Burberry Group plc

Interim Results Analyst Call

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Burberry

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Burberry Group plc

Marco Gobbetti, Chief Executive Officer

Good morning everyone, and thank you for joining us for Burberry's Interim Results presentation. In terms of our agenda today I will start with a brief introduction, before turning to a review of the past six months. After this you will hear from Julie who will cover our financial results and guidance, and we will end with an update on our strategic priorities and outlook, followed by Q&A.

In the first half of fiscal '21 we navigated through a challenging period, as COVID-19 disrupted our momentum and impacted many areas of our business. Total revenue for the half was £878m at reported rates, down 31% and adjusted operating profit was £51m, a decline of 75%.

As you will remember, we started the year with strong momentum, delivering 11% growth in the first four weeks of January. This was disrupted by COVID, resulting in a 45% decline in Q1 comp. However, comp sales have since recovered to minus 6% in Q2, accelerated into low single-digit declines in September and returning to growth in October.

Throughout the period regional performance has been highly polarised. And we have continually adapted our approach to capture opportunities as they arise, driving double-digit growth in Americas and Asia in Q2. Clearly other regions continue to be challenged, including EMEIA where second lockdowns have recently come into place in many areas and some parts of Asia impacted by a structural decline in tourism.

COVID has created an uncharted situation, with multiple store closures, health and safety considerations, and a complete disruption to how we go to market. At the same time it also challenged us as a business to respond and adapt quickly and shield innovation across many areas of the company. As a result, despite the extremely challenging environment over the last six months we continue to make good progress on our strategy. And I would like to call out four areas in particular.

First, our product continued to resonate, driving out performance of our full price channels. Second, we have started to see good traction in leather goods, with momentum driven by our newly established shapes. Third, digital sales are up high double digits, with dot com almost doubling as we leveraged our strength in this area during the pandemic. And fourth, we continue to see strong brand traction, attracting a high share of new and younger customers over the period.

Let me tell you a bit more about the progress we have made across some of our key strategic priorities. Starting with product, we have seen positive performance in our latest collections, driven by new and young customers, in particular, the TB standard monogram capsule was highly successful in attracting younger customers to the brand, critical for both growth and influence. Our most recent collection, Winter 20, launched in October and has been performing very well, particularly in our key strategic category outerwear, which is delivering good growth in the first four weeks since launch.

We have also started to see good progress in leather goods, which grew single-digit in the second quarter and outperformed total retail. The next family architecture we established, Lola, TB, Pocket and Title, which you can seen on the right hand side of the slide now account for the majority of full price sales in women's bags.

In addition we're seeing strong additional momentum for the Olympia bag, which we launched as part of Autumn Winter 20. As a result, we have seen a significant increase in the weight of full price channel sales, which is up double digits. This is a testament to the excellent customer response we have seen to our product, as well as a deliberate shift away from mark down activities, which we will continue to control in the coming months.

These results have been supported by the multiple brand activations we have launched throughout COVID. For instance, for our recent summer monogram capsule we leveraged our digital expertise to create our first computer generated campaign during lockdown. The capsule features self portraits captured at home by Kendal Jenner, and was complemented by creative collaborations. We also highlighted the playful summer print with unexpected activations, such as hot air balloons in Inner Mongolia and our monogram inscription in Dubai desert, which you can see here.

We extended this period of innovation to our September show, which we made available for all to experience digitally on Twitch. By doing so we became the first luxury brand to partner with the live streaming video platform. To date with 118 million views our September show has become our most viewed show on record.

As markets rebounded we have been quick to drive recovery by localising plans and shifting resources. This has resulted in high exit rates and strong performances in Americas and Asia. In Americas we delivered comparative stores sales growth of 21% in Q2, and stronger performance in the US, driven by momentum with new younger customers and full price sales. Similarly, in Asia we delivered comparable store sales growth of 10%. Our localised plans in China and Korea supported strong growth in these regions, and mitigated the performance of other Asian markets, including Japan.

In China luxury demand has rebounded quickly, driven by a robust domestic economy and the repatriation of spend. Here we have delivered double-digit growth every month since June, with a focus on three areas. First, dedicated content, the most recent example of which was our local trench campaign. This launched in September, featuring brand ambassador, Zhou Dongyu and Song Weilong, and drove our highest interaction rate ever on WeChat.

Second, we engaged customers through new physical activations, including the launch of our social retail store and multiple pop-ups.

And finally, we placed an increased focus on digital, for example, through our first super brand day with Tmall, which brought the highest single day sales to date and connected us with new customers in tiers two and three cities.

Applying the learnings from China we extended the localised model to Korea. Here our strategy was to tap into regional consumer passion points by collaborating with local taste makers, such as Korean singer, Yuri and native editorials, such as 'GQ Korea' to support key calendar moments. We also drove engagement with consumers offline through pop-ups and elevated instore installations. In Americas we have seen an increase in overall luxury demand, supported by a strong economic environment and a shift in luxury spend from experiences to goods. In this context we have seen double-digit growth in Q2, accelerated by traction with young customers.

We drove this by generating brand heat and visibility through the delivery of locally relevant content, including styling key cultural influences, such as Beyoncé and Billie Eilish. We also collaborated with local content creators, such as American artist and musician, Eliza Douglas, for our September show to appeal to young fashion forward consumers.

Given the importance of digital in today's environment we have also leveraged our strength in this area during the pandemic, driving strong double-digit increase in digital sales. In particular, dot com sales have almost doubled in Q2, indicating high customer intent to engage directly with our brand.

Performance has been supported by a series of digital activations. First, we amplified our collections and capsules through immersive words on dot.com, a good example of which was our interactive online Surf World, which drove high engagement from young consumers. Second, we supported key categories through new formats, such as digital popups on dot.com. Finally, we boosted overall digital performance through exceptional visibility activations with third party platforms to connect with new consumers.

In this environment, success continues to depend on bridging online and off line worlds. Burberry has been a pioneer in this space, and in China we recently opened our first social retail store in Shenzhen Bay in an exclusive partnership with Tencent. Since its launch in August the store has outperformed our expectations, creating considerable brand heat and attracted a high share of new and young customers to the brand. Importantly, the store cements our partnership with Tencent and demonstrates our commitment to Chinese consumers more broadly.

