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Burberry

Third Quarter Trading Update Conference Call - 14th January 2016

BURBERRY

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Fay Dodds, Vice President, Investor Relations

QUESTIONS FROM

Antoine Belge, HSBC

John Guy, MainFirst

Elena Mariani, Morgan Stanley

Thomas Forte, Brean Capital

Thomas Chauvet, Citigroup

Tom Gadsby, Liberum

Mario Ortelli, Sanford Bernstein

Rogerio Fujimori, RBC

Julian Easthope, Barclays Capital

Warwick Okines, Deutsche Bank

Key Highlights

Carol Fairweather, Chief Financial Officer
Good morning and welcome to Burberry's Third Quarter Trading Update conference call. With me this morning is Fay Dodds from our Investor Relations team. I will make a few brief comments on this morning's announcement and then we will be happy to take your questions.

In a tougher external environment for luxury than we were expecting retail revenue for the third quarter was up 1% underlying. Comparable sales were unchanged year on year, an improvement from Q2, but below our internal assumption, principally in Hong Kong and the United States.

The trading pattern throughout the quarter was uneven with a very late Christmas. Accessories were more resilient than apparel, which was impacted by the unseasonably warm weather in many of our key markets.

Ahead of Lunar New Year and in what remains a challenging external environment we currently expect FY 2016 adjusted PBT to be broadly in line with current market forecasts. This outcome will be supported by a further reduction in the performance related pay charge, additional discretionary cost savings, and an FX benefit of about £10m.

So let me take you through the revenue detail by region. In Asia Pacific comparable sales improved versus Q2, with a mid single-digit decline in the quarter. Mainland China and Korea both returned to growth and our relatively small business in Japan once again posted exceptional growth. Hong Kong and Macau again saw comparable sales decline by over 20%, with the continuation of very weak footfall for us and for the sector.

To give you an indication of the adverse impact of these markets, comparable sales for Asia Pacific would have been up by a mid single-digit percentage, excluding Hong Kong and Macau, and the comp for the Group as a whole would have been 3% positive rather than unchanged.

EMEIA achieved mid single-digit comp growth, consistent with the second quarter; with an improvement from domestic consumers, offset by slowing, but still positive growth, from travelling luxury customers, although these patterns varied by country.

The UK, our largest market in EMEIA, became more challenging in the third quarter, with a slowdown from travelling customers, particularly Chinese and Middle Eastern consumers, likely related to the strength of sterling compared to the euro. However, this was more than compensated for by Italy and Spain which continued to deliver growth in excess of 20% and a strong performance from Germany. These performances were underpinned by the travelling luxury customer, but we also saw a return to growth among the Continental Europeans at home.

And finally in the Americas we saw the region improve to marginally positive growth in the quarter, with Canada, Brazil and Mexico together, again up double-digit and the US local consumer returning to growth.

So before turning to 2017, let me just highlight some of the positive results of the quarter. First, digital commerce outperformed in all regions, seeing the benefit of our investment both in mobile, which now represents the majority of traffic to the .com site and with improved conversion is our fastest growing digital channel. And also the rollout of the single pool of inventory model into our largest digital markets, the US and the UK, following the trial in China. While we continued to work with companies including Apple, Google, DreamWorks and WeChat to ensure newness in our brand reach.

Second, given that Q3 is more heavily weighted towards domestic customers we were pleased to see them return to growth in all three regions, helped, we believe, by a good response to our Festive initiatives in terms of marketing, customer service and product; where small leather goods and scarves, including monogramming, were a highlight.

And finally our focus on retail productivity drove positive results in terms of improved conversion, both in store and online globally. Initiatives included better leveraging our customer insights and Burberry Private Client programmes, incentivising our sales associates differently, and fast tracking bestselling lines including ponchos, lightweight cashmere trench coats, new quilts and key bag shapes including the Banner bag.

So before we take your questions a few words on the outlook for 2016/17. As you work through your model, we will as usual in April, give specific guidance on the contribution from new retail space, wholesale and licensing. And please remember that Japanese licensing income will step down by about a further £15m, compared to 2015/16.

