BRYAN, GARNIER & CO

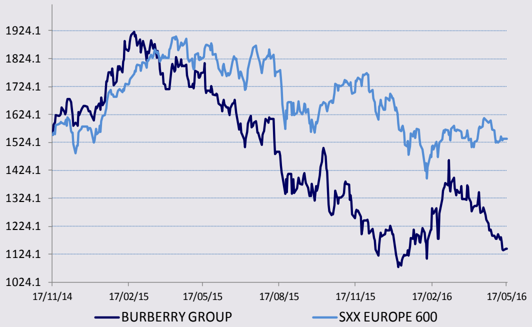
INDEPENDENT RESEARCH

19th May 2016

Luxury & Consumer Goods

Bloomberg	BRBY LN
Reuters	BRBY.L
12-month High / Low (p)	1,808 / 1,078
Market capitalisation (GBPm)	5,087
Enterprise Value (BG estimates GBPm)	4,450
Avg. 6m daily volume ('000 shares)	2 284
Free Float	100%
3y EPS CAGR	2.6%
Gearing (03/15)	-38%
Dividend yields (03/16e)	3.24%

YE March	03/15	03/16e	03/17e	03/18e
Revenue (GBPm)	2,523	2,515	2,630	2,735
EBIT(GBPm)	455.0	417.8	420.0	485.0
Basic EPS (p)	0.75	0.69	0.70	0.81
Diluted EPS (p)	76.75	69.90	71.84	83.01
EV/Sales	1.80x	1.77x	1.65x	1.53x
EV/EBITDA	7.8x	8.1x	7.7x	6.7x
EV/EBIT	10.0x	10.7x	10.3x	8.7x
P/E	14.9x	16.4x	15.9x	13.8x
ROCE	49.0	41.4	40.2	45.3



Burberry

Too early to sing in the rain!

Fair Value 1200p (price 1,143p)

NEUTRAL

Coverage initiated

We are initiating coverage of Burberry with a Neutral recommendation and a Fair Value of 1,200p. In a luxury sector enduring a slowdown in growth, Burberry is likely to underperform the sector in 2016/17 as was the case in 2015/16. In our view, Burberry suffers from a riskier profile compared to peers. The share is trading with a small discount vs the sector average on 2016 EV/EBIT.

- Burberry is a global luxury brand. However, its current profile looks riskier than some of its peers in view of i/ its relatively lower weight in retail (73% of sales) compared with some most comparable rivals, ii/ over-exposure to Chinese customers (37% of sales vs. an average of 30% for the soft luxury sector), and above all, iii/ very high exposure to Apparel (53% of sales), the most volatile and most competitive segment in the luxury industry.

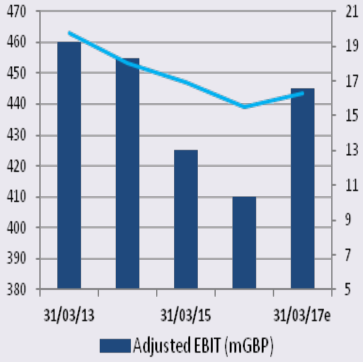
- In 2015/16 (end March 2016), Burberry sales declined 1% a same forex (underlying) including a 1% increase for Retail network (-1% at same stores including -5% in Q4 alone). Consequently, and given a 5% OPEX increase at same forex, EBIT margin (GBP418m) declined 140bp to 16.6%.

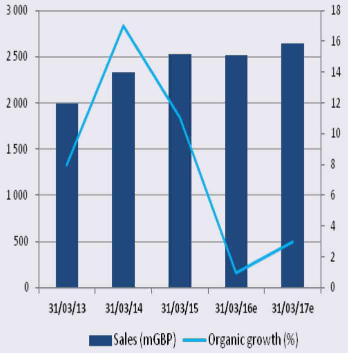
- For 2016/17, we are expecting sales to stabilize at same forex, of which a 2% increase for Retail (stable at same stores). EBIT should remain unchanged despite cost savings program that will have a positive GBP20m impact this year (GBP100m on three years). EBIT margin should therefore decline 60bp to 16.0%.

- Even though Burberry is 100% free float, we do not believe in a modification of the UK group's capital. Indeed, the size already reached (market capitalisation of GBP5bn or EUR6.5bn) and the group's high dependence on ready-to-wear/Apparel does not make it an ideal candidate for an acquisition. Our Fair Value of 1,200p is the result of a DCF valuation (WACC of 8.9% and growth to infinity of 2.5%). With a 11x 2016 EV/EBIT, the stock is trading with a slight discount versus our luxury sample average.

Analyst:
Loïc Morvan
33(0) 1 70 36 57 24
lmorvan@bryangarnier.com

Sector Analyst Team:
Nikolaas Faes
Antoine Parison
Virginie Roumage





Company description

Burberry, british brand founded in 1856 by Thomas Burberry, worldwide known for its trench coat, is a major player in the luxury industry. The group pofits from clear strengths (a glbal and diversified brand, an efficient digital strategy and an healthy balance sheet). Nevertheless, Burberry is currently penalised versus its peers by i/ a too small % of sales achieved via Retail even if this weigth is improving; ii/ an over exposure to the Chinese clientele (37% of sales, on of the highest in the sector) and iii/ a too high % of sales achieved with Apparel (53% of sales). Floatting is 100%, hence Burberry is one of the very few luxury european brands without a family control.

Income Statement (GBPm)	**2012**	**2013**	**2014**	**2015e**	**2016e**	**2017e**
Revenue	1,999	2,330	2,523	2,515	2,630	2,735
Change (%)	*7.6%*	*16.6%*	*8.3%*	*-0.3%*	*4.6%*	*4.0%*
Change LFL (%)	*-%*	*-%*	*-%*	*-%*	*-%*	*-%*
Gross Profit	1,442	1,659	1,765	1,763	1,850	1,925
Adjusted EBITDA	539	580	585	550	560	625
EBIT	428	460	455	418	420	485
Change (%)	*16.7%*	*7.5%*	*-1.2%*	*-8.2%*	*0.5%*	*15.5%*
Financial results	4.9	(1.0)	4.3	3.0	3.0	3.0
Pre-Tax profits	350	444	444	416	413	478
Tax	(91.5)	(112)	(104)	(101)	(95.0)	(110)
Minority interests	(4.9)	(9.8)	(4.8)	(5.1)	(4.0)	(4.0)
Net profit	200	323	336	310	314	364
Change (%)	*-24.2%*	*61.2%*	*4.2%*	*-7.9%*	*1.5%*	*15.9%*
Cash Flow Statement (GBPm)						
Operating cash flows	346	445	440	434	455	505
Change in working capital	38.9	80.6	39.5	93.9	17.6	16.1
Capex, net	176	151	154	138	160	150
Financial investments, net	(0.43)	(2.0)	(0.66)	0.0	39.5	41.0
Dividends	114	131	145	157	148	157
Other	59.3	(20.8)	(47.5)	(40.0)	0.0	0.0
Net debt	(297)	(402)	(552)	(637)	(750)	(891)
Free Cash flow	131	214	246	202	277	339
Balance Sheet (GBPm)						
Cash & liquid assets	426	546	617	712	802	943
Other current assets	540	665	717	783	818	851
Tangible fixed assets	409	398	437	426	446	456
Intangible assets	210	195	194	190	190	190
Other assets	160	161	209	203	203	203
Total assets	1,746	1,966	2,173	2,314	2,460	2,643
LT & ST debt	130	143	65.2	51.5	51.5	51.5
Other liabilities	564	615	657	642	660	676
Shareholders' funds	1,053	1,208	1,452	1,621	1,748	1,916
Total liabilities	1,746	1,966	2,173	2,314	2,460	2,643
Capital employed	790	845	921	1,001	1,038	1,065
Financial Ratios						
Gross Margin (% of sales)	72.15	71.19	69.97	70.10	70.34	70.38
Adjusted EBITDA margin (% of sales)	26.98	24.91	23.19	21.86	21.29	22.85
EBIT margin (% of sales)	21.42	19.76	18.03	16.61	15.97	17.73
Tax rate	26.14	25.23	23.29	24.30	23.00	23.01
Net Margin	10.01	13.84	13.32	12.31	11.94	13.31
ROE (after tax)	19.68	27.67	23.99	19.71	18.49	19.52
ROCE (after tax)	51.44	54.02	49.03	41.38	40.22	45.33
Gearing	(28.17)	(33.32)	(38.04)	(40.75)	(42.92)	(46.51)
Pay out ratio	40.50	41.78	45.86	52.01	50.61	43.80
Number of shares, diluted	250,000	447,800	447,800	447,800	447,800	447,800
Per share data (p)						
EPS	0.80	0.72	0.75	0.69	0.70	0.81
Restated EPS	1.19	75.26	76.75	69.90	71.84	83.01
% change	*12.8%*	*6 215%*	*2.0%*	*-8.9%*	*2.8%*	*15.5%*
BVPS	4.21	2.70	3.24	3.62	3.90	4.28
Operating cash flows	1.38	0.99	0.98	0.97	1.02	1.13
FCF	0.52	0.48	0.55	0.45	0.62	0.76
Net dividend	29.00	32.00	35.20	37.00	37.00	37.00

Source: Company Data; Bryan, Garnier & Co ests.

Table of contents

1. Investment Case

Why the interest now?

The reason for writing now

We are initiating coverage of Burberry group with a Neutral recommendation and a Fair Value of 1,200p. Within our sample of luxury groups, Burberry, even if the brand is a global one, seems to have the most risky profile compared to its most comparable peers. Therefore, we are currently cautious for this reason.

Cheap or Expensive?

Valuation

At 11.5x, the share is trading with a slight discount versus the average of our luxury stocks in terms of 2016 EV/EBIT. We see no speculative appeal for the share, especially in view of its size (market capitalisation of GBP5.4bn or EUR6.7bn) and the lack of potential synergies in the luxury industry, which in our view would cause any acquisition to destroy value. Our DCF model yields a Fair Value of 1,200p.

When will I start making money?

Catalysts

Beyond macro-economic and currency factors as well as geopolitical risks that are currently affecting the entire luxury industry, Burberry also needs to face the challenge of restoring better sales momentum and operating margin following the 480bp narrowing since 2012 to reach 16.6% in 2015/16). This is set to involve a cost-cutting strategy (operating and industrial costs) as well as the optimisation of its network of directly operated stores.

What's the value added?

Difference from consensus

Our sales and pre-tax profit assumptions for the year are in line with current consensus, given company guidance (close to GBP400m (before cost saving three years plan).

Could I lose money?

Risks to our investment case

The main risks concerning Burberry are i/its high exposure to the ready-to-wear market (53% of sales) ii/ its higher share of wholesale sales than certain peers and iii/ its high dependence on Chinese customers (37% of sales), three factors that increase volatility in the business model in a still-uncertain luxury sector backdrop.

2. A global luxury brand

The Burberry Group is made up of the sole same-named Burberry brand and is therefore a mono-brand company like Hermès and Salvatore Ferragamo.

2.1. Brand history

2.1.1. From 1856 until today

The brand has been founded in 1856 by Thomas Burberry

Burberry is a global British luxury brand founded in 1856 by Thomas Burberry at the age of 21. As of 1879, the first model of the famous water-proof trench-coat emerged and the first London-based store opened in 1891. At the beginning of the 20th century, the equestrian logo was created and became the emblem of the British brand. In 1909, Burberry opened its first store in Paris on Boulevard Malesherbes. Then in 1920, the brand was floated on the stock market for the first time. In 1955, it was acquired by UK retail group Great Universal Stores (GUS), and only in 2002 was Burberry listed on the LSE during an IPO following the definitive and total withdrawal of its previous shareholder GUS. Since then the group's free float has totalled 100%.

While product design is carried out entirely at the London head offices, production is handled either internally in workshops located in the UK or outsourced in Europe, with outsourcing accounting for around 80% of production. Whereas leather goods are the roots of brands such as Louis Vuitton and Hermès, like footwear is to Salvatore Ferragamo, Burberry's heritage lies in outerwear.

