Burberry Group (BRBY.L)

Rating	NEUTRAL*
Price (21 May 14, p)	1,518.00
Target price (p)	(from 1,600.00) 1,620.00¹
Market cap. (£ m)	6,734.62
Enterprise value (£ m)	6,272.0

**Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.*
¹Target price is for 12 months.

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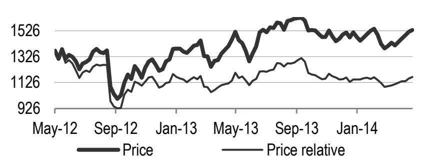
INCREASE TARGET PRICE

Japan: sensible plan, transformation underway

- **We retain our Neutral rating on Burberry with a new TP of 1620p (from 1600p). Our EPS forecasts for FY15-16e were slightly raised (by c1%) due to a lower tax rate assumption while our EPS forecasts for FY17-18e were modestly cut (by c2%) due lower sales assumptions for Japan in FY17e closer to the company targets disclosed yesterday.** Our FY15e adj. PBT forecast of £464m (impacted by FX headwinds) is broadly unchanged (based on +8% retail comps and 16.9% retail/wholesale margin).
- **Realistic goals for Japan, with Blue/Black licensing contract from Sep'15 mitigating the financial hit:** We were too optimistic in our previous model assumptions for Japan, in particular the department store concession network ramp-up: Burberry plans to add about 10 concessions a year in FY16-FY17 (it already has 10), which is below what we see for its main peers (c50-60 DOS). Burberry plans to invest in free-standing stores, in marketing to reposition the brand and in digital, but will need more time to get the right retail space in department stores. That said, the new licensing contract for Blue/Black should help it to mitigate the profit impact while avoiding conflict with its global collection. Mgmt. L-T vision of achieving 10% of global revenues from Japan as its peers will require more time and money.
- **Thesis**: Since we do not see Burberry's superior organic sales growth (11% CAGR thru FY17e) translating into superior earnings growth (8% CAGR thru FY17e), we see a Neutral rating as appropriate. The group is up against difficult comparatives (after consecutive quarters materially outpacing its peers with double-digit comps growth), but we continue to like its valuation on EV/IC vs. ROIC, its strong brand momentum and organisational focus.
- **Catalyst & valuation:** 1Q15 IMS due mid-July. Burberry trades at a modest premium to the sector at 18.2x cal. 2015 P/E, but looks attractive on EV/IC and HOLT®. Our TP was set as an average of HOLT and historical multiples.

Share price performance



The price relative chart measures performance against the FTSE ALL SHARE INDEX which closed at 3628.99 on 21/05/14
On 21/05/14 the spot exchange rate was £.81/Eu 1. - Eu .73/US$1

Performance Over	1M	3M	12M
Absolute (%)	5.4	-0.5	-1.5
Relative (%)	3.3	0.2	-2.6

Financial and valuation metrics

Year	03/14A	03/15E	03/16E	03/17E
Revenue (£ m)	2,329.8	2,465.4	2,801.7	3,084.8
EBITDA (£ m)	598.90	607.23	675.12	728.52
Pre-tax Profit Adjusted (£ m)	461.00	464.21	512.32	570.31
CS adj. EPS (p)	75.39	77.25	85.14	94.67
Prev. EPS (p)	—	76.46	83.85	96.40
ROIC (%)	43.25	39.38	43.13	42.80
P/E (adj., x)	20.14	19.65	17.83	16.03
P/E rel. (%)	133.0	137.4	135.9	133.0
EV/EBITDA	10.6	10.3	9.0	8.1

Dividend (03/15E, p)	32.82	IC (03/15E, £ m)	903.36
Dividend yield (%)	2.2	EV/IC	6.9
Net debt (03/15E, £ m)	-505.8	Current WACC	9.07
Net debt/equity (03/15E, %)	-35.9	Free float (%)	95.00
BV/share (03/15E, £)	3.1	Number of shares (m)	443.65

Source: FTI, Company data, Thomson Reuters, Credit Suisse Securities (EUROPE) LTD. Estimates.