In the spirit of Shenzhen we have also used digital to mitigate the impact of reduced traffic and tourist spend in our wider store network. In this environment we have been amplifying our appointment strategy, launching new formats, such as at home and virtual appointments that deliver a luxury shopping experience and make our clients feel safe. This strategy has already proven to be a commercial success, and has driven double digit growth in sales from appointments in Q2.

Our recovery has been underpinned by strong cost and cash discipline, and we have taken swift mitigating actions to contain costs and protect our financial position. In terms of liquidity we diversified our borrowings into longer-term financing, with the issuance of our first £300m sustainability bond in September. The liquidity provided by the bond has been supported by costs savings and we're on track to delivery £23m of Opex reductions this year, ahead of our original guidance of £15m.

We're also on track to achieve the annualised £55m from the rationalisation programme announced at Q1, and plan to reinvest some of these into consumer facing activities. Finally, we continue to place a strong focus on our people and responsibility agendas, making good progress on our commitments. Our retail operations in mainland China, Hong Kong SAR, Macau SAR, Malaysia, Singapore and Thailand, are now carbon neutral in addition to our EMEIA retail stores and the Americas region. We further supported the decarbonisation of our supply chain, helping our Italian suppliers in their transition to renewable energy.

As part of our commitment to fostering a strong culture of inclusion and belonging. We introduced a global diversity and inclusion policy. We also strengthened our community support. This included becoming the first luxury company to join the Stonewall Diversity Champions programme for the LGBTQ+ community.

We expanded our creative arts scholarships and Burberry Inspire, the Burberry Foundation in school arts and culture programme. And for the festive season we have partnered with England footballer and youth advocate, Marcus Rashford and organisations, including the International Youth Foundations, to support young people in the UK and around the world.

Before handing to Julie, who will cover financial results and guidance I would like to share with you a short video, highlighting some of the examples from the half that I've just mentioned.

[video plays]

Over to you, Julie.

Julie Brown, Chief Operating and Financial Officer

Thank you, Marco, and good morning ladies and gentlemen. As Marco outlined, half one was impacted by store closures due to the COVID pandemic. We started the financial year with 60% of our stores closed, with the majority reopening by June and this caused a significant recovery through the second quarter.

Looking at the results for the half and referring to year-on-year changes at constant exchange rates. Total revenue was £878m, down 30%. Adjusted operating profit was £51m, a decline of 71%, impacted by significant operational gearing, but partially offset by the actions we took to manage the cost base. Adjusted diluted earnings per share fell by 85% and was impacted by an elevated tax charge on depressed half one profits. We expect a tax rate on adjusted profit of around 30% for the full year.

Free cash flow in the half was minus £45m, and as previously announced, no interim dividend has been declared and we will review this at the full year results in May. The next slide shows the progression between the quarters of the retail operations by region. As previously reported, key one comp fell 45%, but this recovered to minus 6% in Q2. The progression has continued with September being down low single digits driven by a full price channel mix with October returning to positive growth.

We covered Q1 at the time of the results so I will focus on Q2, taking each region in turn. Asia Pac grew by 10% with a mixed performance in the region. Mainland China accelerated during the period ahead of the June exit rate, and enhanced by strong full price channel performance. Korea also showed a marked improvement, but this was partially offset by Japan and the rest of Asia Pac that were impacted by a reduction in tourist spend. EMEIA fell minus 39% in Q2, also impacted by a significant reduction in travelling consumers, although our domestic business showed positive trends.

Continental Europe fell broadly in line with the regional average but domestic spend increased in the mid 20% range in the period. The Middle East fell mid-single digits with domestics up strongly. The UK was impacted with the absence of tourists having a major impact on London, although local spend grew. The Americas saw a 21% growth, benefiting from a stronger performance in the US with September seeing further acceleration. This was driven by strong growth from new younger consumers.

Overall, as Marco mentioned, digital showed strength throughout with strong double-digit growth globally and Americas with triple-digit growth. In terms of guidance our Q2 retail comp of minus 6% was ahead of expectations, largely due to the outperformance in Americas.

Turning now to our total half one revenue performance where Group revenue fell 30% at CER and 31% reported. In retail half one comparable store sales fell 25%. Space was a 4% headwind that led to total retail sales falling 29%. This reflected the closure of six stores related to our rationalisation programme, together with the timing of closures for refurbishment. We expect space to turn positive in half two with the full year being close to neutral. Wholesale declined minus 38% as we reduced inventory in the system to actively limit excess stock with third parties. All regions saw double-digit sales declined, particularly Asia due to the impact of duty free. Wholesale came in at the better end of our guidance range. Finally, licensing fell 24% due to the COVID-19 outbreak.

Turning to product and looking at the retail wholesale performance overall with all growth rates quoted at CER I'll talk to the trend in Q2 as Q1 was seriously impacted due to store closures.

In apparel Women's had a more difficult period, falling 16% largely due to outerwear demand being subdued whilst people are working from home. The rest of Women's ready to wear came in line with a group average comp of Q2 year-on-year, with dresses and knitwear performing well. Men's saw positive 2% growth in Q2 driven by jackets, jersey wear and trousers. Children's and Other had a strong quarter rising 27%.

Turning to Accessories Q2 declined 5%, largely due to scarf sales, partially offset by the strength in leather goods that increased by a low single-digit percentage this quarter. We're now seeing the first year where the new collections have been the majority of the available range. As Marco said it is a long-term objective to increase our focus on leather goods and we are pleased with the progress made to date with the new shapes gaining traction. The pocket bag is now our bestselling design with the TB bag and Lola also performing well. The new shapes account for over 60% of our women's bag range. We introduced the Olympia into store last month to complement the collection.

We've also seen a strong performance in shoes, especially casual and active ranges. We've been selling the new product now for 18 months and we're starting to see a high level carry forward into the following seasons, building longevity within our product range.

