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Burberry Group plc

Preliminary Results Analyst Call

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Burberry

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Marco Gobbetti, Chief Executive Officer

Good morning everyone and thank you for joining us for Burberry's Preliminary Full Year results presentation. Before we start, I want to acknowledge the extraordinary circumstances we have all been living in for the past several weeks and express my sympathy to anyone affected by COVID-19. On behalf of everyone here at Burberry we hope that you and your loved ones remain safe and healthy as we navigate these extraordinary times.

In terms of our agenda today, I will start with a brief introduction to remind us where we are in our transformation before turning to the impact COVID-19 has had on the business, the immediate steps we are taking to address it and our resulting financial performance for the year. You will then hear from Julie who will follow the financials in more detail. And we will end with an update on our strategic priorities and outlook before turning to Q&A.

As you can see we'll cover a lot of ground today, but ultimately I have four key messages I want to emphasise.

First, we have made excellent progress with our strategy, successfully completing the first phase. Before COVID, we were delivering strong momentum across brand, product and sales, ahead of our expectations.

Second, although COVID-19 has had a materially negative impact on our industry and our business, we responded rapidly to the outbreak safeguarding our teams, customers and communities. Throughout the crisis, our brand heat has remained strong.

Third, we have taken swift mitigating actions to contain costs and protect our financial position. As a result, we have a strong balance sheet and liquidity position to see us through this next phase, also leaving space for investment as markets recover.

Finally, we have a strong programme in place to navigate the next 12 months. Our overall strategy to anchor in luxury fashion remains the same and is reinforced by these events.

As mentioned, the end of this financial year marked the close of the first phase of Burberry's strategic transformation. Over the past two years, we have successfully built the foundations for our strategy. In this next phase, we will strengthen these foundations, adapting to the new environment and position the brand for acceleration and growth in the long-term.

You will recall we have six strategic pillars and have made great progress across each. In the last year we continued to strengthen our brand, building heat through our campaigns and experiences and signalling luxury. In terms of product, we have now transitioned around 85% of the offer to Riccardo's product and our new leather goods styles have been performing well.

We have made very good headway in transforming our distribution channels by aligning our mainline stores to the new creative vision, and completing the transition of our US wholesale to luxury fashion.

In digital, we sustained our leadership position through innovations such as games and social drops which drove consumer engagement.

And finally, throughout our business we have improved our agility and efficiency, and strengthened the Burberry team. As a result, before the outbreak we were starting to see strong momentum across many of our key indicators.

First, we were seeing strong evidence of brand momentum across both Western and Asian markets. Engagement rate on the two key social media platforms have grown double-digit during the year - and this has continued throughout the crisis. Our most recent fashion show in February, "Memories", also saw double digit growth in the number of press mentions compared to last year's show. We were also seeing strong consumer response to our new product.

Before the COVID-19 outbreak, each new collection delivered double digit growth compared to the prior year, with menswear performing particularly well and leather goods gaining traction, and this contributed to the mid-single digit quarterly growth performance we delivered in the first three quarters despite the challenges in Hong Kong.

In the first four weeks of January, before the outbreak of COVID-19, we also saw strong comp growth – even adjusting for the Lunar New Year effect which fell earlier in the quarter.

The progress I've outlined has been critical to strengthening our foundations, and increasing our resilience and agility ahead of these unprecedented times. However, the outbreak of COVID-19 has inevitably disrupted some of this momentum.

In this section, I want to outline the impact the outbreak has had on our business and the immediate steps we've taken to manage it in the last fiscal year.

In line with government guidelines, we have implemented global store closures, starting in China, where as of early February, around 40% of our stores were closed. As the health emergency moved West, closures accelerated in Europe and the Americas, with all stores closed in those regions at the end of March. Even in stores that remained open, many operated at reduced hours and with significantly reduced footfall.

The outbreak also led to some disruptions on the supply-side. In EMEIA, the major impacts occurred in March, including closure of our leather-goods centre, Burberry Manifattura, and reduced operations at our trench coat factory in Castleford, which in April was repurposed to support the NHS. While these closures were overall manageable and did not limit our capacity, they resulted in a much higher operating complexity, for example in shifting inventory between markets, fulfilment and product development.

Across the organisation, we have taken steps to address the current challenges. First and foremost, we prioritised the safety and well-being of our employees, partners and consumers. In addition to following local government guidelines, we continue to ensure that all of our employees have access to masks and disinfectant gels, and our office-based teams, particularly in the US and EMEIA, work from home.

Second, we implemented actions to protect liquidity and limit discretionary costs. Julie will say more about this shortly.

Third, we have focused our product offer to respond to demand and improved our agility to develop and buy future product. In terms of inventory, we took actions to align our stock with revised demand. In the meantime, we have been introducing initiatives to optimise revenue, including leveraging our leadership in digital and e-commerce and investing appropriately in rebounding markets.

At Burberry, we always have in mind our founder's legacy of protecting others and supporting communities, a central part of our company's purpose. In response to the crisis, we have launched several initiatives to support the relief efforts globally. I would like to give special mention to our team of volunteers at Castleford, Keighley and Blyth who are enabling us to manufacture non-surgical gowns for the NHS and our teams who have sourced surgical masks through our global supply chain for front line medical and care workers. Thanks to their skill and dedication, to date, we have donated more than 150,000 pieces of personal protective equipment, and rising. We have funded research into emergency vaccine development at the University of Oxford that went to human trials last month. And we have donated to charities tackling food poverty across the UK. We have also set up an appeal through the Burberry Foundation to provide much needed support to vulnerable communities globally.