Burberry Group BRBY.L

Price (21 May 14): **1,518.00p**, Rating: **NEUTRAL**, Target Price: **(from 1,600.00) 1,620.00p**

Income statement (£ m)	03/14A	03/15E	03/16E	03/17E
Revenue (£ m)	2,330	2,465	2,802	3,085
EBITDA	**599**	**607**	**675**	**729**
Depr. & amort.	(139)	(145)	(163)	(160)
EBIT (£)	**460**	**462**	**512**	**569**
Net interest exp.	(1)	2	0	2
Associates	—	—	—	—
Other adj,	2	—	—	—
PBT (£)	**461**	**464**	**512**	**570**
Income taxes	(112)	(107)	(118)	(131)
Profit after tax	**349**	**357**	**394**	**439**
Minorities	(10)	(11)	(13)	(15)
Preferred dividends	—	—	—	—
Associates & other	(2)	—	—	—
Net profit (£)	**337**	**346**	**382**	**424**
Other NPAT adjustments	(15)	(15)	(15)	(15)
Reported net income	**322**	**331**	**367**	**409**

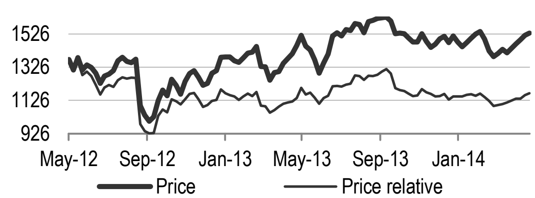
Cash flow (£)	03/14A	03/15E	03/16E	03/17E
EBIT	460	462	512	569
Net interest	1	2	0	2
Cash taxes paid	(111)	(107)	(118)	(131)
Change in working capital	(97)	(20)	79	(20)
Other cash & non-cash items	172	145	163	160
Cash flow from operations	425	483	636	579
CAPEX	(130)	(200)	(224)	(216)
Free cashflow adj.	—	—	—	—
Free cash flow to the firm	**296**	**283**	**412**	**363**
Acquisitions	(3)	—	—	—
Divestments	3	—	—	—
Other investment/(outflows)	(24)	(38)	(43)	(48)
Cash flow from investments	**(154)**	**(238)**	**(267)**	**(264)**
Net share issue/(repurchase)	1	—	—	—
Dividends paid	(131)	(141)	(148)	(163)
Issuance (retirement) of debt	—	—	—	—
Other	(22)	—	—	—
Cash flow from financing	**(152)**	**(141)**	**(148)**	**(163)**
Effect of exchange rates	(14)	—	—	—
Changes in Net Cash/Debt	**106**	**103**	**221**	**152**
.				
Net debt at start	(297)	(402)	(506)	(727)
Change in net debt	**(106)**	**(103)**	**(221)**	**(152)**
Net debt at end	(402)	(506)	(727)	(878)

Balance sheet (£ m)	03/14A	03/15E	03/16E	03/17E
Assets				
Cash and cash equivalents	546	929	1,219	1,449
Accounts receivable	240	259	227	250
Inventory	420	458	477	521
Other current assets	5	5	5	5
Total current assets	**1,210**	**1,650**	**1,927**	**2,224**
Total fixed assets	398	470	551	629
Intangible assets and goodwill	195	201	210	221
Investment securities	—	—	—	—
Other assets	161	161	161	161
Total assets	**1,966**	**2,483**	**2,850**	**3,235**
Liabilities				
Accounts payable	133	141	160	176
Short-term debt	143	423	492	570
Other short term liabilities	356	384	431	461
Total current liabilities	**632**	**948**	**1,083**	**1,208**
Long-term debt	—	—	—	—
Other liabilities	126	126	126	126
Total liabilities	**758**	**1,074**	**1,209**	**1,333**
Shareholders' equity	1,165	1,367	1,598	1,859
Minority interest	43	43	43	43
Total equity & liabilities	**1,966**	**2,483**	**2,850**	**3,235**
Net debt (£ m)	(402)	(506)	(727)	(878)

