expecting second half revenue to be down around 15% at constant exchange rates, of which around half is down to our own actions as before. The remaining half reflects, as expected, a reduced Spring/Summer '10 buy from Wholesale customers reflecting their cautious approach to inventory as for all brands when orders were being placed over the summer just gone. Within this the US is relatively strong, as our product initiatives enable us to gain share in what is still an under-penetrated market for us, while Spain continues to be down high double digit.

And finally on Licensing, we've increased our full year guidance by several percentage points to be between 5% and 10% down, which largely reflects the impact of the amended Japanese apparel license. Remember that overall though, reported licensing revenue will be up year-on-year due to the strength of the yen versus sterling.

So with that, thanks for your attention. Let me now hand you back to the Operator for questions.

QUESTION AND ANSWER

Operator

Thank you. (Operator Instructions). The first question comes from the line of Erwan Rambourg from HSBC. Please go ahead.

Erwan Rambourg - ***HSBC - Analyst***

Hi, good morning. It's Erwan Rambourg at HSBC. Three quick questions, if I can. You mention relative strength in the US for Wholesale, and H2 being down 15%, half of this due to your own actions, which are basically focused on Europe. So can you quantify relative strength, does it mean that the US is slightly down, or is it neutral, or even slightly up?

Secondly, I know this is not about margins, this call, but you have alluded to comps being up, product mix seems to be favorable. I saw a comment on Reuters mentioning that you think that the lower end of the consensus might go up. Can you help us understand how we need to think about gross margin, and how this can sequentially improve in H2 versus H1?

And then finally, just a question on the renegotiation impact of the license. How can you quantify this for the first half?

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Okay. In terms of the relative strength for second half for the US, if you strip through the numbers that we've given, so minus 15% overall, minus 7% is what we would truly classify as being underlying across the Group as a whole. The US is better than that, and Spain is significantly worse than that.

So we haven't -- we're not giving any more guidance at this stage. Clearly the numbers will still move around a little bit according to, the usual triggers either way of cancellations and reorders. But we are very pleased that the US is better than that minus 7%, particularly in the context of those US department stores being very explicit publicly about how they're still planning Spring/Summer '10 down double digits, in their overall open to buys, 15%-20% seems to be the norm. So we are going --

Erwan Rambourg - ***HSBC - Analyst***

So can we think [slots] are slightly down, is that a right way of thinking about the US?

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Better than minus 7%, I don't think we're going to say anything more than that.

Erwan Rambourg - ***HSBC - Analyst***

Okay.

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

And then in terms of margins, clearly when we last spoke to you we weren't sure how the clearance activity would go during the second quarter, we were only just going on sale in July. And you remember what happened at the previous mark down season, December/January, that there was a fair degree of discounting going on across US department stores, our peers etc. And it was somewhat difficult to deal with, and we ended up running sale for longer in our own stores in a very sort of brand enhancing way at the back of the stores but nonetheless running sales for longer.

As it turned out, the mark down season for Spring/Summer '09 was much better in terms of discipline, right across the industry I think. We didn't extend the sale period, and indeed as we moved into August, and then September, we've had an improving trend and all of that has been at full price. So that's why where previously, I think, consensus was for gross margin in this first half to be down maybe 300-350 basis points versus the previous year, we're simply saying now we won't be as bad as that.

Erwan Rambourg - *HSBC - Analyst*

Okay.

Stacey Cartwright - *Burberry Group Plc - EVP and Chief Financial Officer*

Then you talked about renegotiating on -- the renegotiation on Japan. A little bit of benefit in this first half and the rest of the GBP4 million in the second half; so a little bit less than half of that at this point and a little bit more than half in H2.

Erwan Rambourg - *HSBC - Analyst*

Excellent. Thank you very much.

Operator

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

Stacey Cartwright - *Burberry Group Plc - EVP and Chief Financial Officer*

Hi John.

