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Conference Call Transcript

BRBY.L - Burberry Group plc Third Quarter Trading Update and IMS Conference Call

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PRESENTATION

Operator

Good morning ladies and gentlemen. And welcome to the Burberry Group's third quarter trading update conference call. My name is Stephanie and I will be your coordinator for today's conference. (Operator Instructions). I am now handing you over to Stacey Cartwright, Chief Financial Officer, to begin today's conference.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Good morning everybody. With me this morning is Fay Dodds, our Investor Relations Director. We're going to give you a brief overview of our performance in the quarter before taking your questions.

In what remain challenging and volatile markets for all luxury players, we've got three key messages.

First, that we traded satisfactorily through the third quarter, benefiting from the diversity of our model by product, channel and region. And we currently expect adjusted profit before tax for '08/'09 to be in line with the guidance that we gave at the time of the interims in November.

Second, as discussed at the interims, we're tightly controlling costs and cash. And I'll update you shortly on the further cost efficiencies we've identified since we last spoke.

And third, we're improving efficiency, which enables us to focus on and invest in those initiatives and strategies which drive long-term growth.

So, first of all, let me summarize our third quarter performance. Total revenue at constant currency increased by 9%, or 30% at reported rates, as we continue to benefit from the strength of the US dollar, the euro and the Hong Kong dollar relative to the pound.

Retail sales increased by 12% underlying. Comp store sales were down 3%, a slight improvement from mid November, largely reflecting a better December, helped by successful promotions in both mainline stores and outlets. However there was, as you'd expect, continuing pressure on gross margin.

There were big regional differences, with our comps in Europe and Asia up double digit in the quarter, albeit still volatile. And within this, the UK deserves a special mention, up over 20% in the period, benefiting from increased tourist spend, especially given currency movements. The US was, as expected, more challenging. And Spain remained weak.

In wholesale, revenue was up 8% in the small third quarter, reflecting further improvements in on-time deliveries from our supply chain. Note however that for the second half wholesale revenue as a whole, we're expecting a high single-digit percentage decline as reorders have slowed.

In licensing, reported sales benefited from the continued strength of the euro, the dollar and increasingly the yen hedged rate. However, on an underlying basis, we're seeing some softness in demand in Japanese department stores, which is impacting our full year expectations, where we're now looking at a high single-digit decline on an underlying basis for the full year.

Inventory reduction remains a key focus for us, both clearing through existing excess stock, and for autumn/winter '09, which we're now currently selling for, by significantly reducing the amount of inventory that we procure upfront. So we're procuring below our planned retail and wholesale revenue levels. And we're enabled by our investment in supply chain, systems and, most recently, integrated planning.

Now let me turn to the subject of improving efficiencies and controlling costs. You'll remember in November that Angela spoke about how we're accelerating the benefits we're getting from the investments we've made in supply chain, IT and the infrastructure of the business.

At that stage, we identified savings of GBP15m to GBP20m for '09 and '10. And today we've announced further costs savings of GBP30m to GBP35m from a wide range of initiatives, including streamlining operations around the world, in our regions and in corporate functions, and further evolution of our supplier and manufacturing base.

As we detailed in the statement, the first two of these initiatives were announced today and, subject to consultation, could lead to around 250 redundancies in Spain and up to 290 in UK manufacturing.

In total, we're expecting to generate annual savings from all cost efficiencies across all regions and corporate of about GBP50m, underpinning profitability in '09/'10. We estimate the cost of these actions will be up to GBP60m, largely in cash. And this will be charged below adjusted PBT and mainly incurred in the current financial year. All of these actions are examples of the self-help levers that we have.

What these cost efficiencies then enable us to do is to continue to focus on and invest in our key strategies. These include putting our marketing resource behind our core apparel and innovative check bags; driving children's wear, where sales were up over 50% in the quarter; investing in high-demographic markets including London, where we've opened our new store in Westfield and we've refurbished our Knightsbridge store; growth in emerging markets. There were two further stores opened in the Middle East during the quarter, for example. And working more closely with our Japanese partners to drive growth in that market.

