Group Chief Executive Officer's review

NORBERT PLATT, GROUP CHIEF EXECUTIVE OFFICER

We will continue to invest in our Maisons' long-term growth

INTRODUCTION

Until September, sales momentum remained strong and half-year sales were 10 per cent higher, despite challenging comparatives. Since October, the real economy has been strongly negatively impacted by the turmoil in financial markets. All economic indicators turned negative and the 'feel-good factor' severely deteriorated. Demand for luxury goods generally contracted and we saw a decline in sales at Richemont, leading to a very weak pre-Christmas season, with sales down 7 per cent. The final quarter of the financial year saw a stabilisation of the decline.

The business slowdown was anticipated and we began to take appropriate measures from the summer of last year. These measures were complemented by further initiatives starting in October to protect the Group's margins and avoid an excessive build-up in working capital. Through these efforts, the full-year operating profit decline was contained to 12 per cent and cash flow generation remained strong.

I join the Chairman in thanking all our employees for making this possible and understand the worry that these troubled times bring to all of us. We will face the challenges ahead with confidence in our Maisons' inner strength and the knowledge that we will always plan for the long term, just as we have for the last 20 years.

MANUFACTURING

The slowdown in demand has particularly affected our watch retailing partners in most regions. They have adjusted their orders to avoid the risk of over-stocking. Accordingly, we have taken a number of measures to reduce the Maisons' manufacturing output, particularly in the Swiss watchmaking facilities, to prevent a build-up of inventories.

The position is in contrast to the issues we faced up to September 2008; the strong growth in watch orders and sales had resulted in most of our own *manufactures* and external component suppliers being unable to meet demand. We therefore invested in extra capacity and accelerated our verticalisation plans. When the trend reversed, we stopped overtime, did not renew temporary contracts and froze recruitment. To limit under-utilisation, we have maximised in-house production and cut back on outsourcing. Our competitors have taken similar measures, which has impacted our own multi-brand component manufacturing operations. Consequently, we have been forced to downsize some of these operations. In addition, the manufacturing headcount at Roger Dubuis has been reduced following a post-acquisition review, although we are convinced of the international growth potential of the business. The Group is committed to invest in the future of this Maison.

To preserve the employment and know-how in our *manufactures* as much as possible, we have introduced shorter working time in some instances. These programmes allow the Group to retain its qualified staff and avoid job losses, with employees being compensated for lost salary. Certain measures may be extended and further initiatives implemented as circumstances dictate.

Following a review of strategic alternatives, we have decided to sell the Montegrappa writing instrument business.

CAPITAL EXPENDITURE

During the year under review, capital expenditure amounted to some € 350 million in total, despite the freezing of all non-strategic projects in the second half of the year, whilst standing by our commitments to third parties. Our strategic priorities include the continuing roll-out of the Richemont Enterprise Resource Planning IT system, two specific manufacturing projects in Switzerland and selective boutique openings.

The Group's new Enterprise Resource Planning system has so far been implemented in the US market and, in Switzerland, in our central distribution facility in Fribourg and at Cartier's watch manufacturing site in La Chaux-de-Fonds. The new system has been a proven success and has performed in line with our expectations. We will continue the roll-out with the implementation of the Swiss market this summer. We are also in the process of adding additional Maisons to the template. From this summer, our central distribution facility in Fribourg will handle all our Swiss-based watch and jewellery Maisons on a single, integrated IT system. As part of the project, we will also continue to roll-out our euro-logistics process, with a single stock located in Fribourg.

Capital expenditure on new boutiques and other points of sale amounted to € 150 million, of which some € 60 million was in the Asia-Pacific region, with China being the principal area of expansion. Together our Maisons now have 182 boutiques in mainland China and, given the potential and size of the Chinese market, we expect that number to grow further. In other markets, the sales slowdown prompted the decision to close a number of marginal boutiques, particularly in the United States. The cost of these closures has been included in this year's results. Further store closures are planned for the year ahead, although the opening of new boutiques will largely offset these reductions: the overall Group-owned retail network will remain at a similar size.

GROWING OUR BUSINESSES

Our business is suffering in this crisis, but crisis brings opportunity. The cost-limiting measures that I have described above are under our control, whereas sales depend entirely on fulfilling the needs and the dreams of our customers. During this crisis our clients will be fewer in number and even more discerning. We believe they will seek recognised, legitimate luxury brands and will tend to purchase products which they believe to be of lasting investment value. More than ever, new products must meet the highest quality expectations and be delivered with outstanding service. Our Maisons understand this and possess the skills to create, for example, unique high jewellery pieces and complicated watch movements, as well as accessible luxury goods true to their roots and suited to the times in which we all live.

Also moving with the times, a number of e-commerce pilot projects have been launched during the year, including Cartier in Japan. Our customers' experience and the services they request are providing insights which we will use in future e-commerce developments.

The slowdown in many developed markets is not matched by the growth in certain developing markets, including China and the Middle East, where the Group is already strongly represented. Our regional support platforms in the Middle East, Russia and Latin America have continued to improve the services they provide to our Maisons and the year has seen the further integration of our Maisons onto these platforms. As a consequence, the Maisons have strengthened their presence in those markets. In India, we have created an entity to operate our first owned Cartier boutique last November, while our other Maisons have extended their presence there by opening additional franchised boutiques.

We will therefore continue to invest in our Maisons' long-term growth, to provide first class service to our clients and to nurture the creativity and excellence which define luxury goods.

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