John Guy - *MF Global Securities - Analyst*

Hi, morning. Erwan's asked quite a few of my questions but just a comment on the FX. I know that you mentioned a while ago seeing a relative strength in sterling, obviously moving from the lows earlier on in the year, and you were talking about a GBP10 million potential EBIT impact for the full year. Do think that that's still consistent, given where sterling is today, or do you think that that's maybe slightly you being relatively prudent in talking about a GBP10 million hit?

Stacey Cartwright - *Burberry Group Plc - EVP and Chief Financial Officer*

It's still of that order from where we sit today. Remember when we originally were budgeting for 2009/2010, sterling versus the dollar was about 1.45 so we're not back at that level which is where we would have had more of a GBP10 million pick-up, if you like, year-on-year. So we're the same position as we were in June.

John Guy - *MF Global Securities - Analyst*

Okay, and just a second question. Can you remind us how much less stock you had in the Autumn/Winter collection compared to Spring/Summer, what the actual difference is?

Stacey Cartwright - *Burberry Group Plc - EVP and Chief Financial Officer*

We didn't actually say in terms of quantification. We did say we were procuring significantly less for Autumn/Winter '09. And you can take a little bit of a clue from the cash number.

So the fact that our cash is up and improved at the half year, when normally we have cash outflows in the first half, and then inflows and some in the second half, tells you the amount of turnaround; not only have we not had a cash outflow, we've had a cash inflow. And that is largely down to inventory, and a little bit of tax cash flow which we pointed out at the prelims.

John Guy - *MF Global Securities - Analyst*

Fantastic.

Fay Dodds - ***Burberry Group Plc - Director of IR***

Also caused by some spend relating to the cost efficiency program.

John Guy - ***MF Global Securities - Analyst***

Fantastic, thanks very much.

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Okay, thanks John.

Operator

Thank you. The next question comes from the line of Katharine Wynne at Investec. Please go ahead.

Katharine Wynne - ***Investec - Analyst***

Yes, good morning.

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Hi Katharine.

Katharine Wynne - ***Investec - Analyst***

Hi. Sales mix in Retail. Can you perhaps give us a little bit more coverage on that, and where the trends have gone through the second quarter? You obviously indicated the full price demand has picked up quite strongly, but if you can give us an idea of which categories are particularly performing for you?

And secondly, just to elaborate on the US department store demand picture. It's very clear that you are taking share here but again, can you give us a little bit more background on that please?

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Okay, in terms of the categories that are performing, I'll call out non-apparel first, second and third. Non-apparel has been very strong for us; it is consumers looking for the innovative use of our icons. It's what we called out in the last couple of calls, so they're looking for investment pieces which have the demonstrable branding on there, but in a new innovative way.

So the use of our mega check for example, and whether that's large leather goods i.e. handbags or small leather goods, scarves. We have the new variant on a scarf, the snood, which was launched this autumn and again those are selling out extremely well in the stores.

And then shoes. We've really got a much more comprehensive offering now, and even our runway shoes have sold out in the stores and we've got waiting lists on line for them. So non-apparel (inaudible) matters are strongest.

Fay Dodds - ***Burberry Group Plc - Director of IR***

Clearly children's wear, but still from a relatively small base.

Stacey Cartwright *- Burberry Group Plc - EVP and Chief Financial Officer*

So that's the highlights there.

I'm not sure what more I can say on the US department stores, other than the fact that we're going to be better than that minus 7%. And the US department stores, more so than some of our other wholesale partners, will have a little bit more flex around what they might or might not do on reorders, which is why we don't want to be too explicit at this stage because we will need to see how that goes as we go through the next season.

Katharine Wynne *- Investec - Analyst*

Okay, thanks.

Stacey Cartwright *- Burberry Group Plc - EVP and Chief Financial Officer*

Thanks Katharine.

Operator

Thank you. The next question comes from the line of Thomas Chauvet at Citigroup. Please go ahead.

Thomas Chauvet *- Citigroup - Analyst*

Hello.