With that, thank you for your attention. Let me now hand you over to the operator for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions). The first question comes through from the line of Nick Hawkins. Please go ahead.

Jan 20, 2009 / 09:00AM GMT, BRBY.L - Burberry Group plc Third Quarter Trading Update and IMS Conference Call

Nick Hawkins - Cenkos - Analyst

Yes. Nick Hawkins from Cenkos. Good morning.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Hi, Nick.

Nick Hawkins - Cenkos - Analyst

Just on the cost savings that you've announced, are these net? Is there any positive contribution -to [gross margin] made by any of these facilities and people?

Stacey Cartwright - Burberry Group plc - EVP and CFO

You're talking about the two specific actions that we've announced today?

Nick Hawkins - Cenkos - Analyst

Yes.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Spain and UK manufacturing?

Nick Hawkins - Cenkos - Analyst

Yes.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Yes. In all of these places, we are taking out costs that will add to the P&L account in '09/'10, at the cost of GBP60m that we've articulated in the release.

Nick Hawkins - Cenkos - Analyst

Yes. But the GBP30m to GBP35m, that is net? That's the net addition to the P&L?

Fay Dodds - Burberry Group plc - IR Director

Yes.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Yes.

Fay Dodds - Burberry Group plc - IR Director

That's the actual impact on the EBIT.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Are you looking for reassurance that is the net impact on the bottom line P&L account for '09/'10?

Nick Hawkins - Cenkos - Analyst

Yes. I just wanted to confirm that. Thank you very much.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Thanks 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

Hi. Good morning. I have three quick questions if I can.

Firstly, on December, your comments sharply contrast to other comments we've seen in the sector. I understand you have anticipated clearing some product earlier than the previous years, but I'm thinking there maybe some other explanations for your outperforming the sector by so much in December. Maybe you can help us – do you have other types of explanations?

Secondly, I've read on the wire that you're looking to expand space growth by high single digit next year. Can you tell us where specifically? And can you update us on potentially taking back franchised stores in the future?

And thirdly, can you give us an update, given the discounting environment we're seeing now, how much your outlets weigh and what are your plans in terms of openings there? Thank you.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Okay. I think the first question there is why was December relatively good. It's probably worth just talking market by market.

Bear in mind that the US was a very different proposition for us over this last quarter than any of our other markets. The US, what was going on in that market, was really unprecedented. You'll be aware that some of the department stores that went on sale -- went on promotional activities beginning of November. And that gathered pace through the month of November and into December. From our point of view, it made it very difficult for the luxury brands to hold the line. We ended up going -- breaking sale about two weeks earlier, i.e. at the end of the first week in December rather than just after Christmas. And that obviously helped our US business in the month of December.

Conversely, if you look at Europe, we pretty much held the line and broke sale at the same time as in previous years. We did see benefits in the UK market with tourist traffic, European travellers, Chinese tourists etc, which really meant that the UK stores had a very strong December, as well as November actually.

In the European market, France and Italy have performed strongly for us. Again, there's some tourist traffic in there with the likes of Chinese customers. They nonetheless performed well, despite not being on sale.

And in Asia, Korea continues to be the star performer in that market. We've talked previously about how we've repositioned the brand in Korea. We've got the full representation of the Burberry brand now, whereas perhaps in the past, if you wind back the clock two or three years, it was

very focused on just the trench coats and just the classic checked handbag. That's really come a long way in the last couple of years with the new management team that we've put in place there. And Hong Kong broke sale slightly earlier than it did in previous years which again helped the month of December.

Hopefully that gives you a little bit of colour as to what was going on in the individual regions.

Erwan Rambourg - HSBC - Analyst

Okay.