Turning to the income statement there are a number of key areas to highlight. Gross margin increased by 60 basis point in H1, 90 basis points at CER. This was due to a number of factors that included improved regional and channel mix due to the higher proportion of Asian and full price channel revenues, together with reduced charges for inventory provisioning. Overall adjusted operating profit fell 71% at CER and 75% at reported levels and I will come on to bridge this shortly.

We saw a net credit from adjusting items of £37m with the major cash item being £27m related to rent rebates in H1. Other items within adjusted items were restructuring charges and favourable movements on stock provisions and store impairments.

The adjusted profit tax rate was 51%, caused by geographical mix and prior year adjustments on the depressed half profits. Adjusted earnings per share fell 88% with reported EPS declining 66%.

Coming on to the adjusted operating profit bridge from the £203m last year to the £51m achieved this year. H1 saw a £263m decline due to trading, partially offset by the small gross margin improvement and operating savings of over £100m. this delivered a cost base 17% below last year.

The opex reductions came from two main areas. People costs fell £41m and incorporates the cost reduction programmes we achieved as well as variable opex from commissions.

Property cost savings include store closures and lower depreciation following last year's impairments and the non-repetition of the Hong Kong impairments taken last year. In addition to this we delivered a further £26m of rent reductions in H1, that are shown below the line as an adjusting item as mentioned. This led to adjusted operating profit of £59m at CER.

To summarise the headlines, we are on track to deliver the cost saving and store rationalisation programmes. The original cost saving programme has now delivered £136m of cumulative benefits with £148m planned by the end of the year ahead of previous guidance of £140m.

The programme announced in July, focused on office-based activities, is also delivering to plan with savings to be reinvested in customer-facing activities.

As Marco mentioned we are focused on investing in the business with business cases in China, Korea and digital delivering strong returns already in Q2 and this bodes well for our efforts to redirect savings towards consumer-facing areas of the business.

Turning to cash. We generated a free cash outflow of £45m in the half due to the tight control of cash to cushion the impact from trading. Within this total depreciation and amortisation fell by £31m with £24m from the lower right of use asset charge following last year's impairment.

Working capital saw its usual seasonal outflow of £90m and this is broadly in line with the last two years that averaged over £100m. Within working capital gross inventories rose by just 4% at the half and we now expect inventory at the full year to be lower than the level in March 2020, demonstrating strong management of inventory through the pandemic.

In terms of cash, after a cash outflow in April when the majority of our stores were closed, we saw cash flow stabilise in May and we were cash positive from August onwards.

Turning now to cash and capital allocation, capital expenditure at £46m reflects prioritisation of digital and store investments, focused on Asia including nine major projects in China.

In terms of dividend as announced we did not pay a final dividend in respect of full year 2020 due to the uncertainty arising from the pandemic and we will review the dividend position at the full year as guided.

Overall our cash net of overdrafts and borrowings fell just £45m in the first six months and I am pleased to note that by October it was in line with end of March levels.

Importantly we took a number of measures to restructure our financing facilities. We repaid the revolving credit facility in June 2020 and secured a covenant waiver together with an extension to November 2022. For short term security we borrowed £0.3bn under the government-backed CCFF scheme and we obtained a public credit rating and issued £0.3bn sustainability bond which I will refer to later.

As a result we have £1.1bn of cash at the end of H1 comprising £0.5bn of our own funds and a further £0.6bn from borrowings, with a further option of £0.3bn under the revolver if required.

Since 2017 our financial policy has been to maintain a strong balance sheet with solid investment grade credit rating metrics. We benchmarked our target leverage range and built in a further degree of conservatism and targeted the lower part of that range. And this has placed us in a strong position throughout the pandemic.

Our target remains at a net debt to adjusted EBITDA ratio of 0.5 – 1.0x and as at September 2020 we have leverage of 0.9x on a rolling 12 month basis. Which brings us on to the bond that we issued in September to establish medium-term financing and to support our commitment to sustainability.

We secured an investment grade Baa2 stable outlook credit rating from Moody's, a significant achievement during the pandemic and with an uncertain macroeconomic backdrop. This establishes an important foundation providing Burberry with the option of raising finance in the public debt markets.

We chose to issue a sustainability bond to demonstrate and strengthen our ESG and we're proud to be the first soft luxury company to do so. We have published our sustainability framework on the website as well as the second party opinion from Sustainalytics.

Our commitment is to use the proceeds from the bond to invest in three areas: green buildings with specific environmental certifications; procurement of certified BCI cotton, raw materials and finished product; and sustainable packaging. We will report our progress on the use of these proceeds in the annual report at the full year.

As we approach the end of the Brexit transition period I wanted to bring you up to date on the plans we have developed to mitigate the impact. We show the main areas in this slide.

Our international supply chain includes many product journeys across the UK/EU border. Post-transition brings operational challenges and potentially incremental duty costs, absent a zero tariff under a free trade agreement. We have already put a number of mitigating steps in place: secured authorised economic operator status in February 2020 to facilitate efficient cross-border flows. And we've implemented a new trade compliance IT system to optimise product movement.

Additionally we have prepared for the border with the tactical relocation of inventory prior to the end of the year; processes and documentation prepared product journeys across the border; identification of back-up carriers and alternative transportation routes; and established a new process for returns from digital customers in the EU. And finally we seek to maintain access to skilled workers, critical to our business from outside the UK.

Now turning to the financial outlook for the full year. The current lockdowns across Europe have resulted in over 10% of our stores being closed and will impact trading for the duration. I will return to this shortly.

With the brand resonating and attracting new and younger consumers we've taken the decision to defer and reduce markdowns and this will be a revenue headwind in H2 mainly falling in Q3 but will be in the long-term interest of the brand. We expect contribution from space to be broadly flat for the full-year as guided. We expect the tax rate on adjusted profits to be around 30% this year. And turning to currency we now expect to benefit to full-year operating profit of £5m using the 30th October spots due to the weakening of Sterling.

What I would like to highlight is the impact store closures made on the business this year. This chart shows the monthly progression of store closures and comparable sales growth. There is a close correlation so while we are confident of a good recovery in the underlying performance in open markets we expect the recently announced EMEIA lockdown to impact trading in Q3. Given our progress to date we remain confident in our recovery from Q4.