Per share data	03/14A	03/15E	03/16E	03/17E
No. of shares (wtd avg)	447	448	448	448
CS adj. EPS (p)	**75.39**	**77.25**	**85.14**	**94.67**
Prev. EPS (p)	—	76.46	83.85	96.40
Dividend (p)	32.00	32.82	36.17	40.22
Div yield	2.11	2.16	2.38	2.65
Dividend payout ratio	42.45	42.49	42.49	42.49
Free cash flow per share	66.11	63.07	91.93	80.97

Key ratios and valuation	03/14A	03/15E	03/16E	03/17E
Growth(%)				
Sales	16.6	5.8	13.6	10.1
EBIT	7.5	0.4	10.8	11.1
Net profit	7.9	2.7	10.2	11.2
EPS	7.7	2.5	10.2	11.2
Margins (%)				
EBITDA margin	25.7	24.6	24.1	23.6
EBIT margin	19.8	18.7	18.3	18.4
Pretax margin	19.8	18.8	18.3	18.5
Net margin	14.5	14.0	13.6	13.8
Valuation metrics (x)				
EV/sales	2.7	2.5	2.2	1.9
EV/EBITDA	10.6	10.3	9.0	8.1
EV/EBIT	13.9	13.6	11.8	10.4
P/E	20.1	19.6	17.8	16.0
P/B	5.7	4.9	4.2	3.6
Asset turnover	1.2	1.0	1.0	1.0
ROE analysis (%)				
ROE stated-return on	29.6	26.2	24.7	23.7
ROIC	43.2	39.4	43.1	42.8
Interest burden	1.0	1.0	1.0	1.0
Tax rate	25.2	23.8	23.7	23.6
Financial leverage	0.12	0.31	0.31	0.31
Credit ratios (%)				
Net debt/equity	(33.3)	(35.9)	(44.3)	(46.2)
Net debt/EBITDA	(0.7)	(0.8)	(1.1)	(1.2)
Interest coverage ratio	460.3	(204.7)	(2,001.2)	(357.8)

Source: FTI, Company data, Thomson Reuters, Credit Suisse Securities (EUROPE) LTD. Estimates.



The price relative chart measures performance against the FTSE ALL SHARE INDEX which closed at 3614.73 on 20/05/14
On 20/05/14 the spot exchange rate was £.81/Eu 1. - Eu .73/US$1

HOLT analysis for Burberry

Figure 1: Burberry: HOLT-based 12-month fair value of 1770p is calculated assuming our five-year explicit forecast period and relatively conservative assumptions for years 5-10 (see below). Beyond a 10-year competitive advantage window, HOLT assumes CFROI® to gradually fade to 6% and asset growth to fade to 2.5%, reflecting the economic reality of competition, eliminating excess returns and growth regressing to the corporate average: given the strong barriers to entry in hard luxury, this assumption is probably on the conservative side, in our view

HOLT - Credit Suisse Analyst Scenario Data

BURBERRY GROUP (BRBY)

Current Price: GBP 15.15 | Warranted Price: GBP 17.70 | Valuation date: 21-May-14

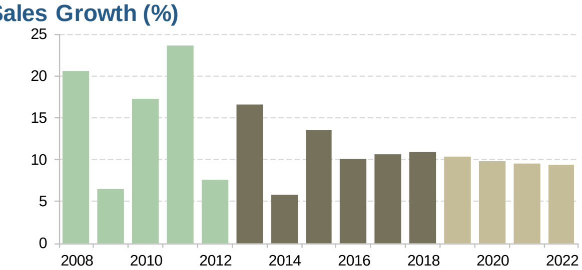
Sales Growth (parallel % point change to forecasts) / EBITDA Margin (parallel % point change to forecasts)

in GBP	-2.0%	-1.0%	0.0%	1.0%	2.0%
-2.0%	-22%	-13%	-1%	11%	25%
-1.0%	-15%	-4%	8%	21%	36%
0.0%	-7%	4%	17%	31%	47%
1.0%	0%	12%	26%	41%	58%
2.0%	8%	21%	35%	51%	69%