Stacey Cartwright - Burberry Group plc - EVP and CFO

In terms of space growth. Yes, we are -- I think we told you in November that we were looking to position CapEx for '09/'10 at roughly half the level that was spent in '08/'09, albeit '08/'09 had the exceptional costs of the new headquarters in there. We're still looking to spend a number that will be in line with depreciation for '09/'10. And we're looking with all of our regions to find the highest performing projects to invest in.

We've raised the hurdle on the IRR that we're expecting out of the projects. We're looking at all the regions, focused on high-demographic areas, so we're not probably entering into new markets, as such. So a good example of that is what we've done in London with the opening of Westfield. We now have a further store in London that we're planning to open in the next three months, which will be in Notting Hill and will be a children's wear only store, for example.

So really focusing on that cluster strategy, that we told you about before, in that you have a flagship store, you've got a secondary store, you've got a specialist store like a kids' only store, and you'll have outlets within one area. There aren't any specific franchise stores converting that are assumed within that high single-digit space growth number.

And then I think the last question, Erwan, was around the relative performance of mainline versus outlet . We never disclose the full detail there. We always talk about in general. We're looking at a broad ratio of a quarter of our retail sales coming from outlets. I think in the quarter that will be a little higher than that, as you'd expect from the promotional activities, the fact that customers generally are out looking for a deal at the moment. But that's completely in line with what we said at the time of the interims that the outlets are a very effective and profitable clearance route for inventory.

Erwan Rambourg - HSBC - Analyst

Thank you.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Thanks, Erwan.

Operator

Thank you. The next question comes through from the line of Lisa Rachal from Redburn Partners. Please go ahead.

Lisa Rachal - Redburn - Analyst

Hi. Good morning. Can you hear me?

Stacey Cartwright - Burberry Group plc - EVP and CFO

Yes, I can. Hi, Lisa.

Lisa Rachal - Redburn - Analyst

Hi. Okay. A few also hopefully relatively quick questions. And the first is on relative areas of strength and weakness, both in terms of between categories and also price points. If you wouldn't mind sharing with us the latest trends that you're seeing there.

The second question is if you're willing to share with us what your new second half wholesale underlying guidance assumes for the US.

And then number three, we can probably deduce from your results some of the areas where you seem to be gaining market share, but I'd be interested to hear from you, I guess what you're hearing maybe from staff in those areas where you definitely feel as though you are outperforming your peers. Thank you.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Okay. I think the first one was around relative strength and weaknesses in categories and price points. The first thing to point out here is we're not seeing people trading down, when you're referring to price points. What we are seeing at all levels of the pyramid is people just spending a little bit less. But there's less footfall to start with, and when people come into the stores, they're just holding back on buying that second item or the third item.

In terms of the specific categories, well we pulled out men's wear, children's wear and the iconic check bag as probably the best performers. Remember, with men's wear and children's wear, this is all part of driving through the strategies of taking back production that was previously under license, on men's wear, making sure that we're offering a full comprehensive assortment of men's wear. And again that's paying dividends for us now.

In terms of children's wear, a massively under-penetrated market for us. And we opened two standalone children's wear stores, for example, just before Christmas in the US. It did extremely well despite the environment.

And then, iconic check bags, or the innovative iconic check bags, we pulled those out as an example of where, if you like, the consumer is looking perhaps for something that is very recognizably Burberry, albeit in a new format, the new mega check or the new exploded check that we're using in the bags and in the mufflers. They're looking for the branding, because they're making an investment here in this difficult environment and they want that to be overt.

I think the second question was around second half wholesale numbers for the US. All I would say is that we are planning very prudently within that guidance. It's down double digit, as you'd expect it to be, because you'll have heard from all the US department stores that they're expecting -- they're planning their business down double digit. When they're coming into buying for the new season, they're planning down double digits. I think some of them have been quoted as saying between 15%, 20%.