To conclude, we have strengthened our liquidity to ensure we are well-financed for any further disruption caused by the virus. We have focused capex on digital and rebounding economies, particularly Asia. Further efficiencies have been extracted from the initial cost reduction programme that has increased to £148m cumulatively from £140m.

We have used this opportunity to further simplify our operations, reduce spend in office-based areas and create a more agile business, reinvesting savings into consumer-facing initiatives and believe we are well-positioned to drive growth into the long-term as we emerge from the disruption caused by COVID-19.

I shall pass back to Marco where he will take you through our longer-term plans.

Marco Gobbetti

Thank you, Julie. Turning to outlook. The past few months have reinforced our strategy to anchor Burberry firmly in luxury as we have seen the industry polarise even further during the pandemic.

Despite COVID we have made strong strategic progress and will continue to strengthen our foundations in the next 12-18 months with two considerations. First, as COVID has changed the macro and luxury industry we will constantly adapt our business investing in markets as they recover and focusing on local customers.

Second, we will need to sustain the good momentum we have built in our brand and product. I believe we can successfully navigate this next intermediate phase and will be in a very strong position to accelerate and grow once luxury demand returns.

As I outlined in May in the COVID environment we have focused on six themes that will be key to driving growth over the next 12-18 months. In the next few pages I will say more about each of these and the plans we have around them.

The first key theme is around brand which has become particularly important in the COVID environment where consumers are seeking emotional connections with brands. Here we will continue to sharpen our luxury brand message by focusing on content and storytelling that is grounded in our authentic brand story.

A good example of this is the recent brand campaign we launched earlier this week. Deviating from a traditional holiday campaign it focuses on the power not only of giving but giving back and building a Burberry community tied to the philosophy of the brand and the altruism of our founder, Thomas Burberry.

The second key theme we set out back in May is to continue accelerating growth in China. We will do this by driving local relevance through locally originated content and campaigns, boosting product performance with high visibility pop-ups and collaborations and also focusing on repatriated customers, leaning on strong partnerships we've built in China.

Across regions with travel restrictions still in place we will continue to focus on actively recruiting local consumers.

In terms of product, we will continue to grow our strategic categories, leather goods and outerwear. For leather goods having built our Women's architecture we will continue to deliver newness and relevance through activations while we establish key shapes within the Men's architecture. For outerwear we will build desire through fabric innovation as well as capsules and collaborations.

Of course COVID-19 will continue to impact in-store traffic and we will keep scaling new omni-channel consumer journeys innovating around new formats to reach consumers at home like the virtual styling event in America as you can see here.

Finally, we know digital will remain very important for luxury customers and we're focusing on two elements going forward. To drive traffic we will supercharge inspiration online by making .com the first release point for bespoke exclusive and localised content and by building digital communities.

In terms of product we will increasingly personalise customer journeys on .com, curating online experiences to local preferences. These themes will be underpinned by focused on local execution as recovery timelines and domestic policies vary by market, rigorous management of cash and cost, as well as organisational agility and operational efficiency. And we will continue to make progress against our social and environmental agendas as part of our commitment to having a positive impact on people and the planet.

To conclude, I want to reiterate two messages. First, despite COVID we have made very good strategic progress, driving outperformance in our full price channels, good traction in leather goods, strong digital performance and a high share of new and younger customers. This has driven rapid recovery and gives us a strong platform on which to deliver.

Second, while we expect the trading environment to remain highly uncertain for some time, especially in key regions such as EMEIA and some parts of south Asia Pacific we have clear plans in place over the next 12-18 months to drive performance and deliver inspiring product to keep exciting our customers.

In light of these foundations and the continued progress we have made on our strategic priorities I believe we will be in an excellent position to accelerate our growth once we exit the COVID environment and luxury demand returns in full.

Before turning to Q&A, for those of you who have not seen it yet, I wanted to share with you our new brand detail which celebrates the pioneering and fearless spirit of young people overcoming adversity today.

[Video plays]

Q&A session

Question 1

Thomas Chauvet, Citigroup

Good morning. I have three questions please. The first one on local demand. You've managed to mitigate the travelling consumer disruption thanks to those efforts on local clientele. What more do you need to do to build that steady local base in key markets? Is it also adapting the store footprint, the merchandising mix may be different Asia from developed markets and local pricing strategy?

Secondly, on your decision to reduce markdown to elevate the brand, you have a much greater ready-to-wear business than some of your direct peers that have done similar strategy, like Gucci or Prada. How does it work in practice with regards to your apparel business, particularly with outlets? And Julie, maybe on that point, how do you think the efforts in the H2 will support gross margin?

And just finally on LFL could you give some colour on the swing from September down low single-digit to October positive, which markets have contributed? I guess maybe China during Golden Week, and probably Japan on the easy comp. Any other geographies or categories you want to highlight in October? Thanks.

Marco Gobbetti

Okay, I think I will start. Good morning everyone and good morning, Thomas. Thanks for your questions. Maybe I will start from your question around local demand.

Local demand has been the focus working on local customers since the onset of COVID-19. This is where the focus of our teams has been.

We've been able to leverage our digital platform, and we have been able to really reach out to them and provide them I think a very good service in terms of styling, in terms of showing the offer, in terms of connecting, and also in terms of transacting with them. And that has been a big advantage I think.

I think in terms of more to do, of course I think there is more to do. There are economies as we know probably in EMEIA that will be impacted for a while in terms of lack of tourism. And therefore we have been working there on preparing the teams, on really training the teams to build our database of clients. We have a good database and we have good programmes for them in store to leverage on. We provided them tools, as I said, to outreach. And within those tools we have also developed a lot of new formats and experiences for our customers to use.

In terms of store footprint I think it's too early to look at any major change in the store footprint. And in terms of merchandising clearly we are adapting and localising the merchandising more and more in the light of COVID, knowing obviously that customers are travelling much less. So, this has always been a focus of ours, but it is particularly important now. It is very important now to have the right assortment and depth of assortment in those markets that are rebounding very strongly, like China, like Korea, like the US. And so that has also been quite an agile work that the team has done there.