On operating expenses, while we remain very focused on continued tight cost control, underlying cost pressures persist across the whole sector and we currently expect around a mid single-digit increase in our opex.

With this uncertain outlook for luxury, as you would expect, we are responding by accelerating our productivity and efficiency agenda, particularly looking at our ways of working, while addressing how to optimise new organic revenue growth opportunities, the resulting investment plans and our capital structure. And we will provide updates on all of these at the Preliminary Results in May.

So thank you and we'd now be happy to take your questions.

Questions and Answers

Antoine Belge, HSBC
Yes good morning I've got three questions please. So first of all - back in October you gave this mid single-digit guidance for comps, which was a bit unusual for you since you

usually don't give that type of guidance, so what was on your mind then and what was different, I would say apart from the warm weather and maybe the attacks in Paris?

The second question is on your PBT guidance, actually not so much for this year, but when we look at next year, given that you said that opex would rise mid single-digit, I think when I look at consensus today I still see people expecting like a mid single-digit increase in PBT, so in your view is it possible for PBT not to be down next year? So if you could shed some light on the way your performance related pay works because we see with like a £60m saving this year, you know the PBT next year will be highly dependent on that PRP?

And finally I think in the press release you mention that you will be looking at your capital structure, what does it mean? Would that mean for instance that you could be returning cash to shareholders? Thank you.

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Carol Fairweather, Chief Financial Officer
Okay, so Antoine, in terms of your first question, in terms of the mid single-digit guidance, I think you're saying where did we - we've come in unchanged and how did that change? When we spoke to you in November we said that the world remained very uncertain out there, what happened subsequently with clearly the events in Paris, which affected consumer sentiment and the travelling luxury consumer globally.

We talked about the US being very uneven and that persisted throughout the quarter, and that's well reported in terms of what we've seen in terms of US wholesale accounts. So the US was another area where perhaps we were impacted. And of course Hong Kong where we had seen some improvement through October, albeit still declining, our internal assumption was not that it would continue over minus 20 down. And therefore that also impacted.

So I would say it was broadly the significant continuing declines in Hong Kong which we hadn't assumed, the US remained uneven, possibly impacted by unseasonably warm weather and consumer sentiment. But they are really why we ended up flat for the quarter, albeit we would have been up 3, excluding Hong Kong and Macau.

And then turning to PBT for next year, we're saying that at the moment it's too early to guide on a number of the metrics, what we are flagging is that the environment does remain uncertain. In light of that, as you would expect, we are responding by effectively accelerating our productivity and efficiency agenda. And also, anticipating how consumer demand in this evolving luxury world will continue to change, and therefore looking at what new growth opportunities there may be by channel, region and product line. And what we're saying is we'll come back and update you on all of that in May. And I'll come onto your point in capital structure in a moment. And therefore I don't think we can guide specifically today on 2016/17 because we're saying it does remain uncertain. We're saying that we do see underlying opex increases in the business, be it annualisation, rent increases.

On PRP to your point, again that's not a matter - you know we can make a planning assumption, but it will really be for the Remuneration Committee to agree what level of

PRP should be reinstated once we have rolled up our budgets. And therefore there's lots more work to do in terms of the budget, but what we're saying today is that in light of that we are responding by accelerating the productivity agenda, particularly looking at our ways of working and really looking at future growth opportunities.

And then to your point on capital structure, and that will very much determine, as we come and talk to you in May around growth opportunities, the investment plans required, and therefore what that means of running an efficient balance sheet. So the plan is to come back to you in May with all of that.

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Antoine Belge, HSBC
Okay, thank you very much.

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Carol Fairweather, Chief Financial Officer
Okay, thank you.

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John Guy, MainFirst
Good morning Carol, good morning Fay, Happy New Year.

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Carol Fairweather, Chief Financial Officer
Yes, and to you John.

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John Guy, MainFirst
Thanks, just a couple of questions from me. Just with regards to the digital outperformance, if you could highlight the quantum of the outperformance please?