And then in terms of gaining market share, this is a difficult one to be specific about. Where we've got our new product categories or our newly energized product categories, like men's wear and children's wear, we obviously know we're gaining market share because we're taking space that hasn't been in existence before.

And clearly our relationship with the big US department stores tells us yes, we think we're taking share in certain of our key categories, whether it's where we've got our core dominance in outerwear, for example, that sort of category.

And remember, I think we told you back in November that we were working with a number of US department stores on splitting our women's wear collection, whereas previously we'd sold both the middle of the pyramid, the London collection, and the base of the pyramid, the Lifestyle product, in the same area. Both categories are performing so well, a lot of the US department stores are now giving us two locations instead of one. So again, manifestation of physical market share.

Lisa Rachal - Redburn - Analyst

Okay, great. Would you just mind confirming, I understand that you restructured your accessories offering for fall/winter '09 to be a little bit more concentrated to the lower end of the pricing curve. Would you mind confirming whether or not you have either already implemented or plan to implement any pricing cuts in any of your markets?

Jan 20, 2009 / 09:00AM GMT, BRBY.L - Burberry Group plc Third Quarter Trading Update and IMS Conference Call

Stacey Cartwright - Burberry Group plc - EVP and CFO

No, not planning any pricing changes, other than tweaks here and there to reflect the local competition. So there's nothing significant to flag. And just to pick up on that point you made, Lisa, about restructuring the accessories offering, it's more as a result of the natural trend. The consumer trend is towards smaller handbags. And therefore that happens to hit those lower price points.

Lisa Rachal - Redburn - Analyst

Okay, great. Thank you very much.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Thanks Lisa.

Operator

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

John Guy - MF Global - Analyst

Yes, good morning. Just a question --.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Hi, John.

John Guy - MF Global - Analyst

Morning. Just a question with regards to the OpEx as a percentage of sales. And I know you don't talk about profit, but you have obviously talked about gross margin being lower. But we've seen some better than expected cost savings come through. So in line with the first half, can we expect in the second half to see the operating expenses as a percentage of sales to fall year on year?

Stacey Cartwright - Burberry Group plc - EVP and CFO

I wouldn't be necessarily factoring that into your model, John. Again, we've got a huge degree of volatility going on in the marketplace. We talked about the different mix between mainline and outlet and how the two channels have a very different profile when it comes to gross margin and OpEx. We've also got a higher proportion potentially of retail sales versus wholesale sales. We told you that wholesale sales will decline in the second half. And obviously retail carries a higher proportion of OpEx as well. So, I'm sorry, I can't give you that assurance.

John Guy - MF Global - Analyst

Okay, thanks. And just on a follow-up. In terms of where you are on the suppliers in Spain, I know that Angela was talking about cutting the level of suppliers from 50 down to around 15 to 20, and they'd be fully integrated. Are you looking to take the same action elsewhere or is that just Spain specific?

Stacey Cartwright - Burberry Group plc - EVP and CFO

This is more Spain specific in terms of giving you those numbers because what we've been doing in Spain is moving the supply chain from a very old-fashioned cut, make and trim approach. So literally the teams in the Spanish head office would administer all of the raw materials.

They'd count out the buttons. They'd organize the trims. They'd organize how many meters of fabric would go into a factory who would then simply sew the product.

It's a very old-fashioned way of working. We're now converting all of the Spanish suppliers to the fully factored approach which is that you deal with larger vertically integrated players who provide that full end-to-end service and they physically are contracting to supply a garment at the end of the process. And that's why you've got the redundancies that you have in Spain today.

In the global business we'd already been embarking on this over the course of the last couple of years. It hasn't been as noticeable, if you like, as it now is in the Spanish marketplace because we didn't have as many people here in the corporate head office who were administering the old-fashioned way of working.

John Guy - MF Global - Analyst

Great. Thank you very much indeed.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Thanks John.

Operator

Thank you. The next question comes through from the line of Peter Testa from One Investments. Please go ahead.