In terms of markdown and the deliberate decision to reduce markdown, first of all it comes from the fact that I think we managed fairly well the inventory, and I think we also have good plans for the next six months, so we feel that we're in a very good position. But it's clearly a strategic objective of ours. Yes, we do have more ready-to-wear than our competitors, however I think we have on the one hand our outlet chain that we can leverage, and on the other hand we feel now that we are building up our carry forward and our evergreen or replenishment items, and therefore we have more of a product range that is continuative and therefore not subject to seasonality or to a shorter shelf life.

Maybe Julie you want to say a word about margin in terms of the markdown?

Julie Brown

Yes, sure. So, just in terms of the markdown first of all and then the second half gross margin, which is the third part of your question, Thomas.

In terms of the markdown impact what we're doing is we're shortening the markdown period, we're having a shallower markdown in terms of volume and we're also doing it later, which will particularly impact the US market. So, we would normally go into a markdown in the US ahead of Thanksgiving, but this year we've decided to delay it considerably into towards the end of December.

So, we would expect an impact on our comparable store sales growth in the third quarter, which across the US and Asia and some countries also in EMEIA that are going to be impacted, we'd expect around a high single digit percentage impact negatively on our third quarter comp.

Just coming back to the question about the gross margin and the second half, clearly we've got a number of moving parts, including the product mix, channel and geography, so we believe regional mix is expected to be favourable, due to China largely and the growth in Asia. The full price changes that we're making in terms of full price channel will also benefit the gross margin in the second half.

And then the key uncertainty really is just around the overall revenue shape and the impact of the second wave and the lockdowns as we enter the winter months. And that's the big uncertainty at the moment, because clearly revenues do determine efficiencies and fixed cost absorption in the gross margin.

But overall once we're through this period, and hopefully the vaccine that was announced by Pfizer on Tuesday will also take good effect next year, overall we're positive about the gross margin and the benefits of the foundational work that we've done over a number of years now.

Marco Gobbetti

And I will just pick up on your third question which was around the trend from September into October regionally. Yes, definitely I think Chinese New Year was an important factor for the Chinese calendar. But we have seen solid improving trends across other geographies. We have seen Korea performing well, we have seen America still doing very well in October. And in terms of product as well I think we have seen in October a strong performance again from outerwear, from leather goods. So, I think it's been a confirmation of the trend fundamentally.

Thomas Chauvet

Thank you Marco and Julie, and congrats on such progress.

Marco Gobbetti

Thank you, Thomas.

Question 2

Louise Singlehurst, Goldman Sachs

Good morning everyone, thank you for taking my questions. Firstly, Marco, I wondered if you could just – it looks very interesting about the markdown activity and the reductions – can you just talk about the timing of that? Is it stronger underlying brand momentum that's giving you the confidence to accelerate that markdown activity reduction, which is obviously positive for the longer term?

And associated with that, are you thinking differently about converting a little bit more to retail longer term from the current 80%? Obviously a lot of progress has been done on that over the last ten years.

And then my last question, just for Julie. I just wondered if you could talk a bit more on the cost saving that we're seeing coming through. There's always a little bit more that comes through, so obviously very hard work from yourself and the team. But how much more is there to come? And where does that additional £8m come from that you've announced this morning? Thank you.

Marco Gobbetti

Good morning and thank you for the questions. I think in timing we had already started to reduce the volume and the timing of markdown over the past couple of seasons. And I think now we're taking that further step. We certainly see that the traction of the brand is stronger in this moment. We are seeing our product ranges performing well. And I think, as we always said, this is a decision on markdown that is very important for the long-term equity and interest of the brand. So, in this COVID environment we know there is going to be a bit of headwind in Q3, but I think it's the right thing to do for us long term.

In terms of converting more to retail, I think we are already pretty much a retail organisation. I think we are over 80% of our business is retail in terms of the bricks and mortar. I think in terms of digital also we are moving, we are progressing towards more of a concession model which is a form of direct return for us. Therefore I think the direction is quite obvious for us, retail, it is clearly the business model for the company. So, I think you will just see us more and more continuing in that direction.

At the same time we will keep a part of wholesale. We believe that there is a very important function of wholesale. I've already explained it a number of times so I won't go again into it. But we think it's very healthy for the brand to be out there and to be in the right location, mixed with the right brands, and attracting perhaps different customers. So, we will continue with a small portion of wholesale.

Julie, over to you for the cost savings.

Julie Brown

Thanks, Marco. Thanks, Louise, for the question, nice to speak to you.

In terms of the cost saving, as you know we're always looking for opportunities to save in areas that are really related to office based activities and also procurement activities, so that we can buy more efficiently to support the business further, and reinvest in commercial areas. So, we're pleased with where we've reached. We've upgraded the normal, the large programme to £148m from what was £140m, and the benefits have come through, £11m has come through in the first half. We're expecting and have plans to deliver £12m now in the second half. So, it will be £23m coming through this year.

In terms of the programme that we announced in the light of COVID, which was very much targeted towards office-based functions, that is running on track. As you've seen from the people cost savings that are coming through in the business already from the bridge I shared, we're basically going to deliver £35m this year on that one, and £55m annualised. No change to those numbers.

But obviously we're focused in terms of that programme on reinvesting it into the commercial frontline; in particular inspiring our consumers is where that money will go. And we've already been doing that, Marco and I and the executive team, in the first half of this year directed some of that spend towards Digital, towards China and towards Korea. And we've already started to see a return. So, a very positive outlook on generating cost savings and reinvesting them.

Question 3

Thierry Cota, Société Générale

Good morning and thank you for taking my questions. First, on the balance sheet, you mentioned focused capex this year. Given the trouble we've seen in H1 can you give us an idea of the kind of decline we should expect for the full year first?

And secondly, on working capital, I was wondering whether we could expect an inflow of working capital for the full year cash flow statement?

Secondly, on sales, could you give some comments on price and mix, the transient of the 1H trend, separating the two if possible? And I was wondering whether any price action was excluded for the near future, as you know we've seen some before the summer across the sector.

And lastly, Julie, you mentioned Brexit, can you confirm that after offsets a Brexit no-deal situation would lead to a few tens of millions of pounds hit at the EBIT level? Thank you.