Secondly, could you give us an update in terms of how your inventory position stands, it was obviously very well managed during the first half of the year and so I just wanted to get a handle on any particular changes over the quarter?

And could you update us in terms of any potential savings that you'll make, I appreciate it's a very small part of your business anyway, but on the discontinuation of the watches line, which is probably something a bit overdue and I think probably quite welcome as you focus more on your core areas, maybe start with those three please?

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Carol Fairweather, Chief Financial Officer
Okay, so digital, as you know John we don't ever split out our digital performance separately, that's not how we think about it or the consumer. What we are saying though is that if you do look at the pure digital metrics they did outperform our mainline

stores. But we've always talked about the fact that you can't look at one in isolation of the other.

We do think that comes off the back of the investment we continue to make in digital. So the fact that we have rolled out these single pools of inventory in the UK, you know collect in store is now in 219 of our stores. So all of the investments we make in digital, and particularly in mobile, I think you heard me say that over half of our traffic now comes through via a mobile device. And so the investment we made in our mobile platform this year I think is what's enabled us to deliver that, again, strong performance in digital.

In terms of the inventory position, I mean at the end of December I'm comfortable with where we are from an inventory perspective. And in terms of the watch licence, as you say this is very much about focusing on our core categories and it's really about making sure that we're dedicating our time and the space in our stores to driving those core categories. So no significant cost savings, but just another item under the productivity agenda.

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John Guy, MainFirst
Okay, and then maybe just a follow up on the opex, and clearly you're guiding to that mid single-digit inflation which is not just Burberry specific. When you think about upward only rent reviews and you think about the longer term picture I appreciate that Hong Kong, at the moment all of your stores are still profitable. But if you still believe, or if you start to believe that the market is going to be on a prolonged structural decline then that might not necessarily be sustainable. So over the longer term should we start to think about the possibility of you downsizing your Hong Kong operations and potentially allocating capital elsewhere?

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Carol Fairweather, Chief Financial Officer
I mean John as you say all of our stores remain profitable. And since we've seen the more challenging environment in Hong Kong we have been out renegotiating rents, we talked to you back in November about reducing our floor space at Pacific Place, albeit it remains our flagship store in Hong Kong. I think we will continue to responsibly manage the portfolio as we move forward, as we do in all markets, as all stores come up for rent reviews and leases come to the end we always look at whether we want to stay there, relocate, or expand or whatever, and we won't do anything different in Hong Kong, but just behave responsibly as you would expect us to.

So nothing new to announce today in relation to Hong Kong, buT as you say all the stores do remain profitable, and we've taken actions - we've talked to you before about actions around staff, actions around rent reviews to protect profitability in that difficult market.

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John Guy, MainFirst
Great, many thanks Carol.

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Elena Mariani, Morgan Stanley
Hi good morning, thanks very much for taking my question. I just wanted a couple of clarifications. The first one is on these additional savings that you've identified. If you could please give us a better idea of how much of this is of the additional cost savings you have identified is going to be recurring going forward and what exactly is the saving coming from?

And then the second question is about the gross margin. What is actually implied right now in your PBT guidance and what should we expect also for next year? Thank you very much.

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Carol Fairweather, Chief Financial Officer
So in terms of the additional savings, as you'll remember between June and November we took out over £20m of planned investment in people in other areas of project and discretionary spend across the business. As we have moved through what has been another challenging quarter that rigorous and robust cost discipline has been maintained. And in light of that we have continued to look at how we don't replace people when they leave, how we reallocate headcount, how we become more efficient in our ways of working, critically reviewing all discretionary spend. And that's allowed us to take out over another £5m worth of costs, compared to when we last spoke to you.

And that will remain. So those costs that we have avoided this year will not go back in next year clearly. All we're saying today is there is some underlying cost pressure in the business from the annualisation of new stores, rent increases, but the £25m we have saved against our plan this year absolutely stays out. And then we'll look at what else we can deliver in terms of future savings under this accelerated productivity agenda, really looking at our ways of working.