The work we have done over the past two years allowed us to respond quickly to this challenge, adapting our business and diverting resources as needed. Our enhanced brand and product offering, as well as digital strength, have also made the business more resilient in these times. However, the impact of COVID on our Q4 has inevitably affected our financial performance for the year.

Our FY20 group revenue declined by 3% versus last year, and adjusted operating profit fell by 8%. Reported operating profit declined by 63%, impacted by one-off items relating to the COVID-19 pandemic. I'll hand over to Julie, who will take you through the details of these numbers.

Julie Brown, Chief Operating & Financial Officer

Thank you, Marco, and good morning everyone. As Marco mentioned, these are clearly unprecedented times, and I'm sorry not to be in a position to see you personally for our year-end results. During this presentation, I'll cover our revenues, operating profit and our cash position and then following Marco's review, I'll come back to review the actions we are taking in the light of COVID.

Before I turn to the results, I would like to say that when I refer to comparable store sales growth, no adjustments have been made for closures relating to COVID or Hong Kong.

So looking at our comparable store sales progression through the year. As you heard Marco say, we started the year strongly with comp of +5% in our year to date to 25 January, despite significant headwinds from the disruptions in Hong Kong.

We benefited from the build of new product to around 85% of our mainline range, with all major collections, delivering double-digit growth. The first 4 weeks of January were also strong with a comp of +11% prior to the COVID outbreak. And, as the quarter progressed, store closures increased and this reduced our Q4 comp to -27%, and the full year to -3%.

Turning to the regions, these charts show the performance pre and post the impact of COVID.

EMEIA had an improving trend in the first 10 months of the year, accelerating to double digits in January. But trends deteriorated in the final two months with significant numbers of stores closed, resulting in EMEIA being stable for the year.

Americas also accelerated in January to a mid-single digit percentage growth. However, similar to EMEIA, by the end of the year all stores in the Americas were closed resulting in a low single-digit decline for the year.

I have shown China separately on the slide due to its significance. China showed strong double-digit growth consistently for the first 10 months of the year, and exceptional growth in the first 4 weeks of January of almost 30%. China was the first region to be impacted by the virus, with sales down double-digits in Q4. For the year as a whole, China was reduced to a low single-digit sales growth.

AsiaPac (including China) grew by a mid-single digit percentage for the first 9 months of the year with the trend impacted by the disruptions from Hong Kong. Growth accelerated in January with AsiaPac growing low teens. However, store closures across the region brought the performance of the fourth quarter down double-digits and to a mid-single digit decline for the full year.

To summarise, this slide shows revenue by channel. For the full year, retail sales declined 4% with comparable store sales of -3% and space of -1%.

Wholesale was adversely impacted in the year. For the first 10 months, wholesale grew 2%, with the growth in luxury wholesale accounts partially offset by the closures of non-luxury doors. However, COVID significantly impacted February and March as we worked with wholesale partners to recalibrate orders, bringing the annual wholesale decline to -3%.

At the group level, if we adjust for the impact of COVID on full year performance, revenues would have grown +3%, ahead of our original guidance. However, the impact of COVID in the final 2 months, resulted in revenues of £2.6bn down 4% at constant exchange rates.

Turning to product and looking at the retail and wholesale performance combined. First of all, I'd like to share the nine month data shown on the left hand side of this chart as this is more indicative of the product trends before the impact of COVID.

Our apparel business delivered good growth with men's up 9% and women's up 2%. The growth was underpinned by a strong consumer response to our new product, partly offset by a weaker performance in replenishment lines.

Accessories declined 3% in the period with a progressively improving performance over the first ten months as we rebuilt our leather goods range with new styles, which resonated strongly with consumers.

Whilst all product categories were negatively impacted by COVID from February, we saw a more resilient performance from accessories during the lockdown period.

Turning to the income statement, please note that I will concentrate on the central section of this slide as this includes the pro forma, like-for-like comparison of full year 19 and 20. The right side of the slide includes full year 20 under the new accounting standard, IFRS 16.

As discussed, sales declined -4%. Gross margin fell 100bps, due to investments in product, design and quality, partially offset by an improved sell-through and tighter discount policies. Operating expenses fell 4%, demonstrating delivery of the cost saving programme and COVID mitigation.

Pro forma adjusted operating profit fell by 8%, and margin declined 70bps at constant and 80bps at reported rates of exchange, reflecting the strong management of the COVID situation in the latter two months of the year.

We had adjusting operating items of £244m predominantly reflecting impairments resulting from the COVID pandemic and I'll return to this shortly. Finally, adjusted EPS fell 5%, benefiting from an improved tax rate and share buybacks.

Taking a more detailed look at adjusted operating profit, starting with our profit in full year 19 of £438m. During the year, our underlying business was strong. However, we faced significant macro headwinds; firstly from the disruptions in Hong Kong and more recently, the COVID pandemic. As you can see, this put significant pressure on our operating profit, in the order of £160m combined, before cost savings.

However, we acted quickly, taking rapid cost action, such as renegotiating rents, restricting recruitment, travel and other discretionary expenditure. This reduced opex by £27m, and in addition, savings ensued from performance related pay.

The significant sales drop off started with only nine weeks to run to the year end, so to have delivered reductions of this order is testament to our rapid response and forensic review of the non-committed cost base. It is also down to the changes we have made in our business over the last two years, which have increased efficiency and agility.

We also delivered an incremental £20m from our original cost saving programme, which I will return to subsequently.

For the full year, profit closed at £404m, having absorbed considerable losses in the order of £50m from the disruptions in Hong Kong. We were on track to deliver profits in line with guidance at the end of January, until the COVID outbreak took our full year adjusted operating profit down to -8% for the full year.

This slide shows our cost saving programme. We delivered an incremental £20m savings from the programme, taking the cumulative to date to £125m. We have accelerated this programme by a year to deliver the full £140m of benefits in full year 21. More than half the savings are coming from operating model and process simplification with around an additional third coming from procurement. This is £20m ahead of the original guidance we gave in 2017 with the cost of change being £105m, i.e. £5m better than original guidance.

In addition, we continue to deliver the store rationalisation programme, which will improve the efficiency of our network. Over 60% of the stores have now been closed, with the majority to close by the end of the year.

Now I want to spend some time explaining the adjusting items, which amounted to £245m in the year.

In total, the significant COVID-related charges are predominantly due to retail store impairments of £157m and £68m of inventory provisions. As part of our year-end work, as usual, we assessed the assets held on our balance sheet for impairment, which is done using projections of future revenue and cash flows over the life of the lease.

Obviously in the current situation, this is challenging and depends on the longevity of the impact from the virus, the macroeconomic outturn and consumer confidence. As I will explain later, our approach has been to develop a range of planning assumptions based on external economic and scientific projections, and our own judgements as to how these might apply to our industry. Our assumptions underpinning these provisions are not worst case, but we believe they are prudent and do allow for a protracted period of recovery.

Now moving to cash. We generated free cash flow in the period of £66m, below the prior year level due to the impact of COVID. Within this, the working capital outflow was significant, largely due to excess inventory resulting from COVID and the phasing of payables. Further increases in cash outflows this year resulted from capex in stores and the acceleration of tax payments under the new HMRC rules.

On this slide I'll discuss our current net cash position. We started the year with £0.8bn of net cash, and lease debt of £1.2bn, giving lease adjusted net debt to EBITDAR of 0.5x. During the year, we generated free cash flow of £0.2bn; invested £0.15bn in capex, and returned £0.3bn to shareholders via dividends and buybacks, both of which were completed before the COVID outbreak.

At the end of the year, including £0.3bn from the revolving credit facility, we had a cash balance of £0.9bn. Our lease liabilities were £1.1bn, giving a net debt to EBITDA ratio of 0.7x, well within our capital allocation guidelines.

I'll hand to Marco now and return later to talk about liquidity management going forward.

Marco Gobbetti

Thank you Julie. Turning to outlook, clearly these are very unprecedented times. The health emergency, public restrictions and economic recession are likely to persist for months to come and their ultimate impact on demand for luxury is difficult to assess. What we do know is that in this environment, consumers tend to focus on strong brands and polarise further between luxury and mass. Diminished demand is likely to increase competition and reinforce the importance of investing in brand and inspiration. This makes our strategy to secure our position in luxury fashion even more critical at this time.

COVID-19 will also have many temporary, and even some permanent effects on the luxury industry. What will not change is the importance of supporting our people and communities. However there are four areas I believe will be key to brand success going forward.

First, as I said, strong luxury positioning will be paramount to win during this period of reduced demand.

Second, as economic outlook and consumer sentiment varies by region, brands will need to adopt a highly localised approach and taking into account a substantial reduction in travel, place increased focus on local consumers. In light of this, accelerating Asia is key, given the region's recovery timeline is ahead of other key markets.

Third, with wholesale facing significant challenges, this crisis has demonstrated the importance of direct to consumer at scale DTC, particularly digital, which will be transformational going forward.

Fourth, in terms of product, we also expect to see consumers looking for quality, leather goods and casualwear. However, with the industry facing widespread store and factory closures, optimising inventory levels and supply chain will be a challenge for the year ahead.

Last, but not least, everything we do will need to be underpinned by the rigorous management of cost and cash over the next 12 months. We have strong plans in place here and have secured funding to see us through a protracted period of store closures. With this in mind, I would like to tell you how Burberry is adapting to this new reality.

Starting with brand. In the current environment we are reinventing the way we communicate at Burberry. At times like these, consumers want to connect emotionally with our brand and we are enhancing our focus on content and storytelling that is grounded in our authentic brand story. We will continue to amplify our voice through partnerships and collaborations, while offering our brand as a platform to nurture communities, another critical element at this time.

Importantly, we are also working in very new ways - to create content within physical limitations, to remain flexible allocating resources quickly between markets and channels, and, working within reduced budgets, to ensure our activations cut through to the consumer.

Looking at the plans we have for the coming months, I am confident we have a strong set of initiatives in place to drive excitement and inspiration with consumers and maintain our brand momentum.

Second, as recovery timelines and domestic policies will vary by country, we are building bespoke plans for each market, rapidly reallocating resources towards rebounding economies. With reduced travel, we have also increased our focus on local customers in all regions, fostering clienteling and one-on-one outreach programmes that are sympathetic to the local environment and sentiment.

Since China announced its lockdown, we have created new ways to connect with our customers. Focusing on engaging Chinese customers at home, or who can no longer travel to our stores abroad, we launched live streaming and our new channel on the social platform Little Red Book, to inspire them with content. We also continue to launch campaigns, some exclusively in China, enhancing them with local collaborations such as the one you see here with Mr Bags.

Finally, we are continuing to support innovation in the market. As I mentioned before, we're excited about launching our new social retail store with Chinese tech leader, Tencent, later this year. With COVID accelerating the connection between online and offline, we believe this is a fundamental testing ground for the new way in which consumers will experience our stores.

Another market in recovery is Korea, where we have strong plans in place to capture the market opportunity, through amplifying key local gifting moments, such as Children's Day and Parent's Day, as well as native collaborations, such as our recent feature on 'Dazed Korea' which you can see here, and partnerships with local third parties and department stores to engage new consumers and drive sales across all channels.

These localised plans in China and Korea have driven solid rebound. In these markets, growth has already surpassed last year's levels, supported by our strong brand positioning, and also benefitting from the repatriation of spend from consumers who used to shop abroad.

We have also seen a strong performance in our online business in China and Korea, growing double digit versus last year, and a significant traction in handbags and small leather goods across a range of styles. Sales trends in both markets continue to improve, with China in particular up double-digits in recent weeks.

We do not expect the recovery trajectory to be the same across markets, especially in the West where it is possible recovery may be slower, but will continue to monitor markets as they open up and ensure we react at speed.

Third, this crisis has shown us how important direct to consumer will be in the coming months.

Today we are predominantly a DTC brand, with strong retail presence across digital and offline. During the crisis we quickly adapted our stores, innovating new ways of reaching our customers, for example through virtual appointments, remote selling, and bringing products to clients when they can't come to the stores. We have also increased our focus on health and safety, adapting the in-store experience to include strict hygiene and social distancing guidelines. These new ways of working will remain critically important over the next few months, as lockdowns gradually ease and consumers slowly regain their confidence.

In terms of digital, we've always had a strong online business and this has shown resilience during this crisis. As you can see from this chart, our global digital demand to date has been strong with double digit increase compared to last year, despite lockdowns in EMEIA and Americas. We have also seen a similar performance on third party platforms where we have always had very strong relationships, with global sales growing double-digit year-to-date versus last year. In the months ahead we will continue to focus on digital, driving performance through large-scale, immersive activations, such as the exclusive digital Leather Goods pop-up you can see here, which we are launching later this summer, and continued digital innovation, including gaming and through partnerships such as WeChat Work, part of our collaboration with Tencent.

Turning to product. We will continue to present a compelling, luxury offer to our customers, injecting energy and newness through our upcoming capsules, shining a light on outerwear, one of our hero products, and, building on the good trajectory we have established. Leather will become an even more important part of our offer.

This year, we will have a dedicated leather goods campaign, which you may have seen just launched in China. This will be complemented by a programme of exciting pop-ups, dedicated to showcasing our new leather goods architecture, starting in China and moving to EMEIA and Americas later this year.

Finally, inventory management will be a priority this year, as we face store closures in many regions. To respond to this challenge, we are closely managing our stock position by reviewing the timing of our seasons, reducing the production of upcoming collections, proactively reallocating current stock across channels and regions to meet demand, and strategically leveraging our clearance channels.

We are also supporting our wholesale partners, where necessary, through order reductions and extended payment terms, and will continue to partner proactively as trading restarts and as we enter into the markdown period.

In terms of supply chain, we are securing capacity, adapting our sourcing and continuing our focus on safety, agility and flexibility. Last, but not least, all of our efforts next year will be underpinned by rigorous management of cash and costs.

I'll hand over to Julie, who will take you through our plans in this area.

Julie Brown

Thank you Marco. Turning to guidance, given current uncertainty, we are not in a position to provide annual guidance, but we have shared a diagram that depicts our modelling and the way we plan to manage the business.

First, we have developed a range of scenarios, based on scientific, epidemiological and economic forecasts. The pace and trajectory of recovery will largely depend on countries balancing social distancing requirements and virus control with reopening their economies, and the pace at which consumers regain confidence.

Second, we have built a range of luxury demand scenarios and applied this to Burberry, sense checking forecasts from luxury demand specialists such as BCG and McKinsey, who are anticipating sector demand to decline between 27% and 45% in 2020. We have then used various considerations, including a regret analysis, to determine the best approach for each major area of our business.

You've already heard Marco talk about the consumer facing initiatives and now I want to focus on the mitigating actions we are taking to protect our financial position. In headline terms, we are managing inventory tightly, but also allowing headroom as markets recover.

In cost terms, we have developed a comprehensive mitigation programme, but at the same time we've ensured agility is built into our plans. For liquidity, we're aiming to ensure the company has sufficient headroom to cope with a protracted period of store closures, a gradual recovery in demand and a possible second wave.

To summarise, our goal is to secure the long term value of our brand, enable efficient and flexible management of the business, and ensure we have the financial headroom to fuel growth when the market opportunity returns.

Taking a look at cost mitigating actions. First, we will benefit from variable savings, such as variable rent and commissions.

Second, we've identified discretionary savings, which are more situational in nature, and these include savings in Marketing, Visual Merchandising and Client Events, influenced by store closures and specific market conditions.

Regarding reward, the Board and senior leaders have decided to take a 20% pay reduction for three months to support COVID charities and Burberry through this difficult period. We've also decided to pause recruitment, reduce T&E and suspend merit awards.

Third, property savings and government support for business rates are also being pursued. Importantly, as mentioned, embedded within our plans is the flexibility to invest in consumer facing activities to fuel growth when demand returns.

Finally, I wanted to summarise our approach to liquidity. Through this uncertain period, we're aiming to ensure that the company maintains sufficient funding headroom, even over a protracted period of store closures. This diagram shows our levers for achieving this.

First, as Marco said, we are managing our inventories tightly. We've also worked with wholesale partners to cancel current seasonal orders, where appropriate, to ensure that we protect our brand and wholesalers can benefit from potential top-up opportunities in the second half.

Secondly, as mentioned, we've developed a cost programme designed to deal with a number of outcomes.

Third, we've reviewed all planned capital projects, and as a baseline, we are only committing to those of the highest priority. This includes projects in Digital, Cyber Security and our store network, including the social retail store in Shenzhen.

Fourth, we are bolstering our cash position by securing additional liquidity and undertaking rigorous cash forecasting. At the end of March, we had £0.6bn of our own cash reserves and had drawn down on the £0.3bn revolving credit facility. Since the year-end, we have also secured £0.3bn under the UK Government sponsored COVID Corporate Financing Facility. In total, we currently have access to £1.2bn of liquidity and we will keep our medium term funding plans under review as the situation develops.

In terms of shareholder distributions, we continue to prioritise investment in the business and we understand the importance of our progressive dividend policy. We face, however, unprecedented times, and to protect long-term shareholder interests we have taken the difficult decision not to declare a final dividend. Future dividend payments will be reviewed by the Board at the end of our next financial year, with the intention to return to our progressive policy at the earliest opportunity.

In terms of near term guidance, we have seen promising early signs in China and Korea. However, we currently have 50% of our store network closed and we expect our first quarter to June 2020 to be severely impacted, with closures likely to be at, or near, their peak. We also expect the travelling consumer to take longer to return, impacting tourist destinations.

To summarise, while we expect it will take some time for the luxury market to recover, and for consumer confidence to return to pre-crisis levels, we are confident in our brand, our strategy, and our response to these challenging market conditions. And with that I'd like to thank you and hand back to Marco.

Marco Gobbetti

Thank you, Julie.

In conclusion, I want to reiterate the key messages we started with today. First, we have made excellent progress with our strategy, successfully completing the first phase. Before COVID we were delivering strong momentum across brand, product and sales, ahead of our expectations.

Second, although COVID-19 has had a materially negative impact on our industry and our business, we responded rapidly to the outbreak, safeguarding our teams, customers and communities. Throughout the crisis, our brand heat has remained strong.

Third, we have taken swift mitigating actions to contain costs and protect our financial position. As a result, we have a strong balance sheet and liquidity position, also leaving space for investment as markets recover.

Finally, as Julie and I have just spoken about, we are well positioned and have a strong plan in place to navigate the next 12 months.

Before I close, I would like to thank our teams worldwide for their commitment and leadership during this time. This global health emergency has had a devastating impact on the lives of many people around the world and a materially negative effect on luxury demand. I am very proud of the way we have responded, both at Burberry and beyond. It will take time for the world to heal from this pandemic, but now more than ever our strategy to anchor the brand in luxury fashion is key, and we are excited about this next phase in Burberry's journey.

I'd like to leave you with a short video.

[video plays]

I'll open the floor to Q&A.

Q&A session

Question 1

Zuzanna Pusz, UBS

Good morning everyone. I have two questions. The first question is on the momentum you saw in January for the calendar year to date. Maybe if you could give us an idea of what was the growth for the beginning of January until the COVID-19 outbreak? And specifically if you could just also specify what was the growth by nationality, given that it's likely that this period would have benefited from the earlier Chinese New Year? So, basically if I could just please ask for growth in January until 21st January? And what was the Chinese consumer versus other nationalities?

Second question is on the one-offs. They are quite big, basically over 50% of your EBIT, so I just wanted to get an idea of how we should think of those impairments? Is there a chance that actually in the future you revise them if actually revenue turns out to be better than what you had initially assumed? And if that happens would it be below the line, like this time, or not?

And just also clarification, because it happens you were the last company to report this earnings season, and none of the companies have basically taken any impairments of that extent, especially for stores. So, maybe just to get an idea, because clearly you probably had a little bit more flexibility in terms of whether to do it or not, and why would it differ versus peers?

Then it's not a question, it's just a follow-up, because you mentioned in the presentation that the Americas region was up mid-single digit in January, but actually in the press release it says it was stable; so just if I could clarify where that difference comes from? Thank you.

Julie Brown

Okay, thank you, Zuzanna, for the questions. Marco, I can take them if you like, since they are related to the figures.

Marco Gobbetti

Sure. Good morning, Zuzanna.

Julie Brown

So, just in terms of the first one related to the momentum and calendar to date. We saw a strong performance in January, so to the 25th January we had 11% growth. We actually saw it across the majority of our nationalities – I'll come to your second question about Americas later – but we also saw it across Americas, and we had double-digit growth in EMEIA. So, I think a very positive trend globally.

As far as Lunar New Year is concerned we did have the benefit this year of a couple of weeks in the timing between this year and last year, but we've actually done a comparison of the same Chinese New Year period for last year and this year, and the trend is very similar. So, there may be some element of offset, but we have actually reviewed that ourselves to make sure it was a reasonable data point to provide you. So, we're very encouraged by 11% to the 25th January just before COVID struck.

In terms of the impairment point, as you know this is caused by simply the fact that we're in the unfortunate position of having our accounting year end when there's a high degree of rigour associated with impairment, linked with, at the time, when we closed our books at the end of March we had 60% of stores closed; all the stores in the West were closed. So, that triggered a significant impairment because you've got to compare the cash flows from the store portfolio by store with the lease obligation of those stores.

Now, we did a review of this actually in January before we knew COVID was going to strike, and there were very few impairments in the second half; it was like one million. So, when we did it again post-COVID it's all been caused by effectively the drop in the revenue projection and the earnings projection relative to that lease obligation. So, of course as a result we treat it as an exceptional item.

And then when you mention about the reversal going above or below the line, clearly if there is any change to this assumption – and we all appreciate we're living in an uncertain world and these assumptions may change – then the reversal of any impairment we've taken would also go below the line. It's also the same with the stock provisions, we make every adjustment below the line. You've seen us do that before with the beauty deal, for instance, where we took distributor provisions, they also reversed below the line if they needed to be adjusted or trued up.

In terms of benefits above the line, there is a small benefit associated with the depreciation charge. If you reduce the value of the store on the balance sheet under IFRS 16 then you get a small benefit in terms of depreciation.

The final part of your question related to the impairment charge relative to other companies. The first thing is, as I mentioned, we've been very unlucky that our accounting year-end has coincided with the coronavirus potentially being at its peak. The charge is based on a series of scenarios, as I outlined on that diagram, and we're using scenarios to manage the business to ensure that we're flexible and agile, but also to determine accounting charges.

In terms of peers, those peers that have not got a financial year-end at this point obviously won't have this obligation. And in terms of American peers, the rules are different. I won't go into the technicalities, we can pick it up later, but it's all about discounted or undiscounted cash flows. We have to use discounted cash flows under IFRS 16.

And then the final part of your question related to Americas. We did see Americas up mid-single digits to the 25th January, so it was a very positive trend that was occurring. But clearly the latter part of it was negative due to the markdown period, so we had a significant headwind in the last week of January in Americas due to that. But it is correct that it was mid-single digits to the 25th.

Zuzanna Pusz

Perfect thank you. Sorry, just to follow up on the first question clarification. You mentioned it was up 11% up until 25th January, and you mentioned EMEIA was double-digit, but I presume EMEIA would have benefited from tourism. Can we just confirm if other nationalities, excluding the Chinese consumer, were also up double-digit up until 25th January or what was the trend of Chinese consumer versus other nationalities, just low or mid-single digit, double-digit, just to get an idea?

Julie Brown

Yes, we won't give the split by nationality in terms of the actual growth rates, but it was across all nationalities. Because in EMEIA, for example, we didn't have the benefit; the coronavirus struck just as it was coming to the end, so it was before the Chinese started to travel. So, we were seeing an improvement in all nationalities.

<u>Question 2</u>

Antoine Belge, HSBC

Two questions. First of all I think you mentioned in your presentation that there's been some hero outerwear performance, could you maybe elaborate a bit on that, especially around the work that Riccardo has done around the trench coat? And also you mentioned accessories outperforming in the lockdown period, so can you also comment a bit on the leather goods and your small leather goods etc.?

My second question relates to the outlook for the gross margin in the fiscal year 2021. I'm not asking you for guidance, but is it fair to say that with the £68m inventory provision, which includes I think a lot of provision on current merchandise that the risk of gross margin pressure is reduced? Thank you.

Marco Gobbetti

Okay, Julie maybe I'll take the first question and you take the second.

Julie Brown

Yes, sure, thanks Marco.

Marco Gobbetti

So, Antoine, in terms of the first part of your question on outerwear I think we have seen in general a good performance of ready-to-wear, particularly with menswear but also with womenswear. And in the outerwear category I think particularly with the men's, with the down jackets and the quilts, which were the objects of a focus for us, both from a product point of view and from a communication point of view, we had very strong results at the end of the year around festive and as we were trading in January and accelerating in January.

For the second part in terms of accessories I think that up until the COVID outbreak we were really seeing a very positive trajectory, and we spent time last time discussing how we rebuilt the architecture of the handbags collection and the leather goods collection in general throughout last year. And I think that we were really starting to see the fruits of all that work that we have done.

We are seeing now, which is the most encouraging thing, as markets reopen now we are also seeing a strong pickup of the leather goods category. It is accelerating quite strongly. And the important thing is also that it is not just one item but there are several items in the handbags and in the small leather goods category that are really driving this growth.

I think that what we're seeing is the work is paying off, the sales are all made by new product. I think at the end of what I can see as pre-COVID our sales were, I think, 98% made of new items. So we have transitioned and I think now we have a very strong platform that we can build on. It's of course, as I always say, a mid-term journey not something you solve in two or three seasons, but I think we have a much, much stronger platform now to base the growth of the category. Julie, over to you.

Julie Brown

Yes, okay, thank you very much. In terms of the gross margin yes, the inventory risk has been reduced by the provision. Again, it's very similar to the impairment though. If we found that we had over provided for the inventory, clearly the reversal would also go below the line in the exceptionals. In terms of what we're seeing, normally we've got a very clear inventory policy that we apply every year, and it's usually the older seasons that get a provision attached to them. However this year, and very unusually, we've got the provision also attached to the current season and the season prior to that, simply because of having 60% of our stores closed and the network unable to sell through that inventory to the same degree. So we've made a provision based on the scenarios I mentioned.

There will be puts and takes on this, you know, pluses and minuses, we true it up inevitably as we sell the product line through, but as I said, in the statutory accounts we'll see a benefit to gross margin from this, but in the management accounts the adjustment goes below the line. And it'll really depend on the virus, how it pans out, and the ability to reopen the stores with social distancing in place.

Antoine Belge

Thank you. Just a clarification on a previous question. So the impairment test, is it fair to say that it's really an IFRS 16 obligation, i.e., without IFRS 16 you wouldn't have had to book those impairment tests on leases?

Julie Brown

IFRS 16 has changed the basis on which we would do this. Under the previous standard we would have taken what's called onerous lease obligations. So again, if the lease was in excess of the potential value of your future cash flows you'd still take what's called an onerous lease obligation. But now, under IFRS 16 you effectively capitalise lease obligations onto the balance sheet as assets and then you're reviewing the value of those assets. I mean, we can go into this in a bit more depth if you like separately, but the rules are different now as a result of IFRS 16, which does require you to take an overhead allocation, for instance, which makes a difference. But no, there would have been a provision under the old basis, but it wouldn't have been formulated in the same way.

Question 3

Luca Solca, Bernstein

Yes, good morning. I have a question on your announcement that more capsules will come to the market. Are you planning to internally develop those 100%; or do you plan to engage other brands to magnify the potential draw and traffic impact on stores and digital?

And a second question on digital, speaking of which, and its relationship to wholesale, what swap do you expect in these two channels going forward? Is it fair to anticipate that wholesale will significantly further reduce, given what is going on, for example with the US department stores and their bankruptcies? And at the same time where do you see the most important opportunity for you in digital mono brand, so Burberry.com or platforms? Thank you very much.

Marco Gobbetti

So, good morning, Luca. In terms of capsules, I think we are planning to do both. I think we're planning to do internal development, but at the same time we don't exclude collaborations. I think we have had a number of successful capsules in this past year, and I think we have great plans for new capsules that are going to come up during the year. So we're quite excited about that. Those capsules are also all supported by excellent, very engaging content that has been prepared. We have seen the launch now in China, just now we launched our handbag campaign. It's the first time that we've done an exclusive campaign on handbags, and that will support also some local capsules because we have some product that is exclusively produced for China. And later on we'll roll that out also to other markets later in the year, as markets will ease out of lockdowns.

In terms, and I'm speaking about handbags, but there will be other capsules actually that will come out, and in fact there is one that will come out in July that I won't disclose now, but that I think is also extremely exciting.

In terms of the digital and wholesale, well clearly we think that this crisis is having an impact on wholesale, in particular in America. From our point of view I think we had completed our reorganisation of wholesale and we are already focused on our key partners in the key locations. So I think the crisis fortunately arrives when this work has been completed, so we're standing on a pretty solid platform. Nevertheless, we are monitoring what is happening in America, we're partnering with our customers, with our retail partners, and clearly we support them when it's necessary, and they are really supportive of the brand as well.

So we think that this crisis is going to accelerate what we call the DTC, so direct to consumer, and digital is clearly a very important element of that. So we are honestly quite pleased with the way that our digital has performed, both before the crisis and during the crisis and how it's performing now in markets that are coming out of the crisis where we see strong growth. And as we announced last time, if you remember, Luca, we are opening our first social retail store in Shenzhen. The plan is going ahead, and we will open it within the year, hopefully during the summer.

And I think we're very excited about that, it's a partnership with Tencent. There is a lot of innovation that is in the store and it responds, I think, very well to probably some of the changes that this crisis will bring about in terms of the customer really using physical and online in the same trajectory, in the same journey of inspiration and shopping in the stores. So I think we are well positioned for the trends that we think will come out of the crisis.

<u>Question 4</u>

Elena Mariani, Morgan Stanley

Hi, good morning. Thanks very much for taking my two questions. My first one is going back to the way you're going to manage inventory, perhaps could you be a little bit more precise in terms of what you plan to do, given that you're now not destroying any products. Also, if I understand correctly, you're not buying back from your retailers. So how do you intend to reconcile dealing with this excess inventory with your long term journey of brand elevation, given that you're literally in the middle of it and probably control over discounting activity is very much key?

And then my second question is about your cost control. Clearly you've shown great control and you've found a way to anticipate some of your savings from fiscal year 22 to fiscal year 21, could you remind us of where exactly those savings are coming from? And also perhaps what has been the trend in advertising as a percentage of sales? I know that you don't disclose the precise number, but has that been stable in the last part of fiscal year 20? Do you plan to keep it stable even in fiscal year 21, or do you find some area of savings also there? I'm just trying to understand your balance between cost control versus brand building and investing. Thank you.

Julie Brown

Okay. Marco, do you want me to take the cost one and you'd like to take the inventory?

Marco Gobbetti

Sure. Shall I start?

Julie Brown

Okay, yes, you go ahead.

Marco Gobbetti

Sure. Well clearly, as Julie has already explained, we're managing inventory very closely. I think we've taken a number of actions in order to manage our inventory, we have adjusted our orders for autumn, reacting very quickly as soon as we saw the first signs of COVID. We are also somehow shifting a little bit our calendar, so we're trying to somehow use some of the time now that is in terms of the recovery that we're seeing in certain markets, and if other markets also are easing out of lockdowns we will extend our Spring/Summer selling, and probably shift Autumn deliveries.

We have done a lot of work on product assortment going forward. In terms of the collections, that will come out very soon now, and they will deliver in November. So that we are really developing collections for what is going to be for clients to buy at that time, at the time they come out. There is, I think, a calendar adjustment that will be one of the changes that will happen as a consequence of the crisis. We're also moving products around the globe very quickly, and obviously focusing on the markets that are rebounding more strongly.

In terms of the excess inventory, clearly we are committed to our no destruction policy. After having optimised our sales channels in terms of markdown and outlet, we have put in place, and we have already experimented, activities in terms of recycling, upcycling, donations, staff sales. So we have a number of actions that we take to manage our inventory. Julie, do you want to speak about cost?

Julie Brown

Thanks very much for the question. In terms of the cost saving I'll talk about three levels. The first one is, as you know we had an original cost saving programme that we'd accelerated and delivered a £20m benefit this year. That's relating to efficiency, operating model, process simplification and procurement changes. As you've seen from that, we're now accelerating that to deliver cumulative £140m by full year 21. This has put us in a good position in terms of process excellence, agility and efficiency in the business. Also very, very clear transparency of the cost base and ownership, to allow us to respond to a situation that we then found ourselves in with coronavirus. So when we hit the coronavirus issue at the end of January, I think we were an organisation that was well prepared for this sort of situation as Marco's has described commercially, but I think also financially.

In terms of the savings this year to give you a bit more flavour, there are three major areas. I would say that one major area relates to variable cost savings, and savings that needed to be made based on the new environment that we found ourselves in. This was the cancellation of some events, because clearly we had closures occurring in the West. We had planned, for instance, for a China fashion show, which then we had to stop. So it relates to very much situational changes that we made to the cost base.

The second area also related to performance related pay changes. We decided to make the decision to freeze the merit increase this year. We also took pay reductions, 20% pay reductions for three months at the Board level and also at the senior management level. So all these things were put in place and will now benefit full year 21 as well as the residual part of full year 20. So I think it was a very dynamic and proactive approach.

Turning to the following year, clearly the basis on which we've planned this is to be entirely flexible depending on how the scenarios pan out. As I've mentioned, we've got cost mitigation in place, but we've also built in considerable agility to respond when markets rebound. Already because we're seeing such very promising signs in China and Korea, for example, Marco's mentioned the leather goods campaign that's already going live in China. So we're being very flexible about the marketing spend in particular that you raised, and getting the right balance between brand building and cost mitigation.

Marco Gobbetti

If I may add on this. As Julie said, flexibility and agility in this context is clearly the key. We will dial up the spend in the markets where we see that the customers have returned to a positive behaviour on spending, as we are doing now in China. We'll do the same in the other markets as they ease out of lockdowns. But the important thing is, I refer to what I said in the presentation, it's about localisation now. We have, I think, fantastic content that is coming out over the next six months, and we had already started on the direction of localising content. We will see also more and more of this following the COVID outbreak. I think as we said, with less customers travelling we will localise and focus even more tailor-made campaigns for different markets depending on the phase of recovery they will be in.

Elena Mariani

Thank you. Just one small follow up on the inventory management. Given you're rebuilding your replenishment products, and I remember that back in December you were saying that you're basically now almost 100% fashion given that the old styles were declining. Where are you in the process right now, and is there a reliable split between fashion and evergreen that you can give us based on where you are? And again a small follow up. In terms of outlet usage, do you intend to use outlets more, increase the number of products there, the breadth of discounting? How do you think that about that channel just in the context of protecting your brand equity?

Marco Gobbetti

In terms of the product, as you saw in the presentation, I think we are now close to 100% of new product. As I mentioned before in outerwear, we have had a lot of work that has been done on outerwear in terms of quilts, in terms of down jackets, in terms of the fashion part and seasonal part of heritage. So even in categories like outerwear we are building what we call the new icons for the future. But it's too early at this stage to separate and to get clear indication from those items, because they basically have been just coming to market or will be coming to market. We need to give them the physiological time, the lifecycle of product, to see them over a period of two/three seasons before we can have indications that are reliable in terms of their performance.

The same thing is for accessories, even more. As I said, virtually today I think 100% of our sales are coming from new items. So as we build those items out, as we create also seasonal variations, we will be able to assess the strength of the item, of the body, and the capacity it has to last over time. So I think this next year is probably what we need to establish a platform and a base for analysis in that respect.

In terms of outlets, I think that we are not planning to dial up outlets. We are planning to use outlets tactically in this situation in order to perform their reason to exist, the physiological reason to exist of an outlet, which is the end of life of the product. So we're not planning to dial up, we're just planning to use them. I think it's good to have them in this situation and in this crisis, because as there is some excess inventory they can be one of the channels that will help us to liquidate through that, and without also disturbing too much our full price customers which tend to be polarised in full price stores. So there is very little overlap between the two channels.

Concluding comment: Julie Brown

Thank you everybody for joining the call. I appreciate we still have a number of calls on the line, but in the interests of time we're more than happy to take the questions later today. We wish everybody a really good weekend, and we hope everybody stays safe. Thank you very much.

Marco Gobbetti

Yes. And I'd like to share the thanks from Julie, thank you very much for this call. We hope all be well and be safe. Thank you.