Julie Brown

Thank you very much, Thierry. If I take the balance sheet and then hand over to Marco on sales price mix, and then I can come back on Brexit.

In terms of the capex, we've been very focused. At the beginning of the year when we hit the Covid pandemic, we sat down as an Executive Team and decided where we wanted to focus in terms of priorities of capex, and we laid things out in terms of priority one/two, depending on the business situation. The areas of focus have been very much on Digital, and we've continued with store refurbishments and new openings, primarily in Asia.

In terms of the first half and the second half, we've decided not to provide specific guidance this time just because of the uncertainty of going into the winter months, but we'd expect capex to step up in the second half. It's expected to be lower than last year, but it will be definitely picking up in the second half, because we have plans for store refurbishments going through.

In terms of working capital, we've had really good control over the working capital. In particular I just refer to the inventory, because the debtors and creditors are well controlled in terms of days sales outstanding and days payables. So in terms of the inventory, which is usually the big swing factor, going into this half year we've managed the inventory well. If you look at the gross inventory level, we've just delivered an increase of 4% in the gross inventories by the first half, which I think is a good performance in view of the pandemic. We're expecting the inventory by the end of the year to be lower than it was at the end of March last year. So I think a good overall performance, largely on the basis of managing the inflows coming in to the inventory, but also the strong sell-through results that we're getting.

I think that was it from working capital. I'll just touch on Brexit, and then maybe hand to Marco if he wants to cover the price mix equation.

In terms of Brexit, we're obviously still hoping that we get a free trade agreement with a zero tariff, and that is our strong hope with the contact with the government. If we don't get that, we would be dealing with a low tens of millions impact on a no deal or on a normal trade tariff, which for our business is round about the 10-12% mark.. But clearly that's an annualised number, so there's much less impact on our final quarter, and we would look to take mitigating actions as far as we possibly could against that in the business.

Maybe I'll hand over to Marco just if he wants to cover the price.

Marco Gobbetti

In terms of the sales mix, I think we have seen a combination of volume and price increase and AUR increase. I think clearly the strength of leather goods has driven an AUR increase, so I think is a qualitative elevation of our product mix.

In terms of going forward and price increases. As I said in the past I think that there are categories, like for example leather goods, where it's part of our strategy to offer a very good price quality ratio to the customers to give them a very strong perception of value in the product that we are launching, and I think we want to stick to that for a little while more. At the same time I think that we are looking at price opportunities where they are, and so we keep it under control, we keep it under watch. But for the moment I think it has been mostly a link to the volume of the key categories that are entering in the price.

Question 4

Ashley Wallace, Bank of America Merrill Lynch

Three questions from me, please. First of all, just on the potential impact of the lockdown. I guess it's a bit more of a theoretical question on the industry as I understand visibility is low. But considering calendar Q4 and your Q3 is heavily reliant on holiday and gifting, and Christmas is not cancelled, wouldn't you expect that some of the November demand to shift into December, such as the net impact is maybe not as meaningful as in the prior lockdown? And can you maybe talk a little bit about how you've adjusted your holiday campaign to reflect this new situation?

My second question is just a follow-up on Thomas's question around the gross margin. Clearly very strong half one result with some tailwinds and some headwinds. However, as we move into the second half, I can see a number of tailwinds on that gross margin, including the fact that you've got 110 basis points in the comparison base, and you should have higher fixed cost absorption as revenue improves. You guided clearly to lower markdown activity. You continue to have a high rate of Asia and retail. Then finally you should have a lower drag from the annualisation of the Riccardo product investment made last year. So I completely understand there’s a lot of uncertainty and moving parts in gross margin, but what are the incremental headwinds in half two versus half one? Because for me I'm struggling to identify any.

Then my last question is really just on Riccardo, who's a very important part of the brand turnaround story. Can you maybe talk about the commitment Riccardo has on seeing the turnaround play out as I guess the press over the summer were speculating about a potential departure. Can you maybe give us your view on that speculation or that commitment of Riccardo over a full recovery coming through? Thank you.

Marco Gobbetti

Thank you, Ashley. Julie, maybe I'll take the first and third and then I'll pass over to you. In terms of the lockdown, clearly we all hope obviously that the lockdown in a number of countries in Europe will be limited to the month of November, and that we will be able to reopen our physical stores as of the beginning of December. But at the same time, we have started two things.

First of all, we had already I think shifted a little bit the timing of the launch of holiday, because the whole calendar had shifted a little bit this year with the reason of the first lockdown, so everything had been shifted a bit. But now we are actually leveraging very much our remote selling, although we've already started in the lockdown to start the season strongly. We have launched our holiday campaign now and I think we're very pleased with that campaign. It's a broad campaign, it really taps into our brand authenticity, and it's very much focused on digital and digital activations and communication on digital and advertising. So from that point of view I think we want to compensate as much as we can in the lockdown that is over the next few weeks.

Julie has already spoken about markdowns and the further shift of markdown from Q3 and Q4.

Taking it to Riccardo, I cannot answer it. Riccardo is very committed, is very happy. Riccardo is staying with the brand. I think in my experience there have always been rumours about designers moving from one brand to the other. They usually come up when on the press we have other brands that are clearly looking for designers. So I'm not surprised that there have been rumours, and I won't be surprised if there were more. Talent is concentrated and focused on a number of great designers and so I think it's quite normal. But at the same time I have to be clear, Riccardo is happy and staying and committed. So, Julie, over to you.

Julie Brown

Thank you, Marco. In terms of the gross margin, Ashley, you summarised the positives relating to the margin very well. We are expecting a regional favourable mix largely due to China and Asia, and the focus on full price will also benefit the gross margin. As you mentioned, compared with the prior year there could be movement on fixed cost absorption as we navigate the second wave. But as Marco explained, we're doing everything we possibly can to offset the impact on the stores being closed in Europe through use of the digital channel and reaching out to customers.

In terms of the headwind that is likely to occur, clearly we've still got some older lines of inventory, prior seasons, that we're holding in the outlets, and clearly one of our objectives would be to finish with a clean inventory position. So in some ways there could be a negative mix effect coming through the outlets. That's the main one I think to draw to your attention.