In 2006, Angela Ahrendts was nominated CEO of the group and remained in the position until May 2014 when she was replaced by Christopher Bailey, the brand's Artistic Director since 2001 who is still in the role today. The group is the only large-sized luxury brand whose CEO is also the artistic director.

2.1.2. Main recent stages in the brand's development

In 1970, Burberry signed a licence agreement with Japanese groups Mitsui and Sanyo Shokai to develop the brand in Japan. However, as of 2000, a downstream integration strategy was implemented with the takeover of the group's former licensee in Spain. The same decision was made in 2002 concerning activities in Asia following an agreement with its retailers. In 2008, Burberry's development in Japan continued thanks to the creation of a joint venture in accessories with historical partners Sanyo and Mitsui. The integration continued in 2010 when the group took control of its distribution in China. A new stage of the brand's development was crossed in 2011 with the creation of the e-commerce website, Burberry.com, which is now present in 44 countries and can be accessed via iPad and iPhone.

Downstream integration continued with the announcement in 2012 that the group was taking back direct control of the perfumes businesses, previously entrusted to InterParfums. This business therefore became the UK brand's fifth division, alongside Apparel for men, women and children, and accessories.

In order to perfect the group's integration, in 2015, Burberry announced it was bringing the Japanese businesses back in-house after the licence agreements expired. This recovery of direct control should enable the brand to expand its presence and roll out the Burberry collections in a owned store network and via e-commerce websites. As of 2014/2015, Burberry therefore opened a flagship DOS in Osaka and relocated its Omotesando stored to Tokyo. Other openings took place during 2015/16.

Finally, in November 2015, the group announced the creation of a single Burberry brand uniting the former *Prorsum*, *London* and *Brit* lines (segmentation was implemented in 2005, whereas the brand was primarily marketed in the wholesale network). This plan is to be carried out during 2016 and should be complete by the end of the year. The move should simplify the presentation of all product lines and eventually prompt cost savings. It also aims to showcase the brand's British heritage, as all of its products are designed and developed in London.

2.2. A global brand, but with a riskier profile at present

Burberry is a global luxury brand diversified by product, distribution network and region, and distributed via a network of directly-operated stores, as well as franchises, present in all regions and in all product types.

A brand with a riskier profile vs most of peers…

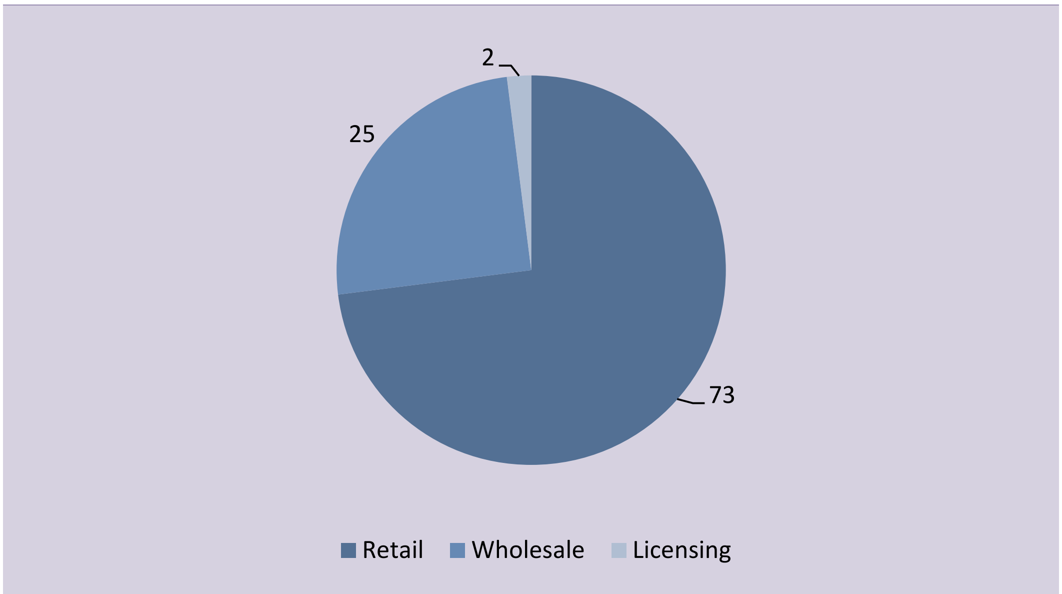
However, relative to certain peers, the UK group's profile seems to us riskier. Indeed, **i/** it is relatively less exposed to retail than other global luxury brands, **ii/** it is highly dependent on Chinese customers who are still volatile and above all, **iii/** the weight of Apparel is far higher than for other luxury groups, meaning Burberry is less resilient in an uncertain backdrop whereas inversely, the weight of leather goods is lower.

…a relatively less Retail exposed than most comparable peers

2.2.1. "Only" 73% of sales derived from the retail network

The Burberry brand derives 73% of its sales from the Retail network compared with 25% for the Wholesale network.

Fig. 1: Breakdown of 2015/16 sales by distribution network (%)



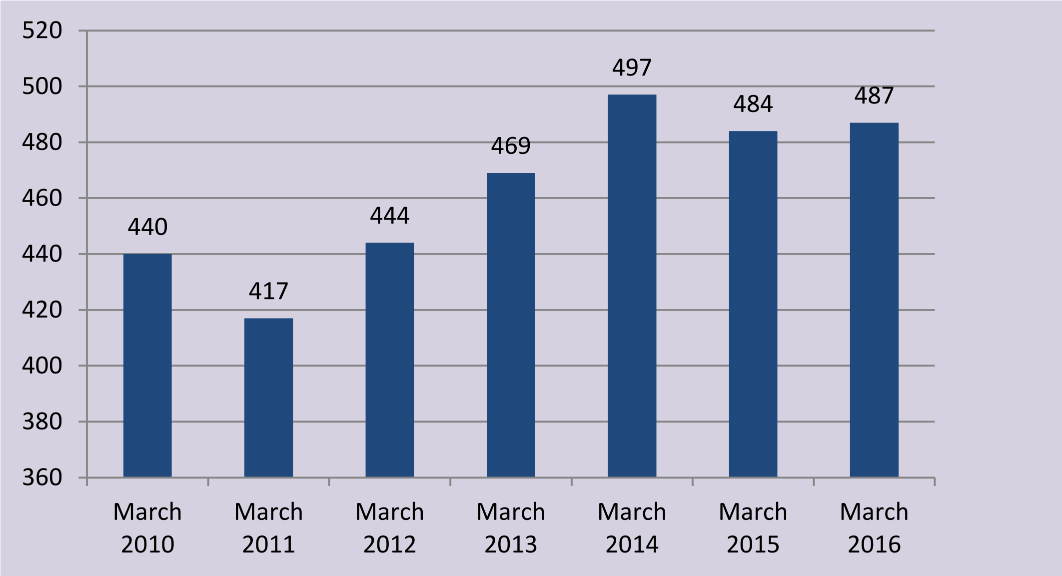
Source: Company Data; Bryan, Garnier & Co ests.

At end-March 2016, the retail network included 487 stores (three more than at end-March 2015) including 215 mainline or free-standing stores, 214 concessions in department stores and 58 outlet stores. During 2014/15, 16 free-standing stores were opened, including those in Los Angeles and Osaka, although these openings went hand in hand with almost as many closures, resulting in an overall change of virtually zero. In 2015/16 (FYE 31st March 2016), 18 free-standing stores were opened (13 in H1 and five in H2), although here again, just as many stores were closed (17 including nine in H1 and eight in H2) or a total of 215 mainline stores compared with 214 at end-March 2015. Similarly, a few airport stores have opened over the past year, after seven in 2014/15. In comparison, Louis Vuitton manages around 485 stores on our estimates (with no outlets) and Gucci 525 with a few outlet stores.

A number of DOS almost unchanged in 2015/16…

During 2015/16, sales in the directly-operated stored network grew modestly (+1%) excluding forex, after rising 13% in 2014/15. On a same-store basis, the decline was even 1% (+1% in H1 and -2% in H2 including a 5% fall in Q4). Few groups provide same-store data (Moncler, Hugo Boss, Tod's, Ferragamo…) thereby making sector comparison difficult.

Fig. 2: Change in DOS network (including outlets)



Source: Company Data; Bryan, Garnier & Co ests.

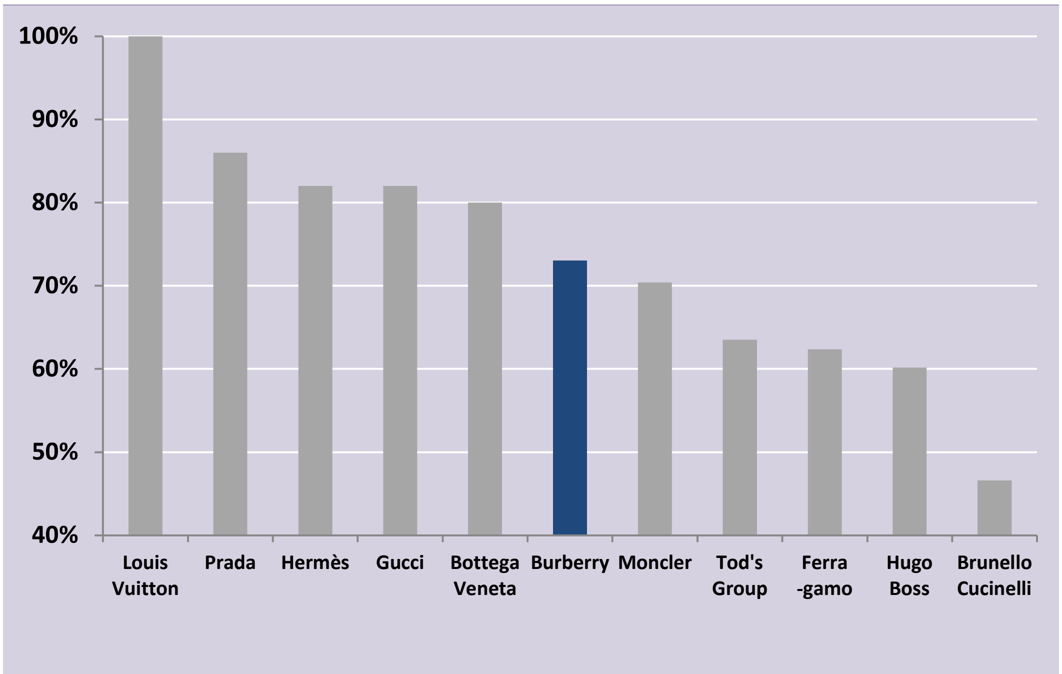
Without mentioning Louis Vuitton, which controls 100% of its store network, this ratio of 73% for Burberry is slightly lower than the average of major luxury brands, which stands slightly above 80% as for Gucci and Hermès, but higher than the weight of retail sales for smaller Italian brands such as Tod's (63%) and Salvatore Ferragamo (62%). Burberry has a similar weight to Moncler (70%).

The gap between the retail ratio at Gucci and Hermès' compared with Burberry is, in our view, due to the UK brand's higher exposure to ready-to-wear and also by the very recent move to bring Japanese distribution back in-house (the potential of which has yet to be fully exploited). This was previously under licence, whereas the country is primarily a retail market for its rivals.

From now on the group's aim is to improve the productivity of its existing stores (see chart below) and to focus on the consumer purchasing experience in order to increase conversion rates and the average basket.

The chart below shows how far Burberry lags behind its peers in terms of the weight of retail sales, which is also similar to the lag in terms of profitability since the retail network is more profitable than the wholesale network, thereby partly explaining LV's exceptionally high margin of more than 40%.