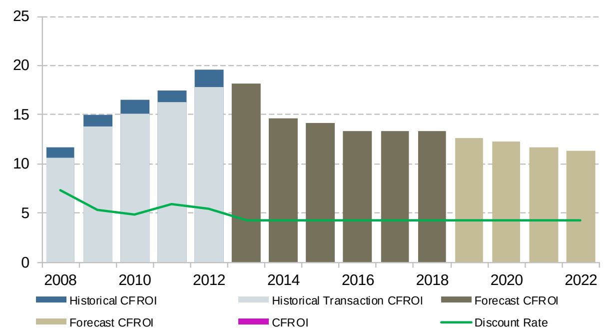
More than 10% downside | Within 10% | More than 10% upside

	Mar 12A	Mar 13A	Mar 14E	Mar 15E	Mar 16E
Sales Growth, %	23.7	7.6	16.6	5.8	13.6
EBITDA Mgn, %	25.4	27.5	25.7	24.6	24.1
Asset Turns, x	0.77	0.8	0.8	0.7	0.7
CFROI®, %	17.4	19.5	18.1	14.6	14.2
Disc Rate, %	5.9	5.5	4.3	4.3	4.3
Asset Grth, %	20.9	3.9	11.2	19.3	10.8
Value/Cost, x	3.4	3.3	3.4	2.8	2.6
Economic PE, x	19.2	17.1	18.8	19.5	18.1
Leverage, %	12.5	11.4	10.2	13.8	15.4

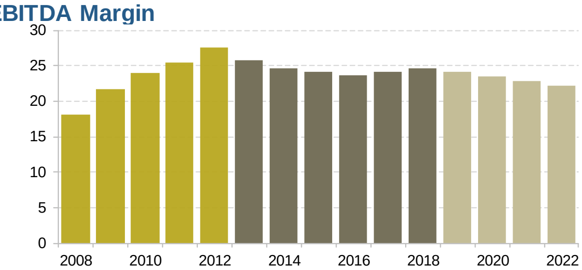
Sales Growth (%)



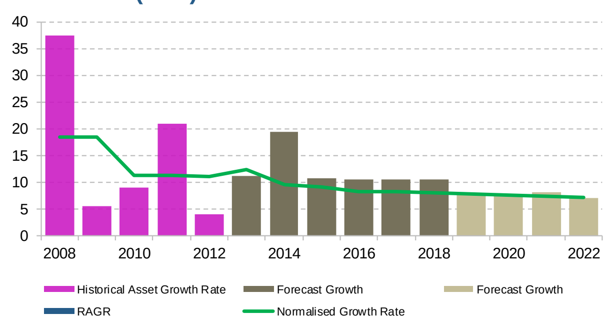
CFROI & Discount Rate (in %)



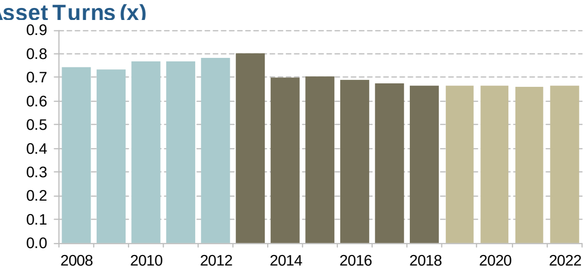
EBITDA Margin



Asset Growth (in %)



Asset Turns (x)