We obviously do get fluctuations also caused by a product mix. It was relatively neutral in the first half of the year, so it may be neutral in the second half of the year, but obviously we'll see how that develops. Leather does operate on a slightly lower margin, so as leather grows it could have a depressive effect on the second half of the margin.

Ashley Wallace

Okay, perfect. Maybe if you don't mind me asking a follow-up on that just on the product. As you mentioned, the product does have a different margin. The trench coats are I think, as I understand, the highest margin product you have, and you flagged weakness in women's outerwear over the Q3 period, so a period that was still relatively warm. This is actually a message we heard from Moncler, the lack of tourists in Europe meant that you didn't get demands for outerwear products which is technically out of season with the locals, which you normally get from the tourists. So as we go into winter do you expect to see a decent sequential improvement in this product category now that it's a more relevant product for local demand as it matches the season in which we currently are in?

Julie Brown

Yes, we would. I think as Moncler have reported it's definitely been an impact with the loss of the tourists in the summer that normally come over from Asia and buy the iconic Burberry trench coat. So that has been somewhat depressed during the quarter. So yes, we would generally expect it to be a positive trend in outerwear going into the winter months as you say because of domestics. So I think the only thing with the product mix is really around leather and whether that has an impact.

Ashley Wallace

But I guess leather was already up in half one as well.

Julie Brown

Yes, it was, absolutely.

Ashley Wallace

Yes.

Julie Brown

Yes. But obviously we've got ambitions...

Ashley Wallace

It might continue through, continuous expansion.

Julie Brown

Yes

Ashley Wallace

Okay, perfect. Thank you very much for your time.

<u>Question 5</u>

Charmaine Yap, Redburn

I have three questions too, please. In terms of leather goods and bags, the Pocket bag is clearly performing very well, as you've mentioned, but they are more broadly in the lower price bracket, maybe £900-£1200. Do you still expect to enhance your offer in the upper price points, or would you focus more in the lower price points where the brand has done really well over the years? That's the first question.

The second one in terms of digital, .com you mentioned almost doubled, I think, which implies third party concessions probably grew less. Were there any specific changes made on the .com to drive this? Do you expect the shift from maybe it was a case of the base, but do you expect this function to continue to go ahead in the upcoming quarters?

And the last question is, sorry, coming back to markdowns: would you expect this impact to annualise by the second half, or would you think that depending on how sales happen next year there could be a little bit more to do in terms of reduction of markdown levels? Thank you.

Marco Gobbetti

Okay, why don't I take the first two questions then Julie? So, in terms of the leather goods I think Pocket has been performing really well, but as I said in the presentation, I think what is good is that now we built an architecture of the offer. So we have a number of families that are performing really well. Pocket is one, Lola is another one, TB is another and the Title bag has also been successful. A successful family.

We're also just launching, we just launched a few weeks ago, Olympia, which is the focus of our campaign. And Olympia, Title, TB, these are handbags that are positioned at a higher price level than Pocket. Pocket is an entry price but it is still a price that is around £1,000, so is not a really low entry price. I always said that the focus for us would roughly have been in between £1,000 and £2,200 and this is exactly where we are focusing. So we're actually very pleased that we are seeing traction across a number of families, not just on one item. And I would remind that those four families only, so before the launch of Olympia, they're already representing over 60% of our business. So I think at this moment I have to say that it's really working out well, according to the way that we planned it.

Moving on to digital, I think we've had an over performance of our own channel, also because clearly this has been the go to for customers and our go to from our sales organisation as well in order somehow to fight our battle during COVID. So that has been actually quite fantastic too for us.

In terms of the parties I think we also had a good business with our third parties, we continue to invest in the relationships with them. As I said, for us it is an activity that, a bit like we did with wholesale we want to control more and more and we're investing in partnership with Farfetch, with Tmall and with other companies as well. So I think you should expect this to continue and because I think obviously digital for us is a very growth of both our .com and third party collaborations. Julie?

Julie Brown

Yes, thank you, Marco. Yes, so just in terms of markdown we're expecting the most pronounced impact to be on the third quarter, largely coming from Asia where we're tightening the markdown reducing volumes, but also Americas where we're undertaking a significant delay. So in terms of there will be obviously a more neutralised impact on the whole of the second half versus the third quarter. And then going into next year we will continue, and we have been working on this as you know when we talked about it at Q3 last year, we've been working on reducing the markdown.

It's the direction we want to go in as a brand in the interests of the long term health of the brand. So what we plan to do next year is probably in the first half when we undertake the mark down we will also undertake a reduction, a considerable reduction I suspect then in the mainline as well. But we'll obviously keep the situation under review and update you as part of our year end results.

I think we can take one more question, possibly two at the most, just depending on the time, but Alex, if we go to the next person?

<u>**Question 6**</u>

Rogerio Fujimori, MainFirst

Hi Marco, hi Julie. Two questions. How should we think about the impact of the mixed shift to retail and online on your EBIT margin? I think you've flagged that you've followed the gross margin accretive, but I was just wondering if it's also EBIT margin accretive in a given geography, say Americas?

And another quick one. Could you just let us know how much mainland China counted as a percentage of your global retail sales in H1 and as a percentage of the total Chinese cluster sales in the half? Thank you.

Julie Brown

Okay, so I can take the EBIT margin and Marco and I can decide how to take the second one. So in terms of the first one, the EBIT margin, so yes we have a positive effect at the gross margin when the retail wholesale balance shifts towards retail. However at the EBIT margin we have the opposite effect because the wholesale business carries very low central overheads for running that business, relative to retail. So therefore there is EBIT margin pressure as we've gone through this first half because of the wholesale mix.

Just in terms of the second part of the question in relation to China, so I'm just looking at the figures, in terms of half one, I mean what we will just talk about is the China mainland performance, so China actually we saw a 40% growth in Q2. This was really coming from a very high percentage of new consumers, younger consumers attracted to the brand, and therefore very encouraging. And again, a similar trend to the position in America, we saw a very good full price channel mix in terms of that number. It was higher than the overall comp .