Fig. 3: Comparison of retail network exposure in luxury group sales

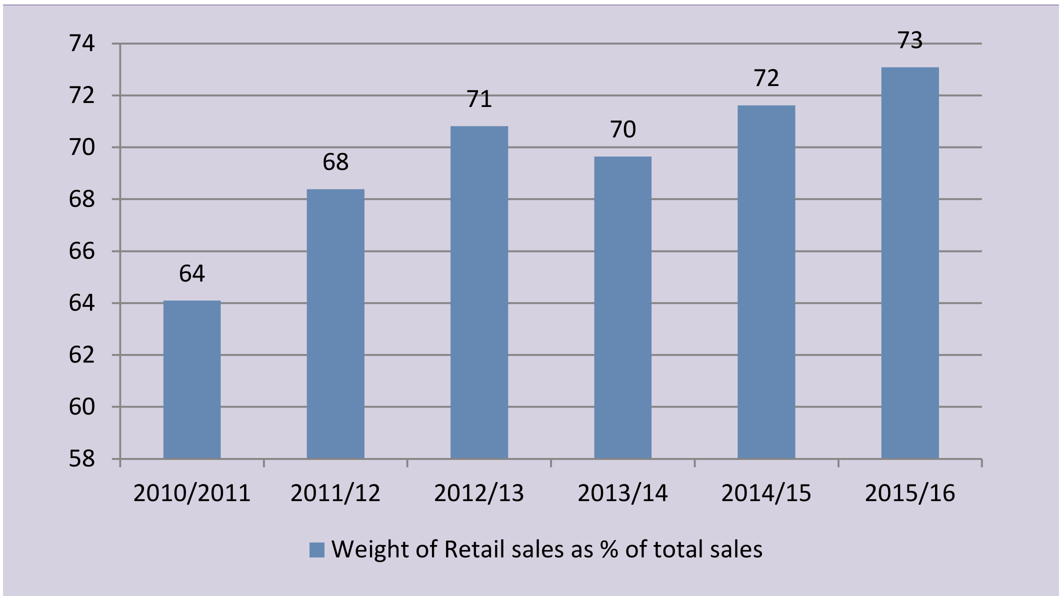


Source: Company Data; Bryan, Garnier & Co ests.

With only only one free standing store opening

In addition, the weight of the retail network has not changed much over the very recent period. Indeed, it already accounted for 71% of sales in 2012 (and 40% in 2006) and the figure is unlikely to change much in coming years, unless perhaps the return of Japanese distribution to the group's control has an impact. In contrast, the ratio did increase considerably between 2009 and 2012 (see chart below) corresponding to growth in same-store retail sales of more than 10% (+14% even over 2011/12). The relatively stable recent figure has been due to the weak performance in same-store sales as well as the pace of store openings, which has slowed recently and is not likely to pick up again in coming years in our view, and could even fall again as was the case in 2014/15. During 2015/16, only one store was opened (net of closures).

Fig. 4: Change in weight of retail sales in overall sales



Source: Company Data; Bryan, Garnier & Co ests.

Nevertheless, Retail sales development is clearly strategic for Burberry management. This move should be more achieved through stores extension and higher sales per square meter and per store than stores openings.

The 25% of sales generated by the wholesale network stems from around 62 franchised stores (end of March 2016), points of sale in department stores, multi-brand stores and the travel retail network. In addition, beauty (sales of GBP203m in 2015/16) is marketed via 80 specialised retailers as Sephora.

Almost 2% of sales stem from licence agreements, essentially in Japan but also in eyewear (Luxottica) and watches (Fossil), although this latter agreement will not be renewed after December 2017. The licence in Japan expired during the year ending March 2016, hence the plunge in the weight of licence revenues (3% in 2014/15), from GBP68m in 2014/15 to GBP42m in 2015/16. A further decline (estimated at GBP20m by management) is also expected for 2016/17.

Similarly, particular efforts are being made to develop the weight of e-commerce sales and especially for mobile usages on iPhone and iPad. Ipad in-store sales account for 25% of digital sales. In addition, management has undertaken a strategy with e-commerce retailers to improve traffic and activity via this network. The e-commerce site is present in 44 countries.

Finally, the travel retail network (15% of wholesale sales and 2% of Retail) is also a future growth opportunity for the Burberry given the expected increase in global tourism (3-4% a year for coming years). In 2015, for example, more than 120 Chinese tourists travelled abroad, including largely to Hong Kong, whereas this figure is set to rise to almost 200 million by 2020. Note that almost 45% of the global luxury market (EUR253bn in 2015 according to Bain & Cie) is generated by tourists and this figure even stands close to 80% in Hong Kong, 60% in Europe, but just 20% in the US and no more than 10% in Japan, despite the influx of Chinese tourists in 2015 given sales price differences between Japan and China.

As such, the brand is indeed present in the main global airports as shown by the table below:

Fig. 5: Main airport sales points

Rank	Airport	Country	Total PAX in 2015	% change vs. 2014	Burberry	Ferragamo	Moncler	Hugo Boss	Prada/ Miu Miu	Tod's
1	Atlanta	USA	101.5	*5.1*	0	2	0	0	0	0
2	Beijing	China	89.9	*4.4*	0	3	0	1	0	0
3	Dubai	UAE	78.0	*10.7*	0	0	0	0	0	0
4	Chicago	USA	76.9	*9.8*	0	1	0	0	0	0
5	Tokyo Haneda	Japan	75.3	*3.5*	0	1	0	0	0	0
6	London Heathrow	UK	74.9	*2.1*	4	0	0	3	1 / 1	0
7	Los Angeles	USA	74.9	*6.0*	0	1	0	0	0	0
8	Hong-Kong	HK	68.5	*8.1*	1	1	**1**	1	1 / 1	0
9	Paris	France	65.8	*3.1*	1	0	0	1	3 / 1	1
10	Dallas	USA	64.2	*1.0*	0	0	0	0	0	0
11	Istanbul Ataturk	Turkey	61.3	*7.7*	1	0	0	0	0	0
12	Frankfurt	Germany	61.0	*2.5*	1	1	0	1	0	0
13	Shanghai Pudong	China	60.1	*16.3*	0	2	0	1	0	0
14	Amsterdam	The Netherlands	58.3	*6.0*	1	0	0	0	0	0
15	Jakarta Soekarno	Indonesia	57.0	*0.0*	0	0	0	0	0	0
-	**Total**	**-**	**-**	**-**	**9**	**12**	**1**	**8**	**5 / 3**	**1**

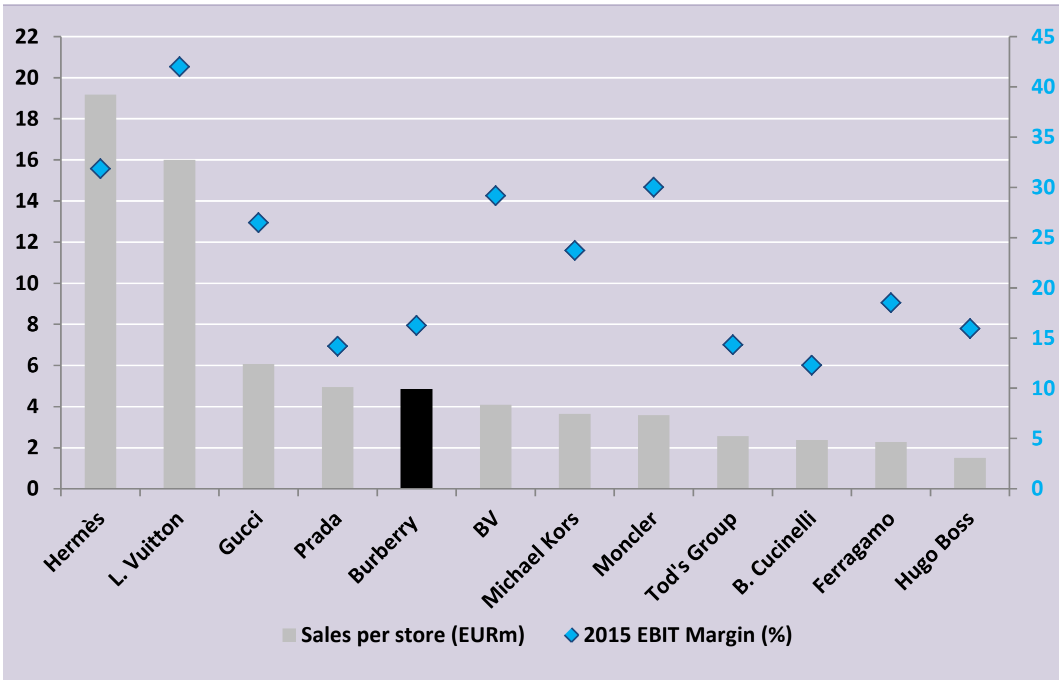
Source: Airports Council International, Company Data, Bryan, Garnier & Co ests

The chart below highlights the fact that Burberry is less performant than other luxury brands in terms of sales per store, at EUR5m compared with EUR20m for Hermès and EUR16m for LV.

Sales per owned store below its most comparable peers!

The explication for this difference in productivity per store, which also implies lower profitability, lies among other factors in the breakdown of sales by business. Whereas LV and Hermès generate a higher weight of sales in fashion goods (respectively 75% and 50%), at Burberry, this ratio stands at just 35% and leather goods generate the highest profitability levels in the sector. The ready-to-wear segment implies bigger stores, for instance, fitted with changing rooms.

Fig. 6: Average sales per retail store of EUR5m



Source: Company Data; Bryan, Garnier & Co ests.

Comparison of sales per square metre could be more relevant, but with no information provided on this front by the majority of brands in the sector, we must make do with sales per store.

2.2.2. 37% of sales generated by Chinese customers

38% of sales achieved in APAC!

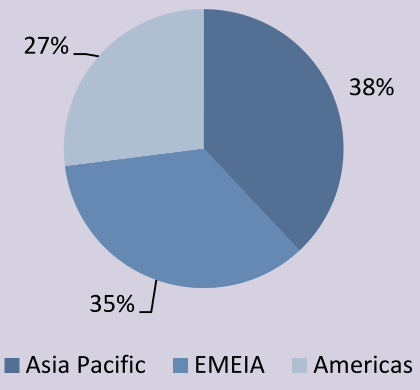
Like other luxury sector groups, Burberry is highly exposed to Asia-Pacific, which accounts for almost 38% of sales, whereas the weight of Europe-Middle East (EMEIA) stands at 35% and that of the Americas at 27% (20% for sector average). Japan (included in Asia) only accounts for 2% of sales given the licence agreement for this country even if this expired during the past year. Japan is breakeven.

Within the Asia-Pacific region, mainland China represents, according to our estimates, 14% of sales at the brand compared with an average of 10% for luxury groups. Similarly, Burberry derives 9% of its sales from Hong Kong and Macao, in line with the sector average. Despite the current backdrop in the former UK colony and the difficulties in negotiating leases with landlords, all of the brand's stores in the country are extremely profitable, which is also the case for the majority of other brands in the sector. In Asia-Pacific, the group also benefits from growth potential in South-East Asia (Indonesia, Vietnam, Thailand etc.) and healthy momentum at the moment in Singapore, like other luxury brands.

Note importantly that in Asia-Pacific (almost 63 free-standing stores and 143 concessions), the weight of the retail network is closer to 85% of sales compared with a ratio of around 65% in the Americas and in Europe. As such, the UK group is suffering especially from the current situation in Asia.

In North America, the aim is to move the existing flagships upscale via extensions and renovations and even relocations, as for the Rodeo Drive store in LA. 70% of Americas sales are done with retail network.

Fig. 7: Breakdown of 2015/16 sales by region



Source: Company Data; Bryan, Garnier & Co ests.

We estimate the weight of Burberry sales generated in the UK at almost 14% of total group sales (UK and Middle-east together account for 40% of Retail sales), which is far higher than the sector average of around 5-6% (France accounts for almost 7% of the global market). In addition, as an example, London is the third-largest city in the luxury sector accounting for almost 4.5% of the global market compared with slightly more than 5% for Paris and 11% for New York. Recent indications provided by certain luxury operators including Burberry highlight the fact that the UK has also suffered negative fall-out from the Paris and Brussels terrorist attacks, albeit to a lesser extent. LVMH's CFO recently stated that Louis Vuitton sales in Paris had dropped double-digit during Q1. In contrast, Hermès stores located in the French capital enjoyed a slight increase in sales.

And above all close to 40% of sales achieved with Chinese clientele!

Far more importantly, given the increasingly high amount of travellers, the breakdown of sales by customer nationality looks more relevant than the breakdown by region. Indeed, on our estimates, Chinese customers represent 37% of Burberry's sales, including 32% from mainland China alone, vs. 22% for Tod's and 28% for Louis Vuitton, but 38% for Prada. Alongside Prada, Burberry is the luxury group the most exposed to Chinese customers as shown by the table below.