And then in terms of gross margin …

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Fay Dodds, Vice President, Investor Relations
Yes, it's only a sales update today so we haven't got anything new to say on the gross margin. I think what we've said to you in the past is don't look for a lot of expansion from gross margin, it's currently at around that sort of 70% level and so it's not going to be a key growth driver for us.

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Elena Mariani, Morgan Stanley
Okay thanks a lot.

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Carol Fairweather, Chief Financial Officer
Thanks Elena.

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Thomas Forte, Brean Capital
Hi good morning, thanks for taking my questions. I wanted to find out a little more information on to what you attribute the improvement in conversion for your mobile and digital efforts? Thank you.

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Fay Dodds, Vice President, Investor Relations
Yes we know that more and more people are going to a mobile device. We've made it much easier for people to shop off of that site. We've improved our payment mechanism, we've got the single pool of inventory so when people come to the site on a mobile device now, previously if they'd have looked at inventory from that site and we weren't in stock in our digital warehouse they wouldn't have been able to purchase that, now given we've opened up these pools in the UK and America. So it's really a combination of all of the investment we continue to make in our digital platforms, be it mobile, single pools of inventory, payment systems. So the ongoing investment which we believe is delivering returns.

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Thomas Chauvet, Citigroup
Good morning Carol and Fay.I've got three questions please. The first one I'm trying to understand a little bit FY'17 various moving parts beyond like for like assumptions. Just a clarification on FX, so the £10m benefits first of all for FY'16, is it based on the spots GBP USD at the end of December so 1.48, or closer to 1.44 which would probably imply further benefits in March '16? And was wondering what maths you've done internally if you apply 1.44 GBP USD and maybe a weaker GBP Euro what does it do to next year's profit? Would maybe £15m, £20m benefit be a realistic assumption?

On your opex growth guidance for next year is it in constant currency the mid single-digit? And I understand the £25m of opex savings won't come back next year but are you actively looking to take more costs out? Have you identified costs potentially not taken out this year but that you could look to remove next year? And I assume also this cost guidance excludes the PRP?

And finally could you elaborate a little bit on what you are seeing in Mainland China, the return to positive LFL, are you assuming like some of your peers that trends have bottomed out? I would also think that the RMB weakness, maybe the travel fear a factor to some parts of Europe would bring back some Chinese tourist demand onshore. Is it what you've seen and what you're perhaps expecting for the rest of the year?

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Carol Fairweather, Chief Financial Officer

Okay so in terms of your FX question or FY'17, so the FX this year was done at the 31st of the 12th spot which as you say was closer to 1.48 than where we're tracking today at around 1.44, so at today's rate there would be a little bit further benefit. But clearly we sort of update you at the closing rate at each quarter and that's what we've factored in. So at today's rates yes possibly a tad more, but remember the FX benefit we've talked to you about today is also the FX benefit that we saw through November and December compared to when we last spoke to you, it's not just for the last three quarters. And as you say I mean at today's rate there would be a benefit next year. We haven't thoroughly worked through our budgets yet and therefore we're not quantifying that at the moment, but yes at today's rates there would be a benefit from FX next year.

In terms of opex yes the guidance is at constant currency. As you say the £25m of cost we've taken out this year we will not be reinstating next year, but we are absolutely actively looking at where we can drive more cost efficiencies out of the business. And therefore there will be a continual focus on all discretionary costs together with this more detailed review of our ways of working, how we become more efficient as an organisation and that's what we'll come back and update you on in May.

And then in terms of China.

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Fay Dodds, Vice President, Investor Relations

Yes we're pleased that that's returned to growth. there's an improvement both in footfall and conversion and I think it's really down just to all the initiatives that we've had in place over Festive in terms of fast tracking, product, using our customer insight data in that market. I don't think we're brave enough to say it's necessarily on an improving trend but we were certainly pleased with the third quarter performance. And clearly as we look into the fourth quarter it's all eyes down for Lunar New Year where we've got lots of exciting initiatives as well.