I think in terms of China in Q2 sales or half one Chinese sales, we can give that to you in a second.

Analyst

Okay, and just back to the first question, the shift to online from physical. Is it also EBIT margin neutral, accretive, dilutive? Thank you.

Julie Brown

Yes, so digital enjoys good margins, so obviously in digital we have the commission going to the third party, if it's a commission arrangement, and then the cost of running digital is relatively low compared with running retail stores. So digital does have a positive impact on the EBIT margin, yes.

I think we can probably take the final question and then we'll stop at 11 o'clock.

Question 7

Luca Solca, Bernstein

Yes, good morning. Thank you very much for taking my questions. I was wondering about the nationality trends and if you could expand a bit more on how you've seen demand for the brand evolve as overseas demand has repatriated. At first sight Burberry seems to be doing much better than most of the peers in the US and seems to be a bit behind in Asia. So I was just wondering whether you could elaborate a bit more on your sales growth by nationality, looking at the European domestic consumers, Chinese and American consumers primarily.

A second question deals with your ability to reduce costs. You produced an incredible progress on SG&A. I wonder if you're planning to execute similar cost efficiencies on cost of goods sold and how this could potentially impact your pricing position, or your margin position going forward and how you see this development from a strategic viewpoint.

Finally, a point that is probably a minor point in the broader frame of the Brexit, but how do you see the change in duty free spend that the British Government has proposed. And is that a done deal or are you still seeing the opportunities that could amend the proposals one way or the other?

Julie Brown

Okay, would you like me to start, Marco, and you chip in?

Marco Gobbetti

Sure.

Julie Brown

Okay, so just in terms of the first part, in terms of nationality, we've seen certainly positive trends in terms of American consumption, local American consumption. We've also seen positive trends with domestics in Continental Europe. The British have been more subdued and we've had some pressure in other parts of the world. We're not going to go into the Chinese cluster as such, but what we will say is focus on mainland China growth at Q2 up 40% and very positive trends seen in full price in China.

In terms of the cost efficiency point and the sort of pricing and margin position; as we're developing the product line and as we're developing carry forward and replenishment lines there is an opportunity for cost of goods efficiencies and our team are working very hard on delivering that. As you know, we have invested in quality, particularly in the leather range. We've invested in quality through the work we've been doing with Burberry Manifattura and also the quality of the leather that we've been purchasing. We have not put the prices up commensurately at this stage, just because we've wanted to develop this category. And I think we will still, I mean, Marco may want to add a comment to this, we will still be very focused on improving the quality of the product as we go through the next year, 12 months.

Marco, do you want to add a comment and then I'll come back on the VAT?

Marco Gobbetti

Yes, definitely I think that we will have efficiencies going forward, particularly as you said, particularly in leather goods I think we have a number of factors. Number one I think we're scaling volumes now and that will bring obviously operational, industrial efficiency and so we'll definitely have an opportunity there. And as I said before, I think that at some point in time we will have also some price opportunity because I think that the value of the product that we offer today is really high at the level of pricing we have. So that's going to be, I think, another opportunity in that area.

Just one word again on nationality, on local trend. Local trends have been strong, basically in the majority of the markets. As Julie said, maybe British customers have been a little bit on the lower side. But when we look at America, we look at China, we look at Korea, we look at Japan, which as a market has been impacted by lack of tourism, but the domestic growth has been quite remarkable for us in Japan. So I think we're seeing a pick up, we're seeing traction with local customers I would say across geographies and that is very encouraging, as I said. It just speaks to the fact that the foundations that we have built over the past few seasons, they are starting to pay off.

And as Julie said many times, we're attracting younger customers today, so we're attracting a lot of young fashion customers into the brand. They're not just buying fashion because they're buying a lot of classic and continental products as well. And the majority of this is done through full price sales. So all together I think it is a good picture. Do you want to take the VAT?

Julie Brown

I'll take the VAT. I'll just come back as well on the specific question about China in the first half. So mainland China retail as a percentage of our total retail in the first half was around 35%, just coming back on the question that was raised earlier.

So in terms of VAT, clearly at this stage we've not reflected the proposed changes to VAT free shopping in our forecast, and in particular the impact it could have on store impairment, because it will potentially move the business outside the UK. So what we're seeing from the proposed changes at the moment is we think it will definitely have an impact on UK retail and tourism, it'll be a muted impact on ourselves in terms of UK retail in the fourth quarter but clearly will have an impact in the long term.

We expect customers from overseas will change their buying behaviour. For example, buying products in the EU VAT free, they'll buy them probably in other countries in Europe rather than come to the UK and take on the 'shop and ship rules', because our customers tend to want to take the product with them. Most luxury customers do. So obviously at this point in time our localisation strategy is really key, we're very focused on the local consumer, as Marco said, and leveraging our digital technology to aid our sales associates' outreach. And we are working with the government in terms of the proposal to change the VAT scheme. We don't want to lose the business in the UK.

Luca Solca

Thank you very much. If I may add a small question on the US, how big a boost did you get from turning some of the wholesale business into retail in that region and is that a material effect on organic growth that you experienced there?

Marco Gobbetti

It's hard to quantify, honestly, and then Julie chip in. It's hard to quantify except as a booster, or if that is what provides the booster that we have seen in our performance. We have completed our wholesale reorganisation, I think we have a very good network of stores now, and the right size in the right locations with the right partners and our partners have seen also strong demand for the product so they've continued to thrive throughout this period.

I think these are changes and moves that will pay in the long term, but I would say, Luca, it's hard to quantify if this is providing an effect. I think the other thing to say is that digital is very important in the US, it's a significant part of our business in the US. And clearly the leveraging of digital, both from the consumer and from our organisation has been quite high, therefore it has certainly helped, but it's helped what we have today which is a strong demand across the country.

Julie Brown

So I think we'll draw it to a close, Marco. Over to you.

Marco Gobbetti: Concluding comments

Yes, I just want to thank everyone. Thanks everyone for participating and for the questions and I think we'll see you in May. Thank you.

Julie Brown

Thank you. Bye everyone.

Marco Gobbetti

Thank you very much. Bye everyone.