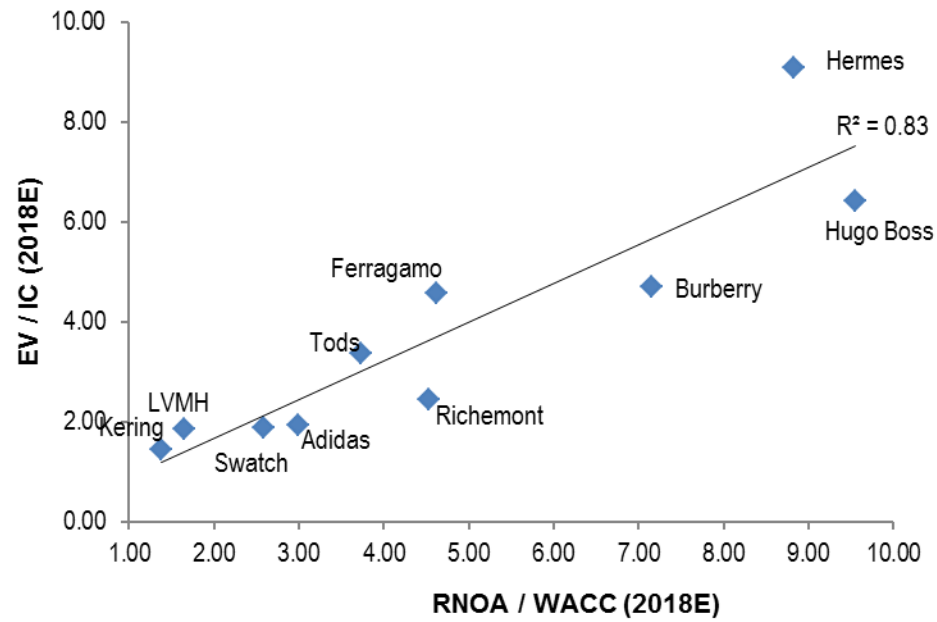
Source: Credit Suisse HOLT®. CFROI and HOLTare trademarks or registered trademarks of Credit Suisse Group AG or its affiliates in the United States and other countries.

Source: Credit Suisse HOLT

Attractive on EV/IC, not cheap on P/E post recent FX-led downgrades

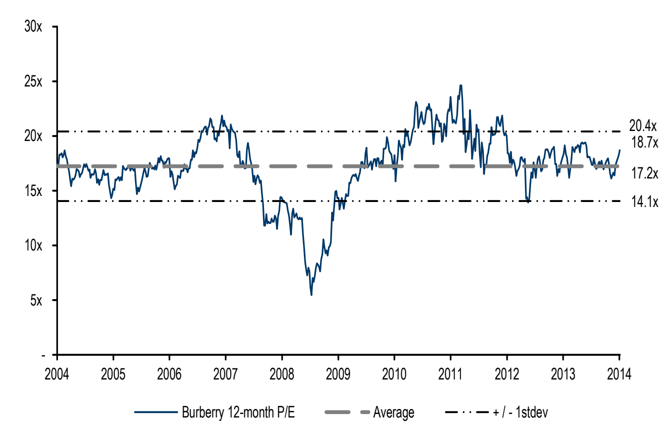
Our 12-month target price of 1620p (from 1600p) was based on a simple average of the fair value provided by HOLT at 1770p (see Figure 1) and a historical P/E analysis suggesting a fair value of 1460p (historical forward P/E multiple of 17.2x applied to our FY16e EPS forecast of 85.1p). The biggest upside suggest by our HOLT-based analysis is consistent with how relatively attractive Burberry looks in our EV/IC vs. RNOA/WACC spread framework.