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Carol Fairweather, Chief Financial Officer

And then you asked about the RMB weakness and whether that will drive. Cleary it may but remember it may drive, depending on where FX rates are, to Europe rather than necessarily to the UK. So there may be a benefit but we'll have to wait and see.

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Thomas Chauvet, Citigroup

And have you measured the demand of the overall Chinese cluster globally in that third quarter versus maybe Q2 or H1? I mean that Chinese demand, is it improving?

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Fay Dodds, Vice President, Investor Relations

No actually it was down to low single-digit in the second quarter and actually it's now down mid single-digit. But importantly we saw growth in mainland China, Hong Kong and Macau remain very, very difficult. We still saw growth in Europe from the Chinese tourists but at a lower rate than in the second quarter.

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Thomas Chauvet, Citigroup
So Chinese demand overall is slowing down a little bit?

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Fay Dodds, Vice President, Investor Relations
Yes.

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Thomas Chauvet, Citigroup
Okay thank you very much.

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Tom Gadsby, Liberum
Hello, good morning, a quick question on wholesale. I know you've only just given bare bones on that today but Nordstrom commented at their Q3 update in November that they were going to be paring back on inventory given what was happening in the US at the time. How has that affected your order book and is anybody else doing similar? What's the order book looking like for the next year?

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Carol Fairweather, Chief Financial Officer
Yes we guided back in November for our H2 wholesale outlook and we said that in apparel and accessories we did expect it to be down at mid single-digit. But there's been no change to our guidance since we spoke to you in November. We did say that was reflecting cautious ordering by wholesale customers globally, but no change to our wholesale guidance today.

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Tom Gadsby, Liberum
But that's for the balance of this year, but what about for spring, summer?

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Carol Fairweather, Chief Financial Officer
We'll come back and guide in April as we always do for the first half of next year.

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Tom Gadsby, Liberum
Okay thanks.

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Mario Ortelli, Sanford Bernstein
Good morning and Happy New Year. Three quick questions from me. You mentioned that the winter was very warm and the festive season started very late. Should we expect more volumes on markdowns this season? And did you make any change in your markdown policy starting maybe before or with higher percentage of discount?

The second question is given the volatile environment and your cost cutting measures, are you reviewing the capex that you will assign for this fiscal year 2015/16?

And the last question, is the underlying sales for this quarter were below your internal projection. How are you changing your internal projection of estimated for Q4?

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Carol Fairweather, Chief Financial Officer
Hi Mario and happy New Year to you. So in terms of the weather and any impact on markdown or duration of sales, nothing significant to call out. In fact, our sale period we had planned to be slightly shorter than last year and we very much stuck to that. We did see people going on sale earlier in certain markets; we didn't change the timing of our sale. And our markdown cadence overall was exactly in line with what we had planned. So, nothing really significant to call out in terms of any change to our markdown strategy. And remember we've got quite a lot of replenishment product in there so although the unseasonably warm weather may have impacted our outerwear sales in this quarter, over half of our outerwear sales is probably on replenishment anyway.

And then in terms of volatile environments and capex review, of course we constantly reprioritise and relook at our capital expenditure plans, and we will continue to do that as we go through the balance of this year and next year. So nothing new to call out. We had talked about capex maybe moderating as we looked forward but we'll come back in May and update you with our guidance for the following year.

And then in terms of underlying sales in Q3 being below our expectations, yes they were for the reasons we just chatted about previously earlier on the call. In terms of Q4 we're not guiding but safe to say it's Lunar New Year, in the same way that we had a great Festive campaign we've got all of our teams working very hard. We've got special product in the store for Lunar New Year, we've got a dedicated marketing campaign and all of our teams remain very, very focused on driving conversion.

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Mario Ortelli, Sanford Bernstein
Thank you.

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Rogerio Fujimori, RBC
Hi good morning everyone. I have three questions. First one about pricing architecture. I know you constantly monitor pricing versus peers but some peers like Prada are talking

about the need of lowering regional price gaps further, so do you believe that's further work for Burberry as well or are you satisfied for now with the current situation?

Second question about Japan, could you give us an idea about how much Japan accounts as a percentage of your total retail wholesale sales today?