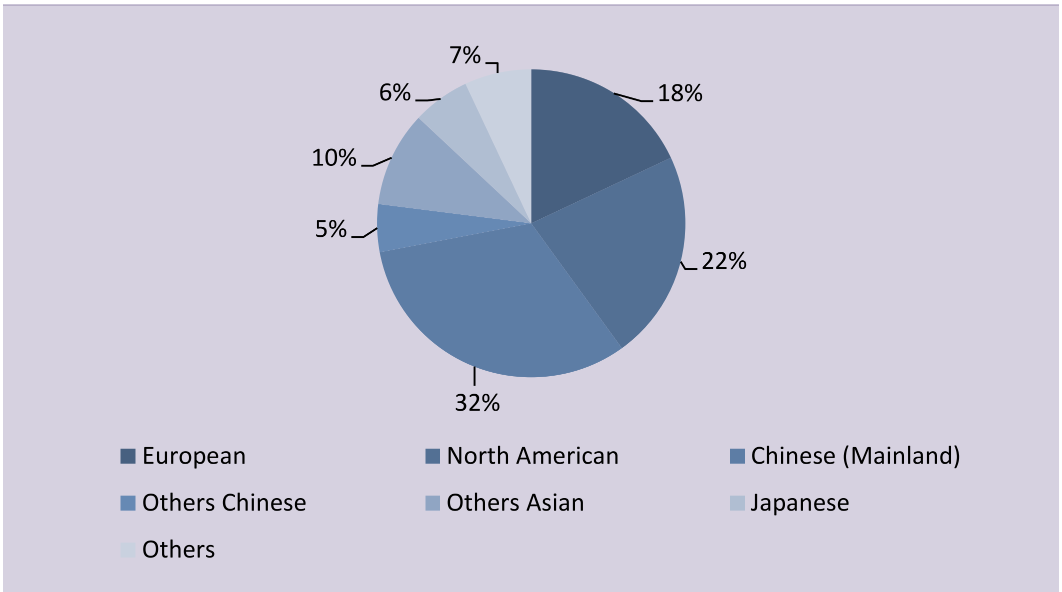
Fig. 8: Breakdown of sales by nationality (estimated)

	Burberry	LVMH	Kering Luxury	Hermès	Prada	Ferragamo	Tod's
European	18	20	21	21	13	15	43
North American	22	17	18	13	11	18	10
Total Chinese	37	27	38	29	40	31	28
Japanese	6	11	13	13	12	12	6
others	17	25	10	24	24	24	13

Source: Company Data; Bryan, Garnier & Co ests.

Chinese customers are by far the largest nationality for the Burberry brand (as for the majority of global luxury brands) whereas US and European customers account for respectively 18% and 22% of sales. Japanese clients represent 5% of the brand's sales. **The dominant weight of Chinese customers is currently a handicap for the UK group and is the second factor that accentuates the group's riskier profile.**

Fig. 9: Breakdown of Burberry 2015/16 sales by customer nationality (est)



Source: Company Data; Bryan, Garnier & Co ests.

2.2.3. Ready-to-wear accounts for 53% of sales!

Third relative weakness: un important weight of Apparel!

A third relative weakness in our view is that the Burberry group has such a high proportion of ready-to-wear/apparel in its sales. The segment represents 53% of the group's sales, which is one of the highest levels in the sector, where the average stands at 24% (50% for the men's segment and 50% for women's) according to Bain & Cie. Meanwhile accessories, including leather goods (16% of total market) represent 30% of the global market compared with 35% of sales at Burberry.

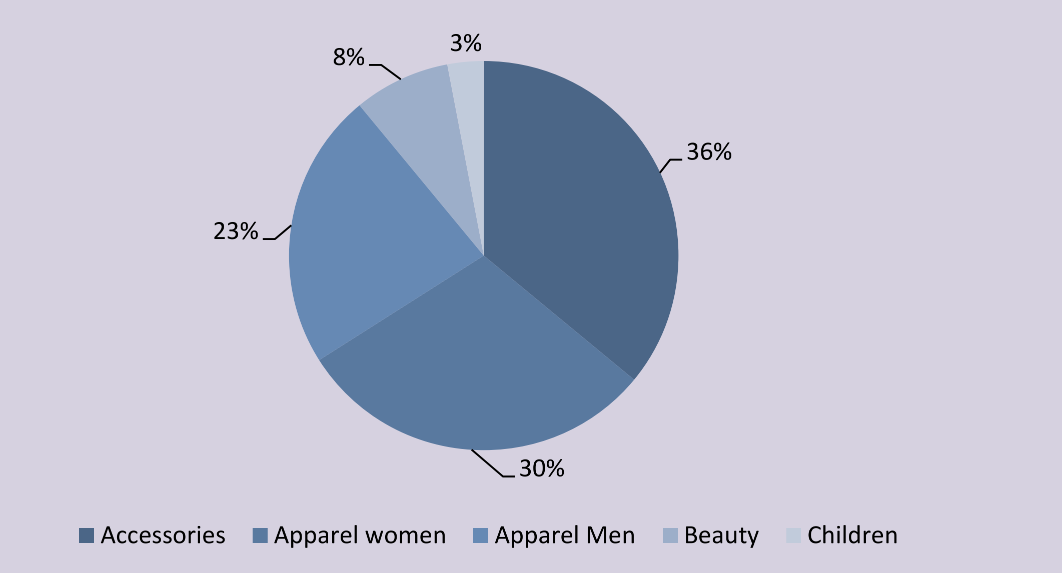
Fig. 10: Breakdown of global luxury market by main segment

in %	2014	2015	chge %	LFL chge %
Accessories	29	30	15	3
Apparel	24	24	13	2
Hard Luxury	23	22	10	-3
Beauty	20	20	13	1
other	4	4	10	1
Total (EURbn)	**224**	**253**	**13**	**2**

Source: Bain & Cie, Company Data; Bryan, Garnier & Co ests.

At Gucci and Hermès, the ready-to-wear clothing business only accounts for 15% of sales, or even 10% at Louis Vuitton on our estimates. These differences highlight the UK group's more volatile profile, which is in our view less beneficial since visibility is cloudier given the more cyclical nature of the apparel business compared with leather goods, and the business is especially dependent on the success of seasonal collections, without mentioning weather effects. To illustrate these differences, Bain & Cie estimates that the accessories segment was more dynamic in 2015 (+3%) than ready-to-wear (+2%), which rose in line with the sector average.

Fig. 11: Breakdown of 2015/16 sales by business



Source: Company Data; Bryan, Garnier & Co ests.

Burberry's management nevertheless capitalises on its heritage to seize growth opportunities in the trench coat segment, whereas 50% of the brand's sales stem from outerwear. A new production workshop focused on the trench coat is set to open in the UK in 2019.

Furthermore, the men's suits segment is also a source of future growth for the brand based on British know-how in this field. The same goes for men's accessories. Indeed, the luxury menswear market (apparel and accessories) has been more dynamic than women's clothing in recent years.

This breakdown of sales makes Burberry a fairly specific luxury market player and less attractive than others in our view, since it is far more sensitive to fashion trends and collections as well as weather conditions, which in our view makes it a more volatile brand with a higher risk profile. At the same time, accessories and especially leather goods account for just 35% of sales whereas this ratio is far higher for other brands (60% at Gucci and even 70% at LV and Hermès for example). Furthermore, competition in the apparel segment is intense and Burberry is not positioned in a niche market unlike Moncler for example.

In 2015/16, accessories sales rose by 1% lfl (+12% in 2014/15) compared with a decline of 2% for women's Apparel (despite the success of trench coats and dresses) and for men's clothing whereas in 2014/15, Apparel outperformed the accessories business with suits having driven growth. Men's accessories account for 20% of overall accessories sales (80% for women). In 2015/16, the accessories business was therefore more resilient than Apparel in a difficult backdrop, which is not surprising.

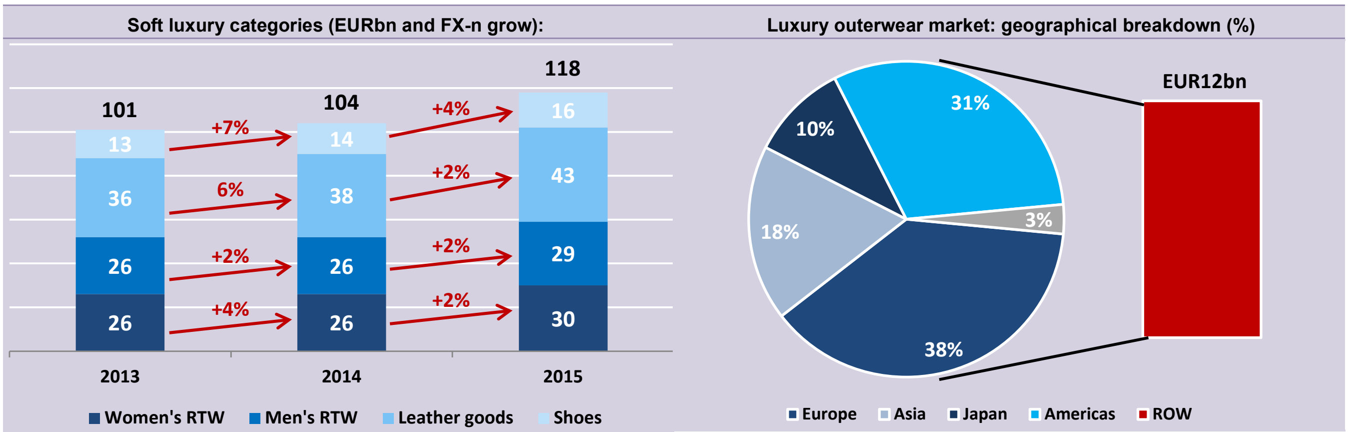
Beauty sales rose by 8% same-currency in 2015/16 (+26% in 2014/15). Here is another potential source of future growth, with the brand still under-penetrated in the market, which is valued at around EUR50bn (20% of the global luxury market) and which gains 5% on average per year, higher than the luxury sector average. Make-up accounts for less than 5% of Beauty sales.

The e-commerce business is far from negligible at Burberry, accounting for almost 8% of the brand's sales, according to our estimates (Burberry management does not disclose this figure), compared with less than 5% for the majority of other brands in the sector.

The outerwear market (50% of sales), in which Burberry operates partially, grew by almost 5% over 2011/14 (+7% on average for the luxury sector) and accounts for a total of EUR12bn, or just 5% of the total luxury market.

The outerwear segment is mostly present in Europe (38% of the market) and in the Americas (31%). Unsurprisingly, Asia-Pacific is a less important market for this segment, accounting for 18% of the market, compared with almost 30% for the luxury sector average. In contrast, Asia-Pacific is above all a sizeable market for leather goods and watches.

Fig. 12: Change in upscale outerwear clothing segment



Source: Altagamma, Bain & Company, Company Data, Bryan, Garnier & Co ests.

3. 2015/16 penalised by mainland China

Like all other brands in the sector, Burberry was negatively affected by the difficult luxury market backdrop in Q4 (January-March), especially in Asia-Pacific (primarily in Hong Kong) and in Europe (due to the Paris and Brussels terrorist attacks), but also in the US due to difficulties in Department Stores. The UK group's high exposure to Chinese customers (37% of sales) is another handicap at present. Furthermore, recent statistics from Global Blue have not been very encouraging for the sector with lower tourism activity especially for Chinese travellers in the first few months of 2016.

3.1. No sales growth in 2015, performance below the sector average

Whereas in 2014/15, retail/wholesale sales rose by 11% on a constant currency basis (+9% in reported terms), growth stood at zero (underlying) in March 2016 at GBP2.47bn, pointing to a fresh slowdown in H2 (stable) after a 1% increase in H1. The deterioration in H2 was also in line with performances of other operators in the luxury sector. Burberry does not communicate quarterly sales trends for the entire group but just for its retail network (see below). Total Burberry sales reached GBP2.51bn in 2015/16, down 1% on a constant-currency or underlying basis.