Peter Testa - One Investments - Analyst

Hi, thank you. I have a couple of questions please. Just firstly on reorders, if you could give some idea please - can you make a comment about reorders to give some idea how important reorders are as the supply chain is evolving.

And secondly, on the cost cutting. You mentioned that's the impact during the financial year, but of course some of the activities will be happening during the year. Can you give us some idea please of what, say, a full year run rate change would be, and then secondly whether this is net of any loss to gross profit as you deal with the Thomas Burberry brand in Spain? Thank you.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Okay. How important are reorders? The majority of what we do from a wholesale perspective is done with upfront orders, but there's always a 5 to 10 percentage point swing in either direction from cancellations and reorders. And that's really what you're playing with whenever you're looking at any particular season.

In our case here, it's very much that reorders are drying up, not because our business isn't performing when we get the product into those department stores, but because the department stores are over-inventoried with other people's products. They really are cutting back on everything rather than saying if I've sold out of trench coats I need to order more trench coats. So that's where the difficulty is in reorders.

In terms of the impact of the cost reductions, we've announced two major programs today with Spain and UK manufacturing. There are other things as well, as you'd expect, given that this is a global review, that we'll be announcing internally over the coming weeks. The majority of what we're actioning, subject to consultation, will be pretty much through before we start our new financial year in April. So the figures that we've given you, we're targeting to get that out as a full year set of benefits, the GBP50m, and to have that in '09/10.

Just to reassure, where we've factored in the benefits of closing something like Thomas Burberry in the benefits number is the net loss, not just the fact that we're taking out costs but that we're losing gross margin as well. We are factoring in the net loss that will be eliminated when we close in '09/ '10.

Peter Testa - One Investments - Analyst

That's very helpful. Thank you.

Operator

Thank you. Ladies and gentlemen, we've got no further questions in the queue. (Operator Instructions). The next question comes through from the line of Phil Clark from Fidelity. Please go ahead.

Phil Clark - Fidelity - Analyst

Yes, good morning.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Hi there.

Phil Clark - Fidelity - Analyst

Hi. I just had a quick question regarding inventory position. A couple of times in the statement you refer to clearing stock. And then just, Stacey, in some of your comments earlier you mentioned you'll be ordering less inventory through next year. So I just wondered if you could give any guidance on where the inventory stands now relative to last year or where you expect it to be at year end.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Yes, what we did say back in November is that you should expect autumn/winter '09 to be the season where essentially we're correcting, we're playing catch-up for the slowdown in demand that we've seen over these last few months. Just remember the cycle that we're on and the way in which the calendar works. We are taking orders now for autumn/winter '09. And autumn/winter '09 starts to be delivered in June, so in five months' time. So that's really the first season that you can impact to the degree that we're talking about here in terms of the drop in sales levels that we're seeing globally.

In terms of where our inventories sit at the end of November -- at the end of December, it's a funny month because you've actually stocked up on spring/summer '09 ready to start shipping in our biggest shipment month, which is January for spring/summer '09. That said, the relative increase at the end of December was lower on a constant currency basis than that that you saw at the end of September. So that provides some comfort that we're eating into this.

The other thing I would just remind you of is that obviously with exchange rates moving as they have done, on a reported basis, our inventory numbers will look higher. So we will come back and just be very clear with you about where we stand on a constant currency basis versus where we stand on a reported basis.

Phil Clark - Fidelity - Analyst

Okay, great. Thanks a lot.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Thank you very much.

Operator

Jan 20, 2009 / 09:00AM GMT, BRBY.L - Burberry Group plc Third Quarter Trading Update and IMS Conference Call

Thank you. The next question comes through from the line of Nick Coulter from Numis. Please go ahead.

Nick Coulter - Numis - Analyst

Hi, good morning. My question --.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Hello.