And my third question is about the inventories. You have been tightly managing inventories; could you give some colour on your inventory position at the end of December? Thank you.

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Carol Fairweather, Chief Financial Officer
So in terms of pricing nothing new to announce today. As you say we've got our pricing strategy in place and we're monitoring as we always do but nothing specific to announce today from us in terms of pricing.

In terms of Japan I think it's around 2% of retail wholesale sales globally, as you said small for us but we did see again great growth off of a tiny base.

And then in terms of inventories as I said earlier I think we are comfortable with our inventory position at the end of December. We'll continue to tightly manage that as we move forward.

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Rogerio Fujimori, RBC
Thank you.

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Julian Easthope, Barclays Capital
Hi, thanks. I suppose one of the downsides of being last in the queue is I always end up asking the nerdy question, so here we go. I think there's probably been about a ten year incubation period for the Accounting Standards Board to come up with a lease standard, so I just wondered if you've taken a look at the implications of that and whether it will have implications for the capital structure comments that you've made in your call?

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Carol Fairweather, Chief Financial Officer
I mean trust me we have had our team looking at that for some time. I know it was issued earlier this week and we're busily working through what that means. Clearly there's a lot of work to do. I mean I don't think fundamentally, I think it's an accounting rather than a - commercially we still need to look at how we want to run the business rather than being driven by accounting standards. But lots of work to do to understand how that will change our reported numbers as we look forward.

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Fay Dodds, Vice President, Investor Relations
But when we look at capital structure you know we always look at our lease adjusted net debt rather than the actual just straight net cash position.

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Julian Easthope, Barclays Capital
And the lease adjusted net debt that you have is that materially different from the accounts - the new standard that they put out?

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Carol Fairweather, Chief Financial Officer
We're working through that at the moment Julian. I think the way in which we're looking at the moment I think is helpful to us, we need to understand exactly what that will look like when we have to put that onto the balance sheet, but we'll come back and begin guiding on that. We're working through how that will look. Clearly we've got a couple of years to prepare for it, but trust me my accounting teams are gearing up for it.

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Julian Easthope, Barclays Capital
Sounds great. Okay thanks.

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Warwick Okines, Deutsche Bank
Morning all. Sorry you may well have mentioned this right at the start but I would have missed it. Have you said what the total PRP and bonus reduction year on year in the current financial year is expected to be?

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Carol Fairweather, Chief Financial Officer
So we said there was around £30m saving year on year when we spoke to you in November. We're saying it could be around double that now so maybe around £60m, but we've still got the fourth quarter to go. And remember the total PRP charge relates to the in year bonus pot, and also to the LTIP charge which also depends on future growth. So as we go through this quarter finalising this year's number and our outlook for the next couple of years, then we will true that number up. But we're saying possibly around £60m, something like that at the moment.

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Warwick Okines, Deutsche Bank
And obviously for next year lots of uncertainties and I'm sure you'll report back in May with a bit more clarity on this cost line as well, but are there sort of commercial reasons why you'd have to rebuild that in the year ahead, you know competition for talent I'm really thinking about?

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Carol Fairweather, Chief Financial Officer
It's absolutely a matter for the RemCo and not for management to decide, but clearly they will be factoring all of that in as they decide what an appropriate level of PRP is to back to reinstate next year. But remember it's always based on performance. And therefore it will be looked at through that lens as you would expect it to do so. But that's a RemCo matter and we'll be able to update you in May on where we land on that.

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Warwick Okines, Deutsche Bank
Brilliant, thanks very much.

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Carol Fairweather, Chief Financial Officer
So, in conclusion, the third quarter has been tougher than we were expecting but our focus on growth and cost control has driven a number of positive results which support FY 2016 profits. While the outlook for the sector remains uncertain, we are responding to this with an intense focus on optimising new growth opportunities and accelerating our productivity and efficiency agenda, whilst always protecting and building the brand.

So thank you and we look forward to speaking to you again on the 14th of April when we have our Second Half Trading Update. Thank you.

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