

We see the recent share price weakness as a good entry point to buy a company with strong long-term fundamentals. We see some clear upside to market expectations on earnings for the next two years. Whilst sales in China could disappoint in the short-term, long-term demand remains solid.

BUY BRBY  
Current share price £1874  
(Oct-21)  
Mkt. Cap. £7.588bn

## 1. COMPANY AND SHARE PRICE DESCRIPTION

### Company description:

Burberry is a British luxury fashion house headquartered in London, England. Burberry manufactures clothing, fragrances, and fashion accessories.

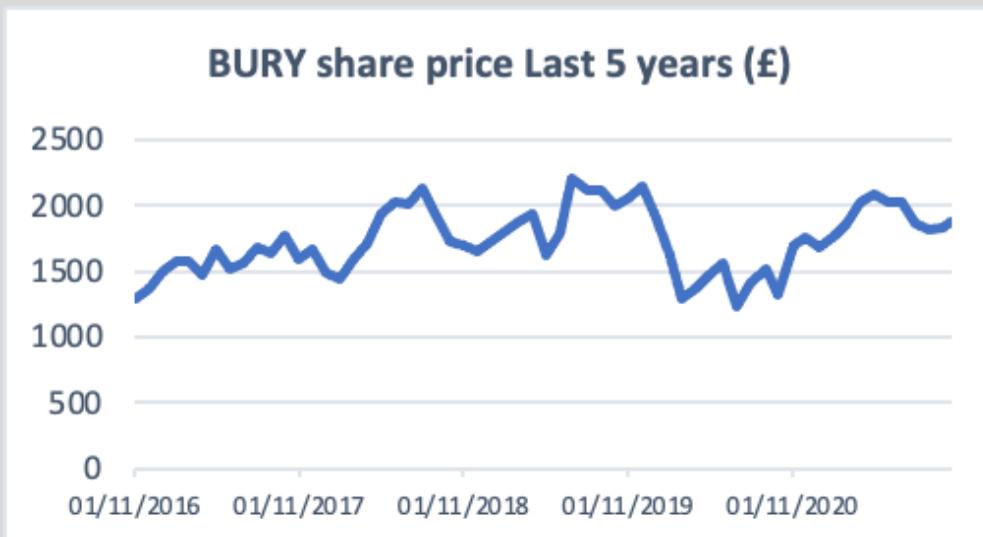
Burberry is founded in Basingstoke by Thomas Burberry in 1856. In the First World War, the water and wind proof gabardine "Burberry trench" is worn by British officers in the trenches, which become a timeless wardrobe essential until today. In 2016, Burberry Prorsum (ready-to-wear), London (trench and accessories) and Brit (casual clothing) were all scrapped and put under one umbrella name of Burberry.

### Activities and geographical exposures

Burberry's business is categorised into accessories (37% of total revenue), women's (28% of total revenue), men's (29% of total revenue), children's Beauty and other (6% total revenue).

FY 2020/21 revenue declined by 10% at CER, as a result of the impact of COVID-19 on trading, especially many of the Group's stores were closed during H1. Revenue growth improved in H2, returning to year-on-year growth in Q4. While accessories and women's sales decreased by double digit, revenue in Children's Beauty and other increased by 13.39%.

## 2. Share price data



## 3. PAST PERFORMANCE AND PEER COMPARISON

### 3.1 Operational performance

	<b>FY18-FY21 Revenue CAGR</b>	<b>FY18-FY21 EBIT CAGR</b>	<b>FY21 EBIT Margin</b>
Burberry	-14.23%	-10.37%	17.84%
Ralph Lauren Corp.	-14.44%	-5.26%	11.75%
Capri Holdings Ltd.	3.04%	-58.48%	7.55%
Prada SpA	-4.97%	17.88%	12.78%
HUGO BOSS AG	-17.96%	-115.40%	-2.39%
<b>Sector average</b>	<b>-9.71%</b>	<b>-34.32%</b>	<b>9.51%</b>

Burberry has more favourable EBIT growth rate and EBIT margin than industry average. BRBY's earnings growth over the past year (205.5%) exceeds its 5-year average (-8.3% per year). BRBY earnings growth over the past year (205.5%) exceeded the Luxury industry -11.9%. Compared to the market, BRBY's revenue (7.8% per year) is forecast to grow faster than the UK market (5.3% per year).

### 3.2 Cash flow generation

	FCF	FCF from operations
Burberry	20.84%	-12.82%
Ralph Lauren Corp.	39.27%	-28.34%
Capri Holdings Ltd.	42.47%	-28.38%
Prada SpA	-89.78%	159.69%
HUGO BOSS AG	-46.20%	23.96%
<b>Sector average</b>	<b>-6.68%</b>	<b>22.82%</b>

From FY18-FY21, FCF has been increasing faster than industry average, although Burberry FCF growth rate is lower than competitors Ralph Lauren Corp. and Capri Holdings Ltd.

### 3.3 Strength of balance sheet

	FY21 ROE	FY21 Net debt/EBITDA
Burberry	27.10%	0.2
Ralph Lauren Corp.	6.50%	0.4
Capri Holdings Ltd.	15.10%	2
Prada SpA	8%	2.2
HUGO BOSS AG	0.10%	2.7
<b>Sector average</b>	<b>11.36%</b>	<b>1.50</b>

Burberry has highest ROE and lowest debt/EBITDA among competitors, which indicate a healthy balance sheet and capital structure.

Looking at company's debt levels on both a relative and absolute basis:

BRBY's short term assets (£2.0B) exceed its short term liabilities (£702.8M). And BRBY's short term assets (£2.0B) exceed its long term liabilities (£1.2B).

Looking at the company's capital structure:

BRBY's debt to equity ratio (22%) is considered satisfactory.

BRBY's debt is well covered by operating cash flow (172.7%).

BRBY's interest payments on its debt are well covered by EBIT (15.2x coverage). Also, its operating cash flow is positive. It has a credit rating of BAA.

## 4. MAIN POINTS OF THE INVESTMENT THESIS

### 4.1. Industry

The global luxury industry had a good performance over the past decades, and it remains a positive outlook even with the pandemic partly because the resilience of some luxury goods companies for a century or two. Also, rising Chinese consumption and the advent of e-commerce are two long-term trends powering the premium-goods industry. McKinsey estimates that China's luxury spending will nearly double between 2020 and 2025. This implies market-beating returns for investors.

### 4.2 Digitalisation

Bain & Co. finds despite a contraction in the overall global luxury industry due to the pandemic, global online luxury sales grew almost 50%, to about US\$59 billion, in 2020, compared to about US\$39.7 billion the prior year. This sales channel is forecast to grow further, from an estimated 23% last year to more than 30% by 2025.

Burberry has earned itself a reputation within the luxury industry as a digital pioneer and leader in integration, creativity, and experimentation. In order to purify the brand message, they focus on outerwear, digital, and target a younger consumer. Burberry reaches to its consumers through Facebook, Google+, Twitter, Tumblr, Pinterest, Instagram and YouTube.

To capture China market growth, Burberry launched its Wechat Mini program on Chinese valentine's day (Qixi) in 2018. Late last year, Burberry and Chinese tech giant Tencent struck an exclusive partnership to develop social retailing in China, which will pioneer a concept that combines social media and retail to create digital and physical Spaces for participating communities to interact, share and shop.

### 4.3 sustainability

By 2022, Burberry aims to become carbon neutral within its own operations and aims to achieve a net zero carbon footprint by 2040. The company is also committed to driving positive change through 100% of its product portfolio by advancing sustainable materials and practices. In 2020, Burberry became the first of its luxury peers to issue a sustainability bond, enlisting the support of investors in delivering its sustainability goals.



## 5. CURRENT AND TARGET VALUATION

### 5.1 Analyst valuation

Using the DCF approach, BRBY (£22.56) is trading below our estimate of fair value (£27.06), with the assumption that the perpetual growth rate is 5-year average of GB long term government bond rate and future cash flows are based on analysts' reports. Overall, I believe the potential of the company's stock outweighs its risk and the stock is currently undervalued.

### 5.2 Comparative valuation multiples

We use PE multiple and find that BRBY is good value based on its PE Ratio (24.3x) compared to the European Luxury industry average (29.5x). Also, BRBY is good value based on its PE Ratio (24.3x) compared to the UK market (24.9x).

## 6. TIMING OF RECOMMENDATION

Market takes time to recover, therefore, this investment suits for investors looking for medium to long term horizon

Post-lockdown buying splurges as consumers hitherto trapped in their homes finally get to go shopping. Bain & Company tracks nine segments across the global luxury market and finds that spending increases across nearly all segments. And China is on track to become the world's biggest luxury market by 2025.

## 7. RISK TO INVESTMENT CASE

### 7.1 dividend risk

BRBY's dividend payments have been volatile in the past 10 years. However, it should not be a factor that deter investors as BRBY's dividend payments have increased over the past 10 years.

### 7.2. growth risk

BRBY is regarded as value stock rather than growth stock. BRBY's earnings are forecast to grow, but not significantly. BRBY's revenue is forecast to grow slower than 20% per year. Therefore, this investment is not suitable for investors looking for significant return in the short term.



Disclaimer: this information is only independent options of the author