3.1.1. Underperformance relative to other sector players

Burberry underperformed peers average last year!

The group's performance was below that of average sector growth, which stood at 3% in 2015, including almost +4% for Louis Vuitton and even an +8% at Hermès but -7% for Prada. Here again, the geographical breakdown (low presence in Japan and over-exposure to Asia-Pacific) and a disadvantageous product mix explained this performance in our view.

Fig. 13: Comparison of organic sales growth at luxury groups (2012-2015)

Chge in %	2012	2013	2014	2015
Burberry	**9**	**19**	**12**	**-1**
Ferragamo	13	11	7	2
Hermès	16	13	11	8
Kering	11	4	5	5
o/w Kering Luxe	15	7	5	4
LVMH	9	8	5	6
o/w F&L div	7	4	3	4
Prada	25	13	0	-7
Richemont	8	10	2	0
Swatch Group	12	6	1	1
Tod's	8	2	0	2
Average	**13**	**8**	**4**	**3**

Source: Company Data; Bryan, Garnier & Co ests.

3.1.2. Deterioration in H2, except in Asia-Pacific

The table below is a good illustration of the overall deterioration in H2 as well as the different recent performances by region from one six-month period to the next. Indeed, whereas retail/wholesale sales in Asia-Pacific were down 6% in H1, they remained stable in H2 alone (-2% for FY), thanks to a return to growth in mainland China and Korea, whereas Hong Kong suffered another sharp decline (decline double digit). At the same time, the situation deteriorated in the EMEIA region (Europe, Middle-East, India, Africa) between H1 and H2, clearly affected by lower tourism flows in western Europe following the Paris terror attacks. Momentum was also far less beneficial in the Americas region especially in the wholesale network due to difficulties with US department stores and lower tourism flows in the US.

Fig. 14: Change in constant-currency retail /wholesale sales in H1 and H2

in %	H1 2015/16	H2 2015/16	FY 2015/16
Asia-Pacific	-6	0	-2
EMEIA	8	3	5
Americas	0	-3	-2
Total Retail/Wholesale	**1**	**0**	**0**

Source: Company Data; Bryan, Garnier & Co ests.

3.1.3. Sales penalised by ready-to-wear

An important factor in analysing sales in the past year is the underperformance of the Apparel segment (men's and women's) whereas the accessories segment including leather goods was more resilient, especially in the second half. Indeed, over this period, ready-to-wear sales dropped 3% (FY:-2%) whereas accessories rose by 1%. These figures show the greater volatility and fragility of Burberry's business model in an uncertain backdrop given the higher weight of Apparel (53% of sales).

Over the year, within the accessories category, ponchos, shawls and scarves as well as new ruck-sack lines performed particularly well.

Fig. 15: Change in constant currency retail/wholesale sales in H1 and H2

in %	H1 2015/16	H2 2015/16	FY 2015/16
Accessories	2	1	1
Women's	0	-3	-2
Men's	-1	-3	-2
Children's	8	22	15
Beauty	4	10	8
Total Retail/Wholesale	**1**	**0**	**0**

Source: Company Data; Bryan, Garnier & Co ests.

3.1.4. Almost table retail sales in 2015/16

Whereas over nine months, Burberry's retail sales (73% of sales) rose by 1% same-currency to GBP1.83bn, over the full-year ending 31st March 2016, same-currency sales were almost stable, implying a decline of almost 0.5% in Q4 alone. On a reported basis, growth stood at 1.7% (GBP1.83bn) thanks partly to recent weakness in the GBP.

Retail sales declined 1% at comparable stores!

Sales were even more sluggish on a same-store basis, dropping 1% for the year-ending 31st March 2016 (+1% in H1 and -2% in H2), showing a clear deterioration in Q4 alone with a decline of 5% after the near-stable level over nine months (but up 3% excluding Hong Kong/Macau) including stable sales in Q3 as well. Note that throughout 2015/16, same-store sales deteriorated constantly from one quarter to the next (see below). Indeed, same-store growth stood at 6% in Q1 but went on to fall by 4% in Q2 (i.e. +1% over H1), primarily due to the lack of Chinese business. In addition, the nosedive in Q4 stemmed above all from the lack of footfall in stores in all regions, especially Europe (fewer tourists), whereas the average basket and conversion rate picked up slightly (despite a slight slowdown in the conversion rate in Q4), due to the deliberate strategy to improve the customer experience in stores (service, reception, sales staff training).

The e-commerce business is one of the main strengths of the UK brand and clearly outperformed the other Burberry businesses to represent virtually 8% of sales, on our estimates as the company does not disclose this figure, compared with almost 5% for the luxury sector average.

Fig. 16: Quarterly growth in retail network sales

	Q1 15/16	Q2 15/16	H1 15/16	Q3 15/16	9m 15/16	Q4 15/16	FY 15/16
Sales in GBPm	407	367	774	603	1,377	461	1,838
Underlying chge (%)	8	-4	2	1	1	-0.5	1
Comparable store (%)	6	-4	1	0	0	-5	-1

Source: Company Data; Bryan, Garnier & Co ests.

Including 5% decline in Q4 alone!

While momentum in same-store retail sales was driven partly by Europe over the year (35% of brand's sales), mostly in H1 meanwhile, with double-digit growth in the EMEIA region, it only rose in mid-single digits in Q3 (October to December) and even fell in mid-single digits in Q4 (January to March). The region was above all penalised by the slowdown in tourism flows (especially from China). France and Italy were especially affected. The situation also remained tricky in the UK and the Middle-East.

Asia-Pacific (38% of sales) showed a mid-single digit decline over the entire year, suffering like other luxury brands, from double-digit falls in the Hong Kong/Macau pairing (-20% for the fourth quarter in a row). However, note at this stage that mainland China restored a positive trend in H2, as for some others brands. As such, excluding HK/Macau, H2 same-store sales in Asia-Pacific rose by almost 5% (mid-single digit) thanks to mainland China and Korea. Note interestingly that the slowdown as of Q2 was above all due to lower footfall in the stores and hence, to a decline in the number of transactions, whereas the average shopper spend picked up slightly.

In addition, retail sales in Japan (which is included in Asia-Pacific at Burberry whereas it is separated for the majority of other luxury groups) virtually doubled in H2 2015/16 (but on very undemanding comparison with the year-earlier period), thanks to the return to in-house distribution with six mainline stores in H1 and 19 concessions, which boosted performance in the region. Japan accounts for 2% of Retail/Wholesale sales.

H2 Retail comparable sales in the Americas were down marginally, amplified in Q4 with a decline of almost 5% compared with a stable level in Q3 and a stability on FY. The slowdown was particularly harsh in the US. Demand from local clients remained sluggish, even in New York, and above all very volatile from one month to the next whereas business with tourists dropped by more than 10%. Burberry is not the only group to point out difficulties in the luxury market in the US.

Fig. 17: Retail sales trends by region (comparable stores)

	FY 14/15	Q1 15/16	Q2 15/16	H1 15/16	Q3 15/16	9m 15/16	Q4 15/16	FY 15/16
APAC	up lsd	decl lsd	decl hsd	decl msd	down msd	down msd	down msd	down msd
EMIA	up dd	up dd	up dd	up dd	up msd	up msd	down msd	up msd
Americas	up dd	up lsd	up lsd	up lsd	stable	stable	down msd	stable

Source: Company Data; Bryan, Garnier & Co ests.

Penalized by poor activity both in APAC and in US!

In our view, the mixed situation in the US has been and is still due to **i/** sluggish financial markets (lack of wealth creation, lower bonuses etc.), **ii/** the strong dollar (lower tourism flows from Europe and Latin America) even if the trend has reversed recently, **iii/** slower consumer spending by US households as the elections approach next November and iv/ tough situation in Department Stores.

Burberry opened more than 40 directly-operated stores in 2015/16, including 18 free-standing or mainline stores in the group's words (13 of which in H1 and five in H2), notably in the Middle-East, Russia and above all Japan, following the take-over of distribution internally. However, the UK brand also closed Mainline stores (17 over the full-year) especially in China, with net closures of three stores out of a total of 63, like the majority of global luxury sector brands, and in South Korea. This resulted in one single net opening globally. Several stores were renovated or extended in order to improve the shopping experience, such as that in New York (Soho) and the Regent Street store in London.

The table below sets out the change in the number of DOS. Note that openings have slowed massively since 2014, without no net opening of a mainline store in 2014/15 and 2015/16, compared with an average annual pace of 20 openings over 2010-2014.

Fig. 18: Change in DOS network

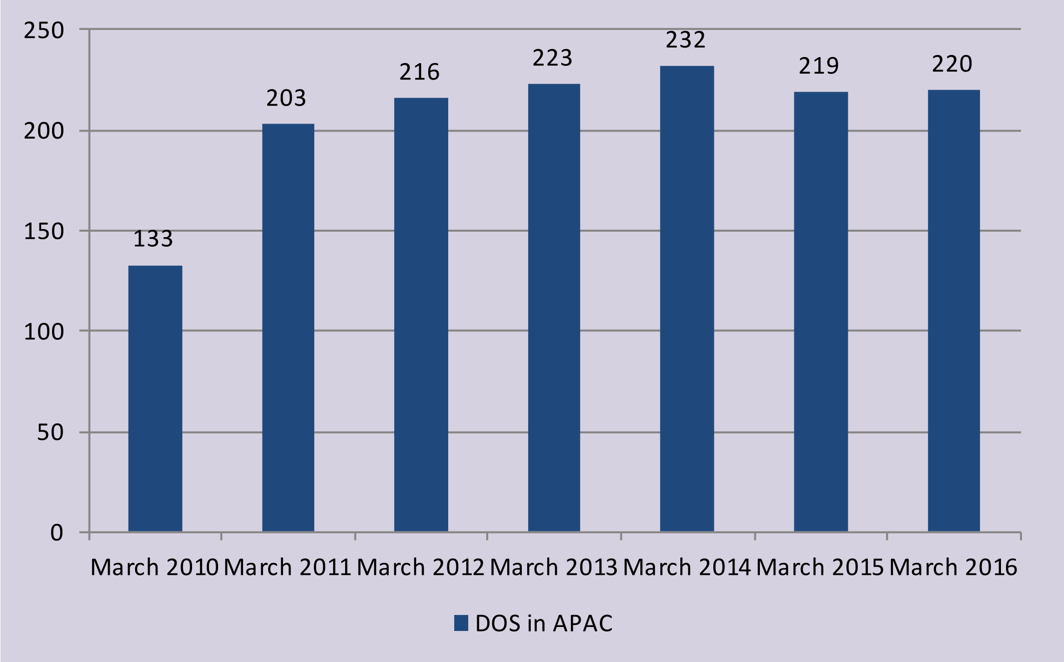
	March 2010	March 2011	March 2012	March 2013	March 2014	March 2015	March 2016
Mainline stores	131	174	192	206	215	214	215
Concessions	262	199	208	214	227	213	214
Outlets	47	44	44	49	55	57	58
Total DOS	**440**	**417**	**444**	**469**	**497**	**484**	**487**

Source: Company Data; Bryan, Garnier & Co ests.

Like the majority of luxury groups, the store network has been adjusted in the Asia-Pacific region (see the chart below) especially in mainland China where Burberry has around 60 stores (63 at the end of March 2016) compared with almost 45 for Louis Vuitton and fewer than 25 for Hermès. In our view, the brand has room to manoeuvre in adjusting its store network, like Gucci, which has almost the same number of stores.

Moving the stores upscale is the other strategic focus for the store network in China (but not only), notably via renovations and/or extensions in order to improve the customer purchasing experience. This is probably also set to involve a relocation of certain stores with a specific focus on Beijing.