Figure 2: **EV/IC vs. RNOA/WACC (2018E): Burberry screens as one of the most attractive in our coverage after taking on board the upcoming changes in Japan**



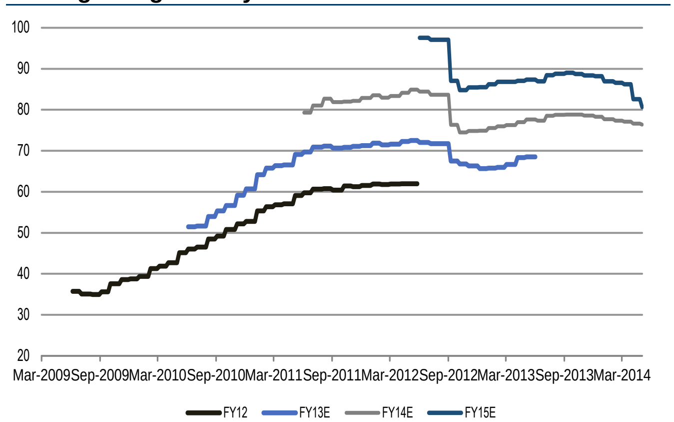
Source: Credit Suisse estimates

Figure 3: **Burberry is now trading above its long-term historical forward P/E average…**



Source: Thomson Reuters, IBES

Figure 4: **…following material FX-led downgrades since the beginning of the year**



Source: Thomson Reuters, IBES

Model assumptions

Figure 5: **Burberry: sector leading top-line growth but margin progression impacted by FX in FY15e and Japan in FY16e**

All figures in £m except when stated

Year to 31 March	2013A	2014A	2015E	2016E
REVENUE				
Retail	1,417.0	1,622.6	1,744.7	2,049.0
Wholesale ex Beauty		476.7	466.5	497.1
Beauty		151.3	185.2	212.3
Wholesale inc. Beauty	472.7	628.0	651.8	709.4
Licensing	109.4	79.2	68.9	43.3
Total	**1,999**	**2,330**	**2,465**	**2,802**
Retail comp sales growth	***5%***	***12%***	***8%***	***8%***
Retail growth at constant fx	12%	15%	12%	12%
Total wholesale growth at constant fx	1%	71%	8%	8%
Wholesale ex Beauty growth at constant fx		32%	2%	6%
Total sales growth at constant fx		**18%**	**11%**	**11%**
Retail and Wholesale Gross profit	1,333	1,579	1,691	1,949
Retail and Wholesale EBIT	336	394	404	476
Licensing EBIT	93	67	58	37
Total EBIT (adjusted)	**428**	**460**	**462**	**512**
Adjusted PBT	**428**	**461**	**464**	**512**
Capex	158	130	200	224
Net cash/(debt)	297	403	506	727
Dividend per share	29.0	32.0	32.8	36.2
Gross margin (retail + wholesale)	**70.6%**	**70.2%**	**70.6%**	**70.7%**
y-o-y change	*250 bps*	*(30) bps*	*40 bps*	*10 bps*
opex as % of sales (retail + wholesale)	*52.8%*	*52.7%*	*53.7%*	*53.4%*
EBIT margin (retail + wholesale)	***17.8%***	***17.5%***	***16.9%***	***17.2%***
y-o-y change	*140 bps*	*(30) bps*	*(60) bps*	*30 bps*
EBIT margin (total)	**21.4%**	**19.8%**	**18.7%**	**18.3%**
	110 bps	*(170) bps*	*(100) bps*	*(50) bps*

Note 1: Retail/wholesale EBIT margin FY13 "normalised" for Performance Related Pay Charge is 17.1%;

Note 2: Rebasing FY14 retail/wholesale operating profits for current FX rates would reduce FY14 operating margin of 17.5% to 16.3%;

Source: Company data, Credit Suisse estimates

CREDIT SUISSE

Companies Mentioned *(Price as of 20-May-2014)*

Burberry Group (BRBY.L, 1515.0p, NEUTRAL, TP 1600.0p)

Disclosure Appendix

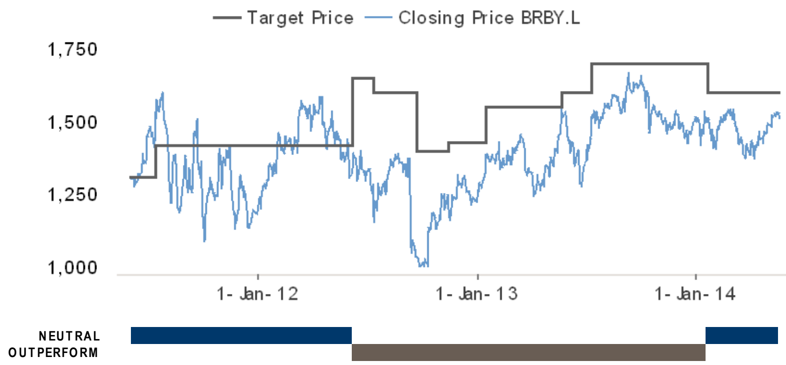
Important Global Disclosures

Rogerio Fujimori and Guillaume Gauville, each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for Burberry Group (BRBY.L)

BRBY.L Date	Closing Price (p)	Target Price (p)	Rating
02-Jun-11	1308.00	1310.00	N
13-Jul-11	1531.00	1420.00	
07-Jun-12	1392.00	1650.00	O
12-Jul-12	1158.00	1600.00	
21-Sep-12	1036.00	1400.00	
13-Nov-12	1231.00	1430.00	
15-Jan-13	1386.00	1550.00	
22-May-13	1532.00	1600.00	
11-Jul-13	1524.00	1700.00	
20-Jan-14	1500.00	1600.00	N

** Asterisk signifies initiation or assumption of coverage.*



The analyst(s) responsible for preparing this research report received Compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities

As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark*over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, 12-month rolling yield is incorporated in the absolute total return calculation and a 15% and a 7.5% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively. The 15% and 7.5% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively. Prior to 10th December 2012, Japanese ratings were based on a stock's total return relative to the average total return of the relevant country or regional benchmark.*

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Analysts' sector weightings are distinct from analysts' stock ratings and are based on the analyst's expectations for the fundamentals and/or valuation of the sector* relative to the group's historic fundamentals and/or valuation:

Overweight : The analyst's expectation for the sector's fundamentals and/or valuation is favorable over the next 12 months.

Market Weight : The analyst's expectation for the sector's fundamentals and/or valuation is neutral over the next 12 months.

Underweight : The analyst's expectation for the sector's fundamentals and/or valuation is cautious over the next 12 months.

**An analyst's coverage sector consists of all companies covered by the analyst within the relevant sector. An analyst may cover multiple sectors.*

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Global Ratings Distribution

Rating	Versus universe (%)	Of which banking clients (%)
Outperform/Buy*	44%	(54% banking clients)
Neutral/Hold*	40%	(50% banking clients)
Underperform/Sell*	13%	(46% banking clients)
Restricted	3%	

For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.

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Price Target: (12 months) for Burberry Group (BRBY.L)

Method: Our 12-month target price of 1,600p is a simple average of (a) peers multiples and (b) HOLT that incorporates our 5-year explicit forecast period. Beyond a 10-year competitive advantage window, the HOLT model assumes CFROI® to gradually fade to 6% and asset growth to fade to 2.5%, reflecting the economic reality of competition eliminating excess returns and growth regressing to corporate average: given strong barriers to entry in luxury, this assumption is probably on the conservative side.

Risk: a) A deeper and longer global recession could depress disposable income than expected; b) a decline in travel activity as a signification proportion of the group's sales are generated by customers who purchase goods while travelling; c) exposure to currency fluctuations, in particular the Yen to Sterling exchange rate and increasing FX risk associated with the USD and Euro; d) intensifying competition from players with greater financial resources and bargaining power with suppliers, wholesale accounts and landlords; e) lack of control of its wholesale and licensing channels to protect the brand's image; f) fashion risk in its core apparel category; need to retain talented design teams; g) dependence on third-party operators (emerging markets) and licensees (Japan); and h) potential takeover risk given 100% free float.

Please refer to the firm's disclosure website at https://rave.credit-suisse.com/disclosures for the definitions of abbreviations typically used in the target price method and risk sections.

See the Companies Mentioned section for full company names

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