Stacey Cartwright *- Burberry Group Plc - EVP and Chief Financial Officer*

Hi Thomas.

Thomas Chauvet *- Citigroup - Analyst*

Hello, I've got two questions. The first one on cash. You indicated you had a cash inflow in H1. If we assume a net cash position of GBP60 million-GBP80 million at your end, I think that's what consensus says, would you think there's an opportunity to resume buy-backs in the second half?

And my second question. What would be the EBIT impact from the closure of the six under-performing stores, and have you identified more stores that you may close next year maybe?

Stacey Cartwright *- Burberry Group Plc - EVP and Chief Financial Officer*

Okay. In terms of buy-backs, we haven't said anything more, other than at the time of the downturn that we were suspending our buy-back activity, and we haven't indicated any change to that since. So nothing more to report on that.

In terms of the EBIT impact of the six under-performing stores, they were loss-making. It's small in the round, I wouldn't pull them out of anything material in these numbers, but they were small loss-making stores.

But in terms of are there any other plans, not in the same way as we have the cost efficiency program. There will always be odd store closures in the normal course of any retail business. But the six that we identified as part of the cost efficiency program were a bulk as part of that initiative.

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

Okay, thank you very much.

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Thanks Thomas.

Operator

Thank you. The next question comes from the line of Warwick Okines at Deutsche Bank. Please go ahead.

Warwick Okines - ***Deutsche Bank - Analyst***

Good morning. Just a couple of questions please. Just a follow up firstly on the product performance. Could you just clarify which part of the price pyramid performed best at full price in the second quarter? Are you saying that the investment pieces are still doing the best or were you, just when you talked about the product a minute ago, flagging that it was slightly different to the previous few quarters?

And then secondly, just a question about the mainline versus outlet stores. Could you give us a change in the Retail mix between mainline and outlet stores in Q2 please, either in absolute terms or in basis points?

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Okay. In terms of the product performance, I wouldn't call out specifically, obviously Prorsum at the top end of the pyramid is slightly more challenged in these times, but through the London and the Lifestyle, or London and now Brit part of the pyramid, we've seen good performance.

I don't think there's anything particular to pull out, other than obviously in non-apparel, we called out that small leather goods have done particularly well. So those will be at, from a mix point of view, at a lower average price point than some of the larger handbags. But that's not about us doing anything on pricing as such, it's simply pushing on items that are a lower average unit retail where consumers are -- that's where the demand has been.

And then I think your second question was around mainline versus outlets. Very similar like-for-like trends for mainline and outlets in the second quarter so nothing that happened that changed the mix.

Warwick Okines - ***Deutsche Bank - Analyst***

Okay, thanks very much.

Operator

Thank you. We have no further questions. (Operator Instructions). The next question comes from the line of Lisa Rachal at Redburn Partners. Please go ahead.

Lisa Rachal - ***Redburn Partners - Analyst***

Hi there, can you hear me?

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Yes, hi Lisa.

Lisa Rachal - ***Redburn Partners - Analyst***

Hi. Two questions. First I was wondering, you started to mention about reordering activity, which of course is always difficult to predict for a second half, but curious what sort of activity, if any, you saw during the second quarter, specifically from the US, especially as major retailers are moving towards ordering less up front and then relying on their strong and efficient supply teams of suppliers like yourself to fill in the gaps as and when they need to.

And then the second question is, you have done a lot of development in your leather goods, especially handbag and small leather good offer, which is around offering better value for money. And I'm just wondering what type of traction you saw in some of the newest offers. And also what the trends were seasonal versus check?

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Okay. The reordering in H2, one thing just to say in terms of the trend that you just articulated on, whether department stores are looking to buy later and reorder later, rather than up front, people do need to be cautious of doing that because you don't necessarily have the inventory for them. And that's certainly a message that all of our sales teams globally, and particularly in the US, are making sure that wholesale customers are aware of.

That said, we do have our core items on what we call replenishment. So whether it's the iconic trench coats or the iconic handbags and mufflers, we endeavor to always be in inventory, to be in stock on those items, and to have a quantity coming through the pipeline in terms of raw materials and work in progress etc.

And that is the variant in all of this. We did see some reorders coming in towards the end of the second quarter. It's one of the reasons we came in very marginally better than the minus 25[%] that we had been forecasting, and we'll have to see how that pans out in H2 as a whole.

I think your second question was around the development of leather goods and what traction we've got on some of the newer styles, as it were. I think we're very pleased with the way in which non-apparel has landed generally. We're seeing great sell-through in some of the core iconic bags like Haymarket and Nova, but we're seeing fantastic response as well to the new variants on the iconic bags.

So I don't think I'd call out one versus the other. It is the case that anything that has more overt branding on it is performing better than that that doesn't, and that extends even into the tailored offering for example. So I think we showed you in the showroom when you were in, Lisa, the fact that if you put the Beat Check underneath the collar of one of the tailored jackets, that really powers the sell-through on that item than if you had it as a plainer black jacket.

Lisa Rachal - ***Redburn Partners - Analyst***

Okay, great. Thank you.

Stacey Cartwright - ***Burberry Group Plc - EVP and Chief Financial Officer***

Thanks Lisa.

Operator

Thank you. The next question comes from the line of Dennis Weber at Evolution Securities. Please go ahead.

Dennis Weber - ***Evolution Securities - Analyst***

Yes, hi there. Actually most of my questions have been asked but two more maybe please. Firstly on Japan, could you just elaborate a little bit on the new agreement again and tell us about the underlying demand in the country, and also what has changed and prompted that change in terms of the licensing agreement for you, obviously outside the things that you have said in the press release?

And then second of all maybe on the cost saving side, you said that obviously the GBP50 million program has now been completed. Is there potentially any more that we can expect? Thank you very much.

Stacey Cartwright *- Burberry Group Plc - EVP and Chief Financial Officer*

Okay. The Japan, it was an amendment to the existing license that we announced a couple of weeks ago and the key feature in that announcement was the fact that the license will now terminate in 2015 rather than 2020. But even in the interim, up to that date, we have secured enhanced production criteria which basically means that we will be paid on a higher minimum rate of production which will help the overall royalties.

So for 2009/2010, that's where the additional GBP4 million comes from. There's another big step up in calendar 2011 which will mean that we will have a similar step up for our 2011/2012 year as well.

In terms of why we made the change, it's part of the ongoing relationship between ourselves and Sanyo, looking at what was appropriate, given the difficult Japanese market place, and the way in which the previous version of the license was worded, they were incentivised to produce inventory that they might not sell through. And that clearly wasn't going to be healthy for them from a cash flow point of view, and not healthy for Burberry the brand, which is why we agreed this change.

In terms of cost savings, is there any more? I know that's always the question and we're constantly seeking out efficiencies across the business but there's nothing more that we would disclose at this stage.

Dennis Weber *- Evolution Securities - Analyst*

Thank you.

Stacey Cartwright *- Burberry Group Plc - EVP and Chief Financial Officer*

Thanks Dennis.

Operator

Thank you. We have no further questions so I'll hand you back to your host to conclude today's conference.

Stacey Cartwright *- Burberry Group Plc - EVP and Chief Financial Officer*

Thank you very much everybody. In conclusion, we think Burberry has delivered a solid first half revenue and profit performance, especially in Retail. We've made good progress on implementing the cost efficiency program which is now complete, while at the same time reducing inventory and generating more cash. As Angela said in her quote, the outlook for the global economy and the luxury consumer does remain uncertain and we are still planning conservatively.

It is too early to tell if the recent stronger retail trends will continue into this all-important holiday selling season but we do think our brand momentum, strong product designs and continuing efficiencies mean that we are well placed as and when global economies recover.

So thank you very much again for your attention. We look forward to speaking to you all on November 17 which is when we release our interim results. Thanks very much.

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