Fig. 19: Change in DOS network in Asia-Pacific



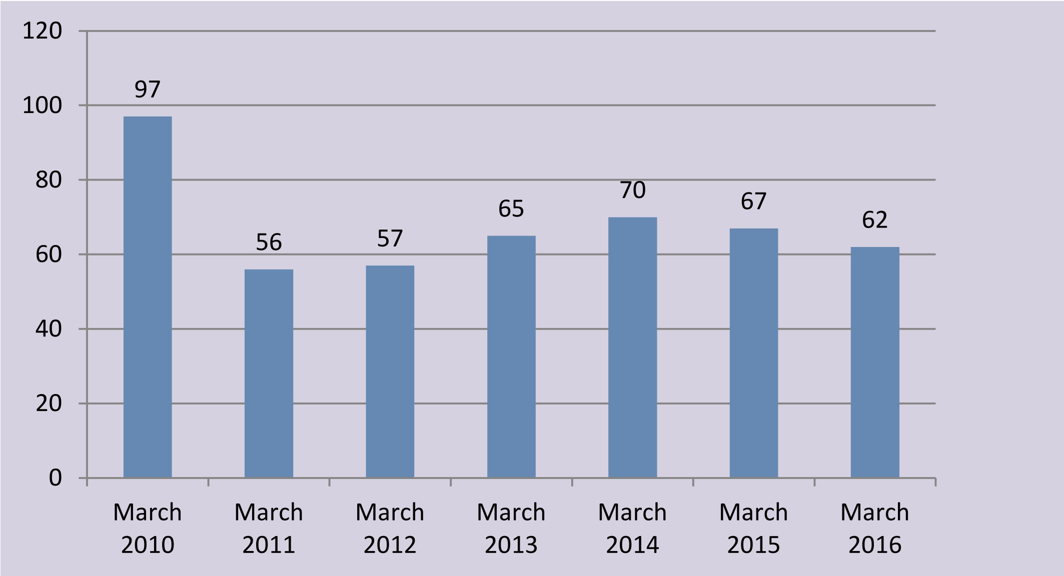
Source: Company Data; Bryan, Garnier & Co ests.

E-commerce sales fared well over the year clearly outperforming compared with the average of retail sales, thanks especially to sales generated via mobile devices (iPhone, iPad etc.). The Burberry e-commerce site is present in almost 44 countries.

3.1.5. 2% decline in the wholesale network over the year

At the same time, the wholesale network (25% of sales) witnessed a 2% same-currency decline in sales over 2015/16 (-1% in H2 after a 3% decline in H1), including a 6% decline excluding Beauty.

Fig. 20: Change in wholesale store network



Source: Company Data; Bryan, Garnier & Co ests.

In Asia-Pacific, trends excluding beauty were clearly negative with a plunge of more than 10% in H1 and H2 due to the travel retail circuit, which suffered from lower tourism flows, especially between mainland China and Hong-Kong/Macao.

Wholesale sales down 2% in 2015/16 despite +8% for Beauty!

The Americas region also encountered a mixed environment with a double-digit sales decline in H2, whereas the group posted a low-single digit increase in H1 in view of a timing effect in deliveries that favoured H1 and penalised H2. Beyond this deliveries issue, Dpt Stores in US are clearly suffering.

Wholesale sales excluding beauty (GBP440m for the full-year 2015/16) therefore dropped 6% same-currency in H2, representing a near 5% decline over the full-year. Wholesale sales excluding beauty are primarily made up of accessories and men's and women's ready-to-wear clothing.

In contrast, the beauty business (GBP191m in full-year sales) posted revenue growth of almost 8% (constant currency) including +10% in H2 partly thanks to the launch of a new men's perfume *Mr Burberry* and the extension of the *My Burberry* lines as with *My Burberry Black*. At the same time, distribution was expanded, notably with the development of a make-up line on the Sephora e-commerce website and in some of the group's stores (40 at the end of the year). Make-up accounts for no more than 5% of Beauty sales. Burberry perfumes outperformed the market (sell-out figures) in numerous key regions, which was hardly surprising given that the brand is just at the start of its development. However, note that the perfumes segment is extremely competitive (the most competitive in the global cosmetics market) and is often affected by relatively short lifespans for the products (women's and men's) with the corollary of higher costs (innovation, marketing advertising etc.), such that margins are often volatile for smaller players.

3.2. Profitability under pressure in 2015/16

In view of stable constant currency retail/wholesale sales over the year (especially in H2) and higher costs, Burberry achieved another sharp narrowing in operating profitability (-140bp to 16.6%).

Fig. 21: Group and retail/wholesale operating profitability

GBPm	2013/14	2014/15	2015/16
Retail/Wholesale sales	2 251	2 455	2 473
Group sales	**2 330**	**2 523**	**2 515**
Retail/Wholesale EBIT	394	399	381
as % of sales	*17.5*	*16.3*	*15.4*
Group EBIT	**460**	**455**	**418**
as % of sales	*19.8*	*18.0*	*16.6*

Source: Company Data; Bryan, Garnier & Co ests.

Wholesale sales down 2% in 2015/16 despite +8% for Beauty!

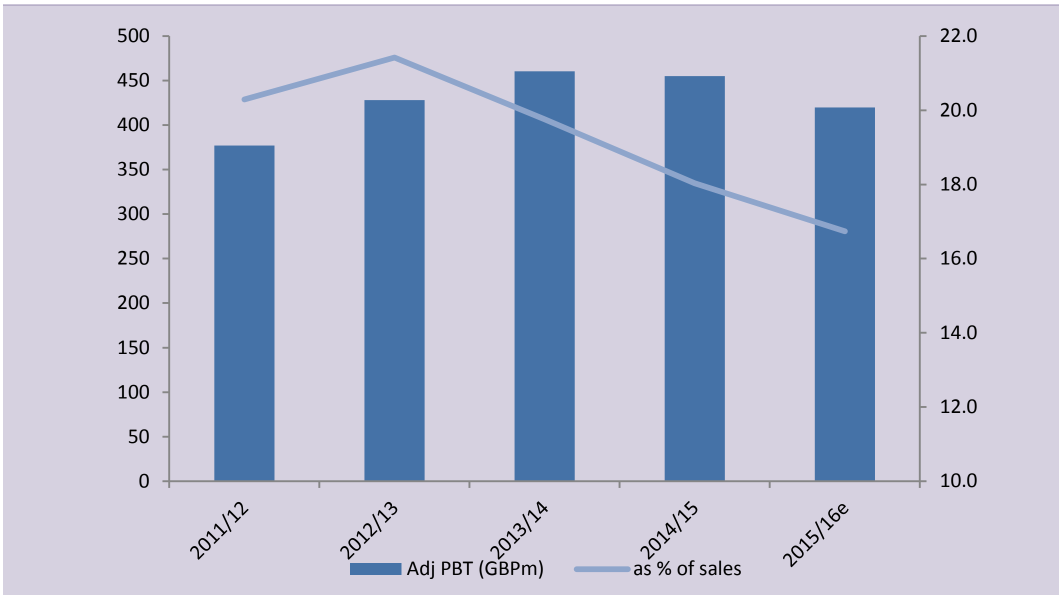
Gross margin remained stable at around 70% thanks to a positive forex effect, partly enabled by the weak GBP (around 15% of production costs and 30% of total costs are denominated in GBP). Similarly, the positive product mix (strong momentum in accessories relative to men's and women's ready-to-wear) should help maintain stability in this ration despite weak sales. For Retail/wholesale alone, gross margin grew 40bp to 69.6% of which +70bp coming from forex impact.

In contrast, operating expenses (of which 30% are variable costs) are set to rise more rapidly than sales (same-currency increase of almost 5%), especially due to higher rental costs. Operating expenses represented last year almost 53.5% of sales (of which 54.2% for the Retail/Wholesale business) compared with 51.9% in 2014/15. Half of the increase is coming from net new space. The balance coming from marketing and IT investments. OPEX amount include savings of around GBP25m (discretionary costs including headcounts and travel expenses.

At the same time, performance-related pay awarded to the main group managers and in-store sales staff is likely to be reduced in order to take account of lower sales levels. As such, after a GBP30m decline in H1, a similar trend is expected for the second half of the year. Under these conditions, the group's adjusted EBIT margin has narrowed by 140bp to 16.6% (GBP418m), namely down around 200bp in H2 alone after a virtually stable level over the first six months of the year (particularly strong operating deleverage in Q4 on our estimates). In line with the Burberry CFO, Carol Fairweather, guidance, adjusted pre-tax profit stood at GBP421m, a 10% decline underlying.

This decline follows on from a trend started in 2013. Indeed, since end-March 2015, Burberry's pre-tax EBIT margin has narrowed by almost 470bp (see chart below).

Fig. 22: Change in pre-tax profit



Source: Company Data; Bryan, Garnier & Co ests.

4. A still uncertain backdrop

Burberry is likely to suffer further from the backdrop affecting the luxury products industry at present: Hong-Kong market still in sharp decline, Europe weakened by lower tourist flows following terrorist attacks and less favourable currency trends, and finally, an uncertain US market. In these conditions, the UK group's business is likely to remain sluggish over 2016/17 and profitability is set to suffer again.

4.1. Still sluggish sales in 2016/17

Almost no growth expected in 2016/17!

During the analysts meeting following the 2015/16 results publication, the group's CEO and CFO were cautious, stating that she expects a challenging environment for the luxury sector for 2016/17 (end of March 2017). In addition, management estimates the space effect in the retail network at 1-2 points (low single digit) thanks to the opening of 15 mainline stores despite the closure of a similar number of stores, reflected in the overhaul of the network and moves upscale in the store network. However, certain stores are due to be extended and renovated (hence the slight positive space impact) in order to improve their sales since the group's main aim is to improve productivity in its existing stores. For this reason, we expect stable same-store retail sales.

Sales in the wholesale network are likely to drop almost 10% same-currency over the first part of the year due to the cautious attitudes of US department stores and a deliberate reduction in the number of sales points in the beauty division, particularly in UK (after an extension that was probably too fast and too costly during previous years?) in order to pursue a strategy of moves upscale. Over the year, the decline in wholesale sales is likely to stand at close to 8%, including stability for Beauty. Similarly, revenues from licence sales (Japan, eyewear) are likely to lose a further GBP20m compared with the 2015/16 level given that the Japanese activities have been brought back in-house.

It seems reasonable to estimate stable same-currency sales for the group as a whole. As such, we are forecasting growth in underlying retail/wholesale sales of 0% (of which +2% for retail and stable on a same-store basis). This points to a near 5% increase in reported terms for the group, taking into account a positive forex effect of almost five points prompted by the recent decline in the GBP, implying sales of GBP2.63bn (see table below).

Fig. 23: Burberry sales (2015/16-2017/18e)

GBPm	2015/16	2016/17e	2017/18e
Retail	**1 838**	**1 990**	**2 065**
chge %	1.7	8.0	4.0
Underlying chge %	*1.0*	*2.0*	*4.0*
o/w at comp stores	-1.0	0.0	2.0
Wholesale	**635**	**620**	**640**
chge %	-2.0	-2.4	3.2
Underlying chge %	*-2.0*	*-8.0*	*3.0*
Total Retail/wholesale	**2 473**	**2 610**	**2 705**
chge %	0.7	5.0	3.6
Underlying chge %	*0.0*	*0.0*	*4.0*
Licensing	42	20	30
Total Group	**2 515**	**2 630**	**2 735**
chge %	0.0	5.0	4.0
underlying chge %	*0.0*	*0.0*	*4.0*

Source: Company Data; Bryan, Garnier & Co ests.

Stable same-store retail sales should break down as follows in our view: an unchanged activity in Asia-Pacific (i.e. low single digit in the group's words), thereby showing a clear improvement relative to 2015/16 (mid-single digit decline), due to comparison with the year earlier period that is set to improve throughout the year in Hong-Kong and the recovery in China (as for all players in the luxury sector). This should take shape over the current year, especially since the Chinese authorities seem to want to fight against Chinese tourist purchases (adjustment in VAT rates for e-commerce purchases, stricter border controls etc.). In one word, Chinese should spend more at home and less overseas versus 2015/16. Pricing effect should be almost zero in 2016/17.

In addition, we expect a slight improvement in the EMEIA region with sales growth of almost 2%, i.e. a low-single digit increase compared with stability in 2015/16, whereas throughout the year, the negative impact of the terrorist attacks is set to lessen, enabling tourists to gradually return to the region. In contrast, in the Americas, we expect stable sales, with no recovery relative to the 2015/16 performances given prospective upsets caused by the US elections next November and a fairly sluggish backdrop (strong dollar, consumer spending affected by uncertain financial markets and Dpt stores situation etc.).

Fig. 24: Change in same-store retail sales by region

	2014/15	2015/16	2016/17e	2017/18e
APAC	Up LSD	Down MSD	stable	Up LSD
EMIA	Up DD	Stable	Up LSD	Up LSD
Americas	Up DD	Stable	Stable	Up MSD
Total Retail	**9**	**-1**	**0**	**3**

Source: Company Data; Bryan, Garnier & Co ests.

4.2. Margin narrowing in 2016/17!

And again margin erosion in 2016/17 (-60bp)

For the current year, we are forecasting a further narrowing in EBIT margin. Indeed, weak prospective sales growth together with higher costs prompted by the increase in rental costs means that EBIT margin is likely to narrow by 60bp to 16%, despite a stability in gross margin prompted by the weak GBP and a positive distribution mix thanks to the outperformance in the retail network relative to the wholesale network, for which sales are expected to decline over the current year, with -10% in H1 alone. As such, we are forecasting a gross margin of 70%, unchanged relative to 2015/16.

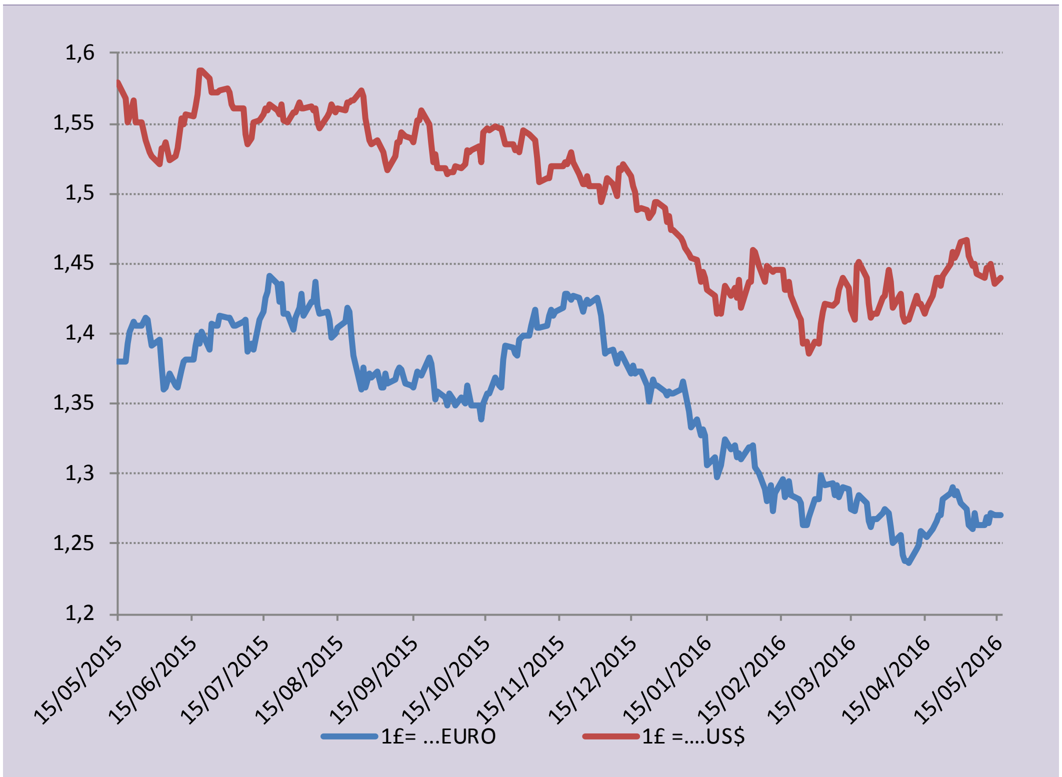
At the 2015/16 results publication the group's CFO stated that pre-tax profit for 2016/17 would probably come in at the low end of analysts' forecasts and we estimate that adj EBIT should be close to GBP420m, implying EBIT of virtually the same level, also due to the 5% increase in same-currency operating expenses expected by management. Under these conditions, adjusted 2016/17 EBIT margin narrow by a further 60bp to 16%. Note that this estimate takes account of a positive forex effect of GBP50m on retail/wholesale EBIT relative to 2015/16 EBIT (at current exchange rates, therefore this impact can change in the future and management was initially expected a GBP60m impact), due to recent weakness in the GBP.

It includes also a GBP20m positive impact coming from the three years GBP100m cost savings plan. Nevertheless, this impact should be partly offset by GBP10m investments.

This cost savings (at least GBP100m) on three years plan is equivalent of 10% of OPEX excluding fixed rent and depreciation. Broadly half is expected to come from change in ways of working (less complexity, eliminating duplication…). The balance will come from lower OPEX.

The charts below highlight the weakness of sterling relative to the euro and the greenback. Since the beginning of the year and in view of fears over a possible Brexit, these exchange rates have dropped by 7% and 3% respectively.

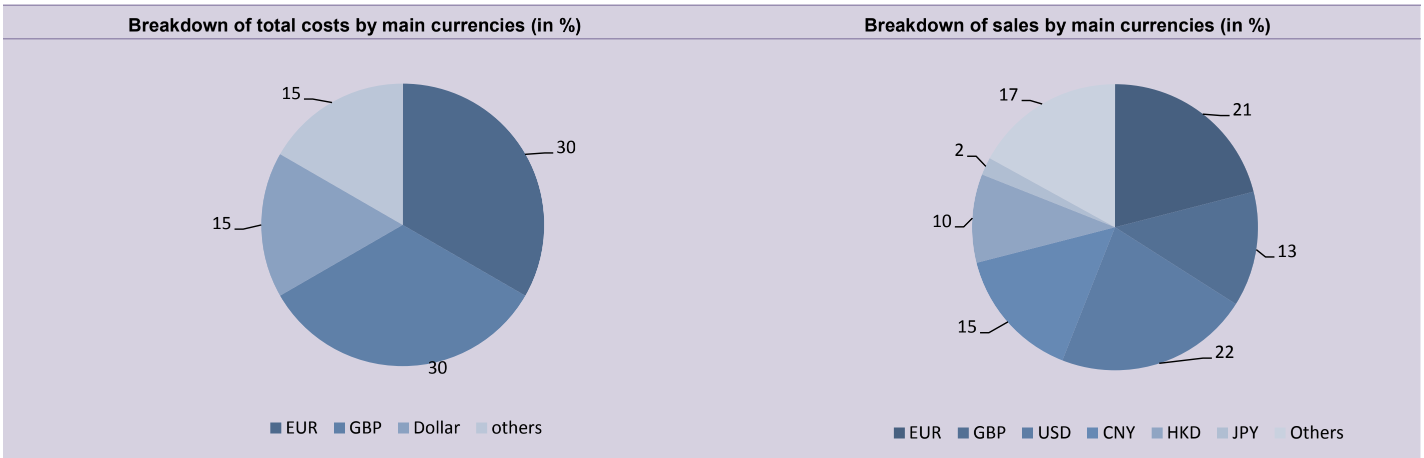
Fig. 25: Change in GBP vs. EUR and USD



Source: Company Data; Bryan, Garnier & Co ests.

The two charts below show the weight of the main currencies in sales and costs, notably the weight of the GBP in sales (13%) and in costs (30%), hence the positive impact of a weak GBP for Burberry's accounts.

Fig. 26: Weight of main currencies in overall sales and costs



Source: Company Data; Bryan, Garnier & Co ests.

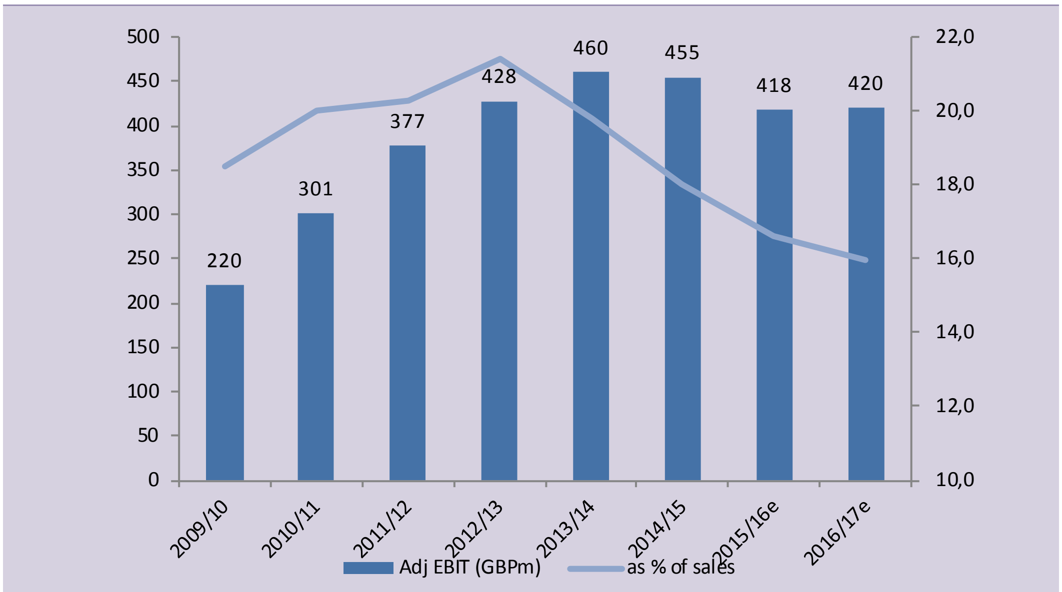
Fig. 27: P&L overview

GBPm	2014/15	2015/16	2016/17e	2017/18e
Retail/wholesale sales	2 455	2 473	2 610	2 705
Group sales	**2 523**	**2 515**	**2 630**	**2 735**
Retail/Wholesale EBIT	399	381	390	430
as % of sales	*16.3*	*15.4*	*14.9*	*15.9*
Group EBIT	**455**	**418**	**420**	**485**
as % of sales	***18.0***	***16.6***	***16.0***	***17.7***

Source: Company Data; Bryan, Garnier & Co ests.

As shown by the chart below, Burberry's EBIT margin has narrowed by almost 540bp since its peak level of 21.3% reached in 2012/13.

Fig. 28: Change in EBIT and EBIT margin



Source: Company Data; Bryan, Garnier & Co ests.

4.3. A very comfortable balance sheet

A 52% pay out ratio thanks to bat cash at GBP660m!

One of Burberry's main assets is its balance sheet, which is historically very healthy with net cash at GBP660m at end-March 2016. As such, the group has the means to pursue its ambitious dividend pay-out policy as shown by the table below. The pay-out ratio with would reach 48% this year followed by 52% in 2016/17 assuming a slight increase in the dividend.

Fig. 29: Change in net cash position

GBPm	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17e
Net cash	338	297	403	552	660	750
Capex	153	176	151	154	138	160
as % of sales	*8.2*	*8.8*	*6.5*	*6.1*	*5.5*	*6.1*
FCF	174	131	214	246	202	277
Net dividend (p)	25.0	29.0	32.0	35.2	37.0	37.0
Pay-out ratio (%)	*40*	*41*	*42*	*46*	*52*	*52*

Source: Company Data; Bryan, Garnier & Co ests.

5. Valuation

We are initiating coverage of the Burberry share with a Neutral recommendation and a Fair Value of 1,200p. Despite the share's disappointing stockmarket ride (-11% over one month) and its fairly accessible valuation, we consider that investing in the stock is too risky in the current backdrop given the profile discussed in this report and we therefore favour other stocks for playing the luxury sector (LVMH, Kering, Hermès).

Moreover, we do not believe in a change in the capital structure which includes a free float of close to 100%. Indeed, beyond LVMH, which recently clearly denied any interest in the group, and Kering, whose financial structure prevents any acquisitions, the size already acquired by Burberry (2015/16 sales of GBP2.5bn and marketing capitalisation of GBP5bn), and the amount that would have to be spent to seduce shareholders (almost GBP6bn or EUR7.5bn) with no real synergies, are the main obstacles behind a scenario of this sort.