Nick Coulter - Numis - Analyst

Hi. My question was actually on the inventory and the gross margin outlook going forward. So that one has been answered. If you could perhaps just guide a little bit on year end net debt expectations. I guess we're looking at the mid 100s? Thank you.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Yes. Clearly without the actions that we've announced today and the GBP60m of costs that will be required to realize the cost efficiency program, we would have been looking at a number that was under 100. Depending upon your assumption as to how much of the 60 is in cash, (we said the majority), but there are some write-offs within that number as well, and then how much we actually action by the end of March, you'll have a number that comes in over 100.

I would point out that obviously we are embarking on consultation today. Whether you're in a 30-day, 60-day or 90-day consultation period and when this finally crystallizes will determine when the cash payments are actually made. And you'll see we're quite tight as to whether some of these cash payments will be made at the end of March or beginning of April.

Nick Coulter - Numis - Analyst

Okay, super. Thank you very much.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Thank you.

Operator

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

Yasuhiro Yamaguchi - UBS - Analyst

Hello. I have two questions please. The first one is the January trading. The improvement you saw in December, is it continuing and you think that the worst is already finished, or still not sure?

The second question is any indications of your expectations for the '09/'10 year please?

Stacey Cartwright - Burberry Group plc - EVP and CFO

Okay. In terms of January trading, well the first thing to remind you is we always normally just report up to the quarter that we're reporting to. We never go into details about the one week, two weeks, three weeks or whatever of trading that we've had under our belts since then. We did make an exception to that back in November, if you recall, when we did update on current trading because there was such a significant shift in trend. And it was important to make sure that obviously investors were fully aware of that.

I think you can take comfort from the fact that we haven't given any further update on these last two weeks' trading. There's nothing that is material that needs to be reported. I would also point out however and we are still (inaudible) and you do just need to bear that in mind.

Yasuhiro Yamaguchi - UBS - Analyst

Okay. Thank you very much.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Okay. And then sorry your last question was around expectations for '09/'10. In the same way that we're talking about very little visibility, we have huge amounts of volatility going on in all our markets, even Europe and Asia which have been called out today. We're still getting double-digit variances on a daily basis, positive and negative, in every store in every market. And therefore it's very difficult to give guidance for '09/'10.

What I would say is look at the phrase that we used in the release here that all of the initiatives we've taken today and announced today are about underpinning profitability for '09/'10.

Yasuhiro Yamaguchi - UBS - Analyst

Okay. Thank you very much for the update.

Operator

Thank you. The next question comes through from the line of Alex Kwok from Nevsky Capital. Please go ahead.

Alex Kwok - Nevsky Capital - Analyst

Hi, morning.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Hi there.

Alex Kwok - Nevsky Capital - Analyst

I just wondered if you could give us a bit more colour on the GBP50m in revenue foregone on the other side of the cost savings.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Yes.

Alex Kwok - Nevsky Capital - Analyst

Will that come from mostly space closure or will some come through in wholesale? What will it look like?

Jan 20, 2009 / 09:00AM GMT, BRBY.L - Burberry Group plc Third Quarter Trading Update and IMS Conference Call

Stacey Cartwright - Burberry Group plc - EVP and CFO

Yes. Well the largest number within that that represents more than half of the GBP50m is the closure of the Thomas Burberry brand in Spain. So that represents the revenue foregone as we close that brand. And then you'll appreciate that we haven't announced everything that is in the program today. This is a massive restructuring program and it's not feasible to get everything synched up from an internal comms point of view. The other areas we'll be announcing over the course of the coming weeks.

Alex Kwok - Nevsky Capital - Analyst

Okay. Thanks.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Thank you.

Operator

Thank you. (Operator Instructions). We've got no further questions coming through so I'll hand back to the host to conclude today's conference.

Stacey Cartwright - Burberry Group plc - EVP and CFO

Well thank you very much everybody for listening in. We look forward to speaking to you again, which will be on April 21 when we have our second half trading update. Thank you very much.

Operator

Thank you for joining today's call. You may now replace your handsets.

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