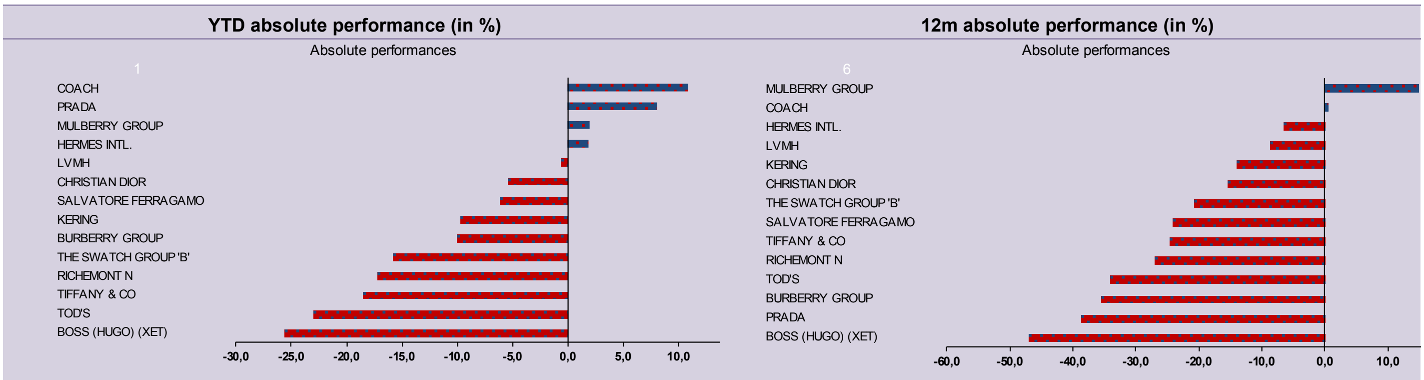
5.1. Underperformance over 12m

Burberry share massively underperformed peers!

Burberry has been one of the worst performers in the sector over the past 12 months, losing 40%, with also a poor performance since the beginning of the year, with the share virtually down 10%. Over 12 months, the underperformance relative to the sector average stands at a hefty 20%, whereas LVMH outperformed the sector by close to 10% over the same period. Since the beginning of the year, the UK share has underperformed our luxury sample by 3% compared with +7% for LVMV. One of the reasons behind this recent poor performance is disappointing H2 sales trading statement. Finally, over the past month, the share price has dropped 11% vs -4% for the sector, following the disappointing 2015/16 sales publication.

This performance reflects also investor mistrust concerning the group's risk profile as discussed previously.

Fig. 30: Stockmarket performances of luxury goups



Source: Datastream; Bryan, Garnier & Co ests.

5.2. 2016 EV/EBIT globally in line with sector average

Although Burberry is trading globally in line with the sector average in terms of 2016 EV/EBIT, after taking into account earnings growth prospects over 2015-2017, Burberry's EV/EBIT to growth ratio is one of the least attractive in our sample of luxury groups at 1.6x vs. an average of 1.4x (excluding Hugo Boss), or a premium of 15%, with LVMH at 1.5x and Kering at 1.4x.

Fig. 31: Peer comparison

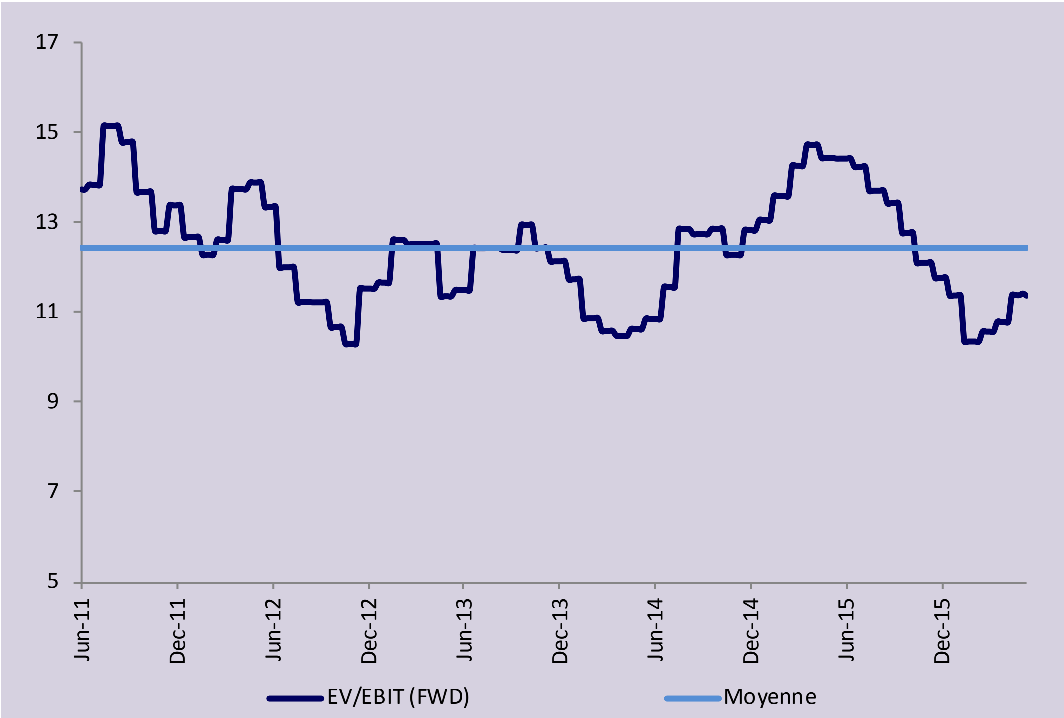
x	2015e EV/EBIT	2016e EV/EBIT	2014 premium on average (ii)	2015 premium on average (ii)
Burberry	11.0	10.5	0%	4%
Hermès Intl	18.8	16.7	-	-
Kering	11.4	9.9	0%	-4%
LVMH	11.0	9.8	-2%	-2%
Prada	13.0	11.8	-6%	-5%
Richemont	10.6	8.5	-7%	-15%
Salvatore Ferragamo	11.7	10.5	3%	5%
Swatch Group	9.7	8.8	-14%	-13%
Tiffany	10.9	9.9	-4%	-1%
Tod's Group	12.6	11.3	11%	10%
(i) Luxury average	**12.1**	**10.7**	**-**	**-**
(ii) Luxury average (excl. Hermés)	**11.2**	**10.1**	**-**	**-**

Source: Company Data; Bryan, Garnier & Co ests

5.2.1. 8% discount vs five years' historical average

On forward EV/EBIT, current Burberry valuation highlights 8% discount versus five years' historical average, which seems to us quite logical given current sector uncertainties and poor group prospects. Actually, luxury sector is trading with a 15% discount.

Fig. 32: EV/EBIT forward on five years



Source: Company Data; Bryan, Garnier & Co ests

5.2.2. Fair Value of 1,200p

Our DCF model yields a Fair Value of 1,200p. This is based on growth to infinity of 2.5%, in line with other groups in the sector. In view of the group's profile and the current situation, we have factored in a beta of 1.05x, implying WACC of 8.9% after taking into account a risk-free rate of 1.6% and a risk-premium of 7% (Bryan Garnier valuation assumptions).

Fig. 33: DCF model

EURm	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e
Net Sales	**2 630**	**2 735**	**2 844**	**2 958**	**3 077**	**3 215**	**3 344**	**3 444**	**3 547**	**3 636**
% change	*5%*	*3.6%*	*4.0%*	*4.0%*	*4.0%*	*4.5%*	*4.0%*	*3.0%*	*3.0%*	*2.5%*
EBIT	400	435	458	482	508	531	552	568	585	600
EBIT margin (%)	15.2%	15.9%	16.1%	16.3%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%
Income taxes	-95	-110	-121	-128	-132	-136	-140	-145	-148	-152
Tax rate (%)	23.6%	25.1%	26.5%	26.5%	26,5%	26,5%	26,5%	26,5%	26,5%	26,5%
Operating profit after taxes	**305**	**325**	**337**	**355**	**367**	**378**	**389**	**401**	**411**	**421**
+Depreciations	140	140	139	133	138	142	146	151	154	158
-Change in WCR	16	12	14	15	21	22	26	23	24	25
-Investments in fixed assets	175	150	142	148	153	158	162	167	171	176
Operating cash flow	**254**	**302**	**320**	**325**	**330**	**340**	**347**	**361**	**370**	**379**

PV of terminal value	2,690
+PV of future cash flows (2016-25)	2,120
= Enterprise Value	**4,810**
Net debt (2016e)	-660
Other liabilities	140
Minority interest	51
Financial assets	145
Theoretical value of equity	**5,424**
Number of shares (m)	447
Theoretical FV per share (EUR)	**1,200**

Source: Company Data; Bryan, Garnier & Co ests.

Page left blank intentionally

Page left blank intentionally

Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 57,4% NEUTRAL ratings 33,3% SELL ratings 9,2%

Research Disclosure Legend

1	Bryan Garnier shareholding in Issuer	Bryan Garnier & Co Limited or another company in its group (together, the "Bryan Garnier Group") has a shareholding that, individually or combined, exceeds 5% of the paid up and issued share capital of a company that is the subject of this Report (the "Issuer").	No
2	Issuer shareholding in Bryan Garnier	The Issuer has a shareholding that exceeds 5% of the paid up and issued share capital of one or more members of the Bryan Garnier Group.	No
3	Financial interest	A member of the Bryan Garnier Group holds one or more financial interests in relation to the Issuer which are significant in relation to this report	No
4	Market maker or liquidity provider	A member of the Bryan Garnier Group is a market maker or liquidity provider in the securities of the Issuer or in any related derivatives.	No
5	Lead/co-lead manager	In the past twelve months, a member of the Bryan Garnier Group has been lead manager or co-lead manager of one or more publicly disclosed offers of securities of the Issuer or in any related derivatives.	No
6	Investment banking agreement	A member of the Bryan Garnier Group is or has in the past twelve months been party to an agreement with the Issuer relating to the provision of investment banking services, or has in that period received payment or been promised payment in respect of such services.	No
7	Research agreement	A member of the Bryan Garnier Group is party to an agreement with the Issuer relating to the production of this Report.	No
8	Analyst receipt or purchase of shares in Issuer	The investment analyst or another person involved in the preparation of this Report has received or purchased shares of the Issuer prior to a public offering of those shares.	No
9	Remuneration of analyst	The remuneration of the investment analyst or other persons involved in the preparation of this Report is tied to investment banking transactions performed by the Bryan Garnier Group.	No
10	Corporate finance client	In the past twelve months a member of the Bryan Garnier Group has been remunerated for providing corporate finance services to the issuer or may expect to receive or intend to seek remuneration for corporate finance services from the Issuer in the next six months.	No
11	Analyst has short position	The investment analyst or another person involved in the preparation of this Report has a short position in the securities or derivatives of the Issuer.	No
12	Analyst has long position	The investment analyst or another person involved in the preparation of this Report has a long position in the securities or derivatives of the Issuer.	No
13	Bryan Garnier executive is an officer	A partner, director, officer, employee or agent of the Bryan Garnier Group, or a member of such person's household, is a partner, director, officer or an employee of, or adviser to, the Issuer or one of its parents or subsidiaries. The name of such person or persons is disclosed above.	No
14	Analyst disclosure	The analyst hereby certifies that neither the views expressed in the research, nor the timing of the publication of the research has been influenced by any knowledge of clients positions and that the views expressed in the report accurately reflect his/her personal views about the investment and issuer to which the report relates and that no part of his/her remuneration was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.	Yes
15	Other disclosures	Other specific disclosures: Report sent to Issuer to verify factual accuracy (with the recommendation/rating, price target/spread and summary of conclusions removed).	No

A copy of the Bryan Garnier & Co Limited conflicts policy in relation to the production of research is available at www.bryangarnier.com

Please see the section headed "Important information" on the back page of this report.

BRYAN, GARNIER & CO

London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the Financial Conduct Authority (FCA) and the Autorité de Contrôle prudential et de resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Munich
Widenmayerstrasse 29
80538 Munich
Germany
+49 89 2422 62 11

New Delhi
The Imperial